How To Organize and Operate A SMALL BUSINESS

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The American Way of Life

INTRODUCTION

THE DEVELOPMENT of the United States has come largely as a result of small enterprisers. Such men cut down the forests, placed the land under cultivation, and built our factories. Even the early toll roads, canals, and railroads were in large part local enterprises financed and built by men who individually had little capital. It was not until the combining of small railroads into large systems and the building of the trunk and transcontinental lines in the 1870's that "big business" arrived in the United States.

Most of the large companies of today were started by men with very limited capital—Swift, a local butcher; Ford, a mechanic building his first cars in a blacksmith shop; Chrysler, who started as a mechanic in a railroad roundhouse and became an automotive engineer; Carnegie, with money saved from his wages as telegrapher and railroad employee; Gilman, founder of the Great Atlantic and Pacific Tea Co., who started selling tea as a sideline in his hide and leather store. Among others, Sears started selling watches by mail in his spare time while a small-town station agent; Montgomery Ward started his business in one small room; Wanamaker began with savings from a small-salaried job; Gimbel's started as a frontier trading post; and so on down the list.

Aside from public utilities most businesses start small and grow up or else are formed by mergers of smaller companies. Many small businesses starting today will be the large- or middle-sized businesses of tomorrow.

It is true that more new concerns fail than succeed. Fear of failure keeps many youngsters with ability from launching their own companies. However, it is young men who can

afford to take chances. If they fail, they can go back to work for another. A great many successful businesses have been started by men who failed in their first ventures. They learned from their failures. A great many successful men after a failure save up a few hundred dollars and start again. Some such men have become nationally known. Cyrus McCormick with his reaper and John Patterson of National Cash Register are two examples. "Nothing risked, nothing gained."

"But," the youngster asks, "what chance does the little fellow have against these giant companies?" Let us leave out of our discussion two types of business—public utilities such as railroads and electric and gas companies; and companies requiring large and expensive machinery in order to produce economically, such as steel mills and automobile factories. In most other types of business the small concern can have many advantages: closer contact with customers; closer and more personal supervision of the detailed operation of the business; ability to make changes in products or procedures more quickly; in many cases lower overhead expenses; and sometimes less government supervision and regulation. I say *can* have. The business is not more efficient because it is small, but the fact that it is small does not keep it from operating efficiently and profitably. Managers of large concerns, aware of the inefficiencies in their enterprises, often point out that an efficient small businessman can "run rings around us." One man started in business with a very few hundred dollars and built a business worth $3,000,000, which he sold to a large corporation of which he became a vice president. He was never sure that he did the right thing. As he put it, "Big business moves so slowly. When I had my own business I could decide on an improvement and have it in operation long before the big company decides to make the change."

It may be said that the large concern has only two advantages: the ability to maintain a research department or departments; and its operation by hired managers. Let us consider

these two advantages separately to see to what extent the small concerns can meet or counterbalance them.

First, research. Research is at the basis of much of the advance in new products and new methods of producing and selling goods. In regard to technical research, the small man can frequently compensate for this first by his own ingenuity in devising and improving his product; second, he can obtain the results of research conducted by government and university laboratories; and third, small concerns can conduct research coöperatively through their trade associations. Concerns too small to maintain their own research laboratories can pool their resources and coöperatively support their own laboratory or finance research fellowships in universities.

The small concern may have less need for commercial research than the large concern, since the owner of the small concern is closer to his customers. It is often said that much commercial research is necessary because the managers of the large company have lost their personal contact with the consumers and must hire interviewers to go out and ask the consumers what they like and dislike about the company's product, its advertising, dealers, or selling methods. The small man often gets this information direct from his customers or his salespeople who contact his customers. When such contacts are insufficient, small concerns can coöperatively employ research organizations to conduct their surveys and other research.

What about the advantage of hired management? An efficient owner is better than a hired manager. The most efficiently operated companies are managed by their founders and owners who have had the ability to start and manage their own businesses. As a rule, they make better products, sell them cheaper, or do both, while earning higher rates of profit than their competitors. If so, why do we say that hired managers are more efficient? Simply for the reason that life is short and uncertain. The efficient manager gets older and eases up. Either he loses some of his energy with age, his doctor tells him to "slow up," or he realizes that "he can't take it

with him" and so starts to enjoy some of the fruits of his arduous labors. But he eases up. Efficiency drops. Finally he retires or dies. In many cases he has no heirs of equal ability to carry on the business, in which case efficiency usually goes down until the business fails or is sold to a competitor—often to a larger competitor.

On the other hand, when a company is too large to be controlled by a family, the managers are hired, and hired on the basis of their ability and performance. They win their positions, by and large, through competition. They may never be as good as the efficient and hard working man who builds his own business but they are commonly more efficient than the sons who were raised with "silver spoons" in their mouths, or the in-laws who "married the business."

Granted that this is true, it need not deter the young man who considers starting his own business. He hopes to succeed in building a profitable business. He doesn't need to worry about the ability of his heirs to carry it on. That is a problem for the next generation. If they cannot operate a business that they inherit, they deserve no sympathy from their fathers or from society.

If this volume helps young persons to determine if they have the ability and personality successfully to operate their own businesses and then encourages them to do so, it will perform a useful function. We need efficient small businesses for the services they render the consumers, and we need them to compete with big businesses. If it also teaches individual enterprisers sound principles and practices needed for successful business operation, this book will be doubly useful.

P. D. Converse
University of Illinois

September, 1949.

PREFACE

FOR MANY YEARS before World War II interest was developing in the place and problems of small business. During the early postwar years attention was centered on helping veterans and former war workers get started quickly in businesses of their own. Relatively little, however, has been done toward providing a well-rounded guide to the fundamental needs, problems, and opportunities of the field of small business as a whole. Such an integration of the subject is one of the objectives of this book.

The book is intended as a text of continuing value to all persons interested in the field of small business. It may be used for independent reading or as a text in college or adult courses for students who later plan to go into business for themselves, as well as for owner-managers who desire to increase their knowledge of modern small business operation. In fact, in note and manual form, it already has been used by the authors for several years in training each of the three groups just mentioned.

When used for individual study or as a text for prospective owner-managers (whether employees or students), best results will be secured if the following outline for individual application is used concurrently: *Manual of Small Business Operation,* by Kenneth Lawyer. New York: Prentice-Hall, 1946.

In the process of assembling material for training present and prospective small businessmen, much of which has been used in this text, several extensive surveys were conducted. In addition, the authors have had the advantage of access to the excellent material on small business released by the United States Department of Commerce, by trade journals, and by the

publishers of many books and pamphlets on different aspects of the subject. It would be futile to attempt to acknowledge the authors' indebtedness individually to each of these sources of information and ideas. In all cases where material or assistance was requested, the coöperation received was most generous. Throughout the text many references are cited, and the bibliography at the end of the book suggests excellent collateral readings.

The text follows a sequence recommended by the authors for persons interested in small business. First the importance of small business, its status, problems, and requirements for success are discussed. Then procedures for becoming a business owner are considered, followed by separate chapters dealing with each important management function involved in operating the enterprise. In all cases attention is given to the relatively greater importance of personal factors in small, as compared to big, business. A short concluding chapter deals with the future of the small independent enterprise. A comprehensive check list for organizing and operating a business is presented in the appendix.

In scope, the text recognizes three main fields of small business: merchandising, including retailing and wholesaling; manufacturing; and service businesses. In most chapters, following a general treatment of the topic, special applications to each of the three main fields are considered in turn. This organization helps to stress the fundamentals basic to all three fields while recognizing variations in application suited to particular needs. At the end of each chapter questions and projects are suggested for review and discussion as well as to guide individual research and application.

Excellent coöperation and much valuable information have been received by the authors from editors of trade journals, trade association officials, Department of Commerce and other Government representatives, Directors of Industrial Development Agencies, officials of the member schools of the American Association of Collegiate Schools of Business, former students

who are now independent businessmen, many owners and managers of small businesses, and other authorities on small business. To attempt to name individuals would be futile, since the number is in the hundreds.

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CONTENTS

CHAPTER		PAGE
	INTRODUCTION	vii
	PREFACE	xi
I.	SMALL BUSINESS—AN AMERICAN ESSENTIAL	1
	What Is Small Business?	1
	Importance of Small Business	8
	Place of Small and of Big Business	14
	Problems of Small Business	20
	Conclusions	28
	Review and Discussion Questions	28
II.	EMPLOYMENT OR YOUR OWN BUSINESS?	30
	Advantages of Business Ownership	31
	Disadvantages of Business Ownership	36
	What It Takes	38
	Plan of Book	48
	Fields of Small Business	49
	Conclusions	54
	Review and Discussion Questions	54
III.	FACTORS IN BUSINESS SUCCESS	57
	Trends in Business Management	57
	Big Business May Be More Efficient	62
	Interdependence of All Business	68
	Success Versus Failure	68
	The Way It Is Done	75
	Risks and Failures	79
	Conclusions	84
	Review and Discussion Questions	85

CHAPTER PAGE

IV. APPRAISING A GOING CONCERN 87
Profits 90
Tangible Assets 93
Intangibles 96
Estimates 101
Advice to the Novice 103
Conclusions 106
Review and Discussion Questions 106

V. JUSTIFYING THE NEW BUSINESS 109
Another Similar Business 110
Seeking Justification for a Unique Idea 114
Surveying Business Opportunities 121
Conclusions 126
Review and Discussion Questions 127

VI. FINANCING AND ORGANIZING THE BUSINESS 130
Capital Requirements for the Small Merchandising Business 133
Capital Requirements for the Small Factory 139
Summary of Variations in Capital Requirements 147
Sources of Funds 148
Selecting the Form of Organization 165
Conclusions 170
Review and Discussion Questions 171

VII. SELECTING THE PROFITABLE LOCATION ... 173
The Retail Location 179
The Small Wholesaler's Location 204
The Small Factory Location 212
Location of the Service Business 228
Conclusions 235
Review and Discussion Questions 235

CHAPTER PAGE

VIII. PHYSICAL PLANT AND LAYOUT 238
Adapting the Building 238
Construction 242
The Store Building—Special Requirements 247
The Factory Building—Special Requirements 248
The Service Building—Special Requirements 248
Arranging the Layout 250
Store Layout 252
Layout in Wholesaling 259
Factory Layout 265
Layout for the Service Establishment 271
Conclusions 274
Review and Discussion Questions 275

IX. ESTABLISHING BUSINESS POLICIES 277
Policies Applicable to All Fields 283
Policies in Retailing 295
Policies for the Small Factory 300
Policies in the Service Business 305
Conclusions 308
Review and Discussion Questions 308
Cases for Discussion 309

X. MANAGEMENT AND LEADERSHIP 312
Management 312
Check List for Retail Grocer's Customer Relations ... 322
Leadership 331
Conclusions 333
Review and Discussion Questions 334

XI. EMPLOYEE RELATIONS 336
Personnel in Merchandising 359
Personnel in the Small Factory 363
Personnel in the Service Business 367
Conclusions 372
Review and Discussion Questions 374

CHAPTER PAGE

XII. RELATIONSHIPS WITH RESOURCES 376
Resources and Policies Available to the Small Business 376
Fundamentals of Buying for the Small Business 382
Buying by the Small Retailer 388
Buying by the Small Wholesaler 407
Buying for the Small Factory and Service Business... 411
Conclusions 422
Review and Discussion Questions 422

XIII. SALES PROMOTION 425
Merchandising 427
Wholesaling 434
Manufacturing 436
Service Business 439
Special Aspects of Sales Promotion 442
Conclusions 447
Review and Discussion Questions 448

XIV. ADVERTISING FOR PROFIT 450
Advertising Media 461
Advertising for the Small Retailer 473
Advertising for the Small Wholesaler 476
Advertising for the Small Factory 478
Advertising for the Service Business 480
Conclusions 484
[illegible] ..... [illegible]

Pricing in Merchandising 493
Pricing by Wholesalers 500
Pricing for the Small Factory 502
Pricing by the Service Business 507
Conclusions 511
Review and Discussion Questions 512
Problems 514

CHAPTER PAGE

XVI. EXPENSE CONTROL 517
Expense Control in Merchandising 526
Expense Control in Wholesaling 538
Expense Control for the Small Factory 540
Service Establishment Expenses 547
Conclusions 549
Review and Discussion Questions 549

XVII. INVENTORY OR STORES CONTROL 554
Inventory Control in Merchandising 557
Stock Control in Wholesaling 570
Inventory Control in the Small Factory 577
Inventory Control in the Service Establishment 586
Conclusions 588
Review and Discussion Questions 588

XVIII. REGULATIONS AND TAXES 591
Principles of Law 594
Regulations Pertaining to Competition, Trade Practices, and Public Welfare 599
Taxes 617
Conclusions 618
Review and Discussion Questions 619

XIX. CREDIT AND THE CUSTOMER 621
Credit in Merchandising 640
Credit in Wholesaling 650
Credit in the Small Factory 655
Credit in the Service Business 658
Conclusions 659
Review and Discussion Questions 660

XX. RECORDS AND RECORD KEEPING 663
Accounting Records 664
Tax Records 677
Miscellaneous Records 685

CHAPTER PAGE

XX. RECORDS AND RECORD KEEPING: *(Cont.)*
Conclusions 690
Review and Discussion Questions 691

XXI. SIMPLIFIED RECORDS SYSTEMS 693
Retail Method of Inventory 709
Service Records 712
Conclusions 717
Review and Discussion Questions 718

XXII. SMALL BUSINESS AND THE FUTURE 720
Permanence of Small Business Field 727
Improving the Outlook 731

APPENDIXES 733
A. Bibliography 735
B. Work Sheet for Estimating Initial Capital Requirements 753
C. Dealer Location Survey 757
D. Work Sheets for a Community Industrial Survey.. 764
E. Check List for Organizing and Operating a Small Business 775

INDEX 783

TABLES AND FIGURES

TABLE		PAGE
1.	Large Versus Small Business, 1939	5
2.	Number of Distribution Establishments, United States, 1947 Estimates	9
3.	Preference of Fayetteville Women for Drug and Department Stores	112
4.	Reasons for Preferring Each of These Stores	113
5.	Reasons for Buying Out of Town	114
6.	Sources of Initial Capital and Forms of Organization Used by Mississippi Entrepreneurs	151
7.	Sources and Distribution of Initial Capital of New Retail and Wholesale Concerns	154
8.	Retail Store—Population Relationships	181
9.	Factors Influencing Rent Ratios	186
10.	Retail Store Rentals Expressed in Percentages of Net Sales, by Size of Town	198
11.	Percentage of Net Sales Spent for Advertising	456
12.	Average Percentage of Total Consumer Advertising Expenditures in Relation to Net Sales Volume	458
13.	Effect of Advertising on Profits	489
14.	Profit and Loss Statement of John Doe, Clothier	519
15.	Profit and Loss Statement of X Manufacturing Company	520
16.	Typical Operating and Merchandising Ratios—1939 Limited-Price Variety Stores	532
17.	The Retail Method of Inventory Valuation	710

* * * * *

FIGURE		PAGE
I.	Method of Plotting Competitive Outlets	195
II.	What an Industry Employing 150 Men Means to a Community	226
III.	Value of Space in a Small Store According to Location	254

FIGURE		PAGE
IV.	Suggested Location of Shipping and Receiving Platforms Where Full-Case Goods and Shelf Stock Are Kept in Entirely Different Places	262
V.	Suggested Location of Shipping and Receiving Platforms in a Long, Narrow Building	263
VI.	Typical Metal Shop Layout	270
VII.	Personnel-Employment Credit Character Form	344
VIII.	Flow of Goods and Records	573
IX.	Simple Balance-of-Stores Record	582
X.	Inter-Bureau Report	629
XI.	Transfer of Record Report	630
XII.	National Retail Credit Association Application for Credit	644
XIII–XVIII.	The "All-Facts Improved Bookkeeping System"	699–704
XIX.	Service Orders and Parts Sales	713
XX.	Bin Card	715
XXI.	Return Material Tag	716

How To Organize and Operate A SMALL BUSINESS

Chapter I

SMALL BUSINESS—AN AMERICAN ESSENTIAL

In America all business was once small business. In 1947 98 per cent of all firms were still classified as small.[1] Like a giant among pygmies, the dollar volume of a small number of big business concerns stands out and dwarfs both the number and importance of small business enterprises.

What is Small Business?

"Small business," like many expressions in common usage, may be difficult to define precisely, yet it has a fairly clear meaning to most people. Obviously "small" must be relative to some standard of size; thus what is small in one area might be large in another. Yet for certain purposes it is desirable to agree upon limits or division points, especially for quantitative considerations of small business.

A healthy competitive community

Senator James Murray states, in his report to the Senate Small Business Committee, that although precise definition is difficult, the people of this country easily distinguish between large and small business. To them small business is a combination of social values, a pattern of civic life, a free society, and a healthy competitive community. It is the small businessman who is the foundation of the home town's growth and development.

[1] The Research and Policy Committee of the Committee for Economic Development, *Meeting the Special Problems of Small Business*, page 9. Policy report of the Committee for Economic Development, New York, June, 1947.

In another sense small business is the fundamental idea of American life. It has been the way for ambitious but poor men to climb the ladder from day labor to business ownership.

Small business has ever been the seedbed of economic growth. Nurtured by competition and stimulated by the prospect of some measure of wealth and comfort to small businessmen, it has fostered new developments, inventions, organizations, advancements which have added greatly to the volume and range of goods and services available to our people.[2]

The Committee for Economic Development sums up this relative concept of small business by stating that,

usually a small business will show two or more of the following characteristics:

1. *Management is independent.* Usually the managers are also owners.
2. *Capital* is supplied and ownership held by an individual or small group.
3. *Area of operations* is mainly local. Workers and owners are in one home community. Markets need not be local.
4. *Relative size within the industry*—the business is small when compared to the biggest units in its field. The size of the top bracket varies greatly, so that what might seem large in one field would definitely be small in another.[3]

A few examples will show how relative size may vary in production and may be misleading when only one standard, like the number of employees, is used. Because of the character of the productive process a plant may have a very large volume of output, yet may employ few workers. Spray-drying operations and coffee roasting and packing are examples. In the former,

[2] Murray, James E., *Place of Small Business in American Life,* pages 1–46. Report No. 47, 79th Congress, 1st Session, February 12, 1945.

[3] The Research and Policy Committee of the Committee for Economic Development, *Meeting the Special Problems of Small Business,* page 14. Policy report of the Committee for Economic Development, New York, June, 1947.

a continuous operation, less than a dozen men can turn out tons of products per day; the latter is also a continuous operation from the dumping of green coffee to storage of the finished product. With the aid of automatic machinery and straight line layout, tonnage per worker is high. By contrast, nut shelling and crab canning are based on hand operations, and the ratio of number of employees to volume of output is very large.[4]

We now come to attempts to define small business statistically. For certain purposes, asset values or net worth may be useful, although volume of business or number of employees per firm are the two bases most commonly used. Four sets of standards are in common use for defining small business. First, we have the popular but indefinite approach that takes some arbitrary number of employees, possibly ten, as the distinguishing point. Small business by this standard comprises all firms with ten or fewer employees. Obviously, this is only a rough approximation, subject to many qualifications and exceptions.

The second and probably most widely used definition is that of the United States Department of Commerce, as follows: Manufacturing plants with 100 employees or less; wholesale establishments with less than $200,000 annual net sales; retail stores, service establishments, hotels, places of amusement, and construction companies, with annual net sales or receipts of less than $50,000.

The Committee for Economic Development gives us the third set of guides. Business units with fewer than fifty employees are considered small business. They make up 98 per cent of the total number of business units. In 1939, the latest year for which census data are available, distribution by size was as follows:[5]

[4] Richter, H. Willard, "Managing a Small Plant is a Large Task." *Food Industries*, September, 1946, Vol. 18, No. 9, page 71.

[5] *Op. cit.*, page 14.

1,503,000	business	units	had	0	employees
1,221,000	"	"	"	1–3	"
305,000	"	"	"	4–7	"
166,000	"	"	"	8–19	"
70,000	"	"	"	20–49	"
52,000	"	"	"	over 50	"

Even among the 52,000 firms with 50 or more employees there were many that were small in their fields. Usually an upper limit of 250 employees is accepted in such cases, a firm with over 250 employees being considered large. Professor Beckman notes that at the beginning of World War II,

> Small business was, however, unevenly distributed throughout industry and trade. In retailing, for example, approximately 86 per cent of all establishments operated as single-line independents. Even in manufacturing as a whole, 82 per cent of all plants were operating as single unit businesses and 98 per cent of the plants employed no more than 250 persons each. In the steel industry, however, the large mills employed an average of more than 6,000 workers and even the so-called "small" steel mills averaged 650 workers per plant.[6]

Table 1 shows the distribution of small business by major fields according to the U. S. Department of Commerce standards.

Any attempt to define small business in terms of maximum dollar sales, such as that of the United States Department of Commerce, referred to earlier, must recognize the influence of changes in the price level. The Department's standards were adopted before the post-World War II rise in prices, and should be used, if at all, with this fact in mind.

In the opinion of the authors, a qualitative definition of small business, such as that of the Committee for Economic Development presented earlier, is the most satisfactory. It is the four attributes therein cited—independent management,

[6] Beckman, Theodore N., "Large Versus Small Business After the War." *American Economic Review*, March, 1944, Vol. XXXIV, No. 1, Supplement Part 2, pages 94–106.

TABLE 1[7]

LARGE VERSUS SMALL BUSINESS, 1939

INDUSTRY OR TRADE	UNITED STATES TOTALS		SMALL BUSINESS		SMALL BUSINESS AS PER CENT OF UNITED STATES TOTAL	
	Number of Establishments	Personnel **	Number of Establishments	Personnel **	Number of Establishments	Personnel **
Retail Trade *	1,770,355	6,210,788††	1,614,310	3,487,964††	91.2	56.2
Wholesale Trade †	92,794	912,795	71,681	355,731	77.2	39.0
Manufacturers ‡	184,230	7,886,567	168,814	2,358,968	91.6	29.9
Service Establishments §	646,028	1,754,538	637,585	1,294,724	98.7	73.8
Hotels ‖	27,987	362,047	25,224	111,183	90.1	30.7
Places of Amusement ¶	44,917	257,200	40,351	145,701	89.8	56.6
Total	2,766,311	17,383,935	2,557,965	7,754,271	92.5	44.6

* Census of Business, 1939, vol. 1, Retail Trade, Part 1, p. 25, "Stores, Sales and Personnel by Sales Size."

† Census of Business, 1939, vol. 2, Wholesale Trade, Table 4, p. 90, "Business Size—Wholesale Merchants."

‡ Census of Manufactures, 1939, vol. 1, p. 120, Table 1, "Summary for Wage Earner Size Groups."

§ Census of Business, 1939, vol. 3, pp. 36-37, Table 2B, "Establishments with Receipts of $3000 or More," and p. 42, Table 2C, "Establishments with Receipts of Less Than $3000."

‖ *Ibid.*, p. 586, Table 4A, "Hotels, Guest Rooms, Receipts, Personnel and Payroll by Size Based on Volume of Receipts."

¶ *Ibid.*, p. 550, Table 3C, "Establishments with Receipts of $3000 or More," and p. 552, Table 3B, "Establishments with Receipts of Less than $3000."

** Active proprietors and number of employees, except for manufacturers, which includes only manufacturing employees.

†† 3,102 proprietors of chains not included where information not available by size groups.

[7] Sixteenth Census of the United States, 1940.

owner capital, local area of operations, and relative size within the industry—that give rise to most of the problems and special needs of the small, as compared to the large, business unit. In general, this qualitative concept will be the one used throughout the text, unless otherwise qualified.

Big business in the United States is less than a century old—small business antedates the Union itself. In 1858 R. H. Macy was still trying to start a retail store one way or the other, and without "closures." Frank Woolworth's initial $50 capital in the 1890's could hardly be called "big business" even at that time. Henry Ford's struggle to build his first "gas buggy" by hand bears little resemblance to the present-day world symbolism of mass production and big business. As late as 1900 the steel industry consisted of numerous small firms engaged in continuous cut-price wars.

Without exception, every one of our present-day examples of big business started in a small way—often with considerable public opposition and ridicule. Railroads, telegraph, telephone, automobile, steel, oil, department stores, chain stores, and mail order houses all were introduced by individuals with an idea—and not much else, and were just beginning to receive recognition as big business before World War I.

Only after 1900 did department stores come to be identified by their present designation. Chain stores were "syndicates" in 1911-12 when the first study of their growth was made by the staff of *Printers' Ink*. Newly developed monopolistic tactics of the large concerns in steel and similar industries did not receive public reaction until 1914, with the passage of the Federal Trade Commission Act and the Clayton Anti-Trust Act.

The 50 years preceding World War I saw the development of giant corporations, trusts and monopolies, mass production, and large cities with their huge skyscrapers, with the result that America became the symbol of bigness throughout the world. Under such circumstances it is easy to lose the true perspective of things as they are. W. J. Cameron, well-known commen-

tator, in a broadcast over the Columbia Broadcasting System, painted a truer picture of conditions just before World War II in the following talk:

If it were not for small towns and villages there would be no large cities—large cities are not self-perpetuating. The same is true of large business—great corporations cannot survive without the aid of small businesses.

Of all businessmen who pay income tax, 96 per cent are small businessmen who earn less than $25,000 a year—earn it and use it. We have about 210,000 industrial concerns; 145,000 of them are small concerns producing less than $100,000 worth of goods a year—which everyone knows is a *very* small production. There are one and a half million retail stores; one and a quarter million of them are independent, single-owned stores.

When we speak of business we must not think solely of large capital, huge industries and famous names. These do not comprise American Business. If one should attend an annual convention of the American Bankers Association, for example, one would see around 5,000 bankers in session, but of these 4,950 are men and women who head country banks, small-town banks, or small-city banks. They are the small bankers who carry the bulk of the business for the bulk of the people. Also, one will find in the hotel business 70 per cent of the hotels that comprise this massive industry have less than 50 rooms each. Examples of this sort may be found in any field—furniture, newspaper publishing, or the dairy business.

Small business is a vast network of communications which sends depressive or tonic influence to the country. We are more dependent on the small businessman than we realize—more than he realizes. The community takes its reading of the national economic temperature from the thermometer of the small businessman's countenance.

This is a small-town and small-business country; that is one phase of our democracy. There is strength and there is wisdom in large numbers of small interests working for the common purpose.[8]

[8] Cameron, W. J., "The Small Businessman." Talk given on the Ford Sunday Evening Hour, No. 20 of the 1939–1940 series of broadcasts over the Columbia Broadcasting System from Detroit.

An interesting problem arises concerning the combined effect of a simultaneous rise in prices and an increase in the number of business units operating in a given field. Early in 1947 the Domestic Distribution Department of the Chamber of Commerce of the United States released estimates of the number of distribution establishments, their increase since 1943, and average annual business per store. These are presented in Table 2. These data might well be compared with similar figures from the census reports for 1939 to study any significant changes. The table also suggests that relatively few small businesses will be found in wholesaling; most lines of retailing, except department stores, contain many small businesses; and the service fields, except theaters, are composed almost entirely of small-scale establishments.

Importance of Small Business

At this point we are concerned with appraising the importance of small business in our economy. Later the advantages and limitations of business ownership will be cited and discussed.

The importance of small business may be discussed in summary fashion according to the following ways in which it contributes to our economy:

1. It is necessary to maintain competition and our system of free enterprise.
2. It is needed by big business, farmers, and consumers; all businesses are interdependent.

Competition and free enterprise

In all but a minute fraction of our economy small business still predominates, numerically at least. A truly competitive economy is necessarily predicated upon the continued existence of small business enterprises. They are as important to our economic democracy as universal suffrage is to our political democracy.

Often the competition for employees resulting from the

TABLE 2[9]

NUMBER OF DISTRIBUTION ESTABLISHMENTS, UNITED STATES
1947 Estimates

KIND OF BUSINESS	NUMBER OF STORES	PER CENT INCREASE SINCE 1943	AVERAGE POPULATION PER STORE	AVERAGE AN'L BUSINESS PER STORE
Retail				
Grocery	370,000	20	380	$50,000
Eating and Drinking	335,000	29	420	36,000
Filling Stations	240,000	31	590	16,000
Miscellaneous	230,000	34	610	42,000
Food, Non-Grocery	125,000	24	1,130	36,000
Apparel	90,000	13	1,570	84,000
Drugs	60,000	16	2,100	59,000
Motor Vehicles	57,000	81	2,500	95,000
Hardware & Farm Impl.	52,000	43	2,700	45,000
Dept. & Gen. Merchandise	50,000	5	2,800	260,000
Building Materials	48,000	49	2,900	79,000
Home Furnishings	47,000	58	3,000	70,000
Meat and Seafood	35,000	14	4,000	48,000
Country General Stores	31,000	—2	4,500	55,000
Automotive Parts	28,000	69	5,000	53,000
Liquor	25,000	48	5,600	76,000
Radio and Appliances	25,000	99	5,600	56,000
Shoe	20,000	3	7,000	75,000
Total–Retail	1,868,000	29		$51,000
Service				
Barber and Beauty	225,000	23	630	$3,400
Business Services	135,000	56	1,050	10,600
Laundry and Cleaning	104,000	11	1,350	12,000
Miscellaneous Personal	101,000	37	1,400	7,800
Auto Repair	89,000	48	1,580	8,500
Amusements	30,000	20	4,700	28,400
Hotels and Lodgings	21,000	—11	6,700	60,000
MovieTheaters	13,500	10	10,400	116,000
Total–Service	718,500	29	200	$12,000
Total–Wholesale	230,000	50	610	$575,000
Combined Distribution	2,816,500	30		

[9] Chamber of Commerce of the United States, *Distribution News Letter* No. 4. Washington, March 7, 1947.

presence of many small businesses makes for better working conditions and higher wages. A few large firms employing 10,000 may offer less variety of work and less attractive positions than 200 firms with an average personnel of 50 each. Ownership and control of productive resources by the state would seem to be the only protection of society if small business should disappear.

Competitive capitalism insures freedom of enterprise, provides an outlet for individual creative impulses and abilities, and also provides a livelihood for a large segment of the total population. Of those gainfully employed seven per cent are small businessmen, 45 per cent of all employees are in small business, and 30 per cent of those in manufacturing are employed by small firms.

Individuals and small business provide the major fund of new ideas and inventions. Records of the U. S. Patent Office show that from 1921–1938, 43 per cent of the patents were issued to individuals, and 34.5 per cent to 17,500 small- and medium-sized business establishments.[10] Small business often serves as the proving ground for new ideas and products, patented or unpatented. Many of these may never achieve public acceptance, but must be given a trial before it is possible to know their future. Big business tends toward conservatism in this respect, and some of our cherished products of today would still be in the fairy tale stage had it not been for the daring pioneer efforts of small businessmen with confidence in a new idea. Small enterprise is the backbone of America, and it exerts a stabilizing influence on our social order.[11]

Small business is an important segment of total business needed to adjust supply to price and demand relationships.

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[10] Schmidt, Emerson P., "Small Business, Its Place and Problems." *Post-War Readjustments*, December, 1943, Bulletin No. 7, Chamber of Commerce of the United States.

[11] Beckman, Theodore N., "Large Versus Small Business After the War." *American Economic Review*, March, 1944, Vol. XXXIV, No. 1, Supplement Part 2, pages 94–106.

In a sense small business is the marginal area where new firms appear in response to an increase of demand, and the least efficient are eliminated when demand drops off. For example, during World War II most of the wartime shrinkage of over 500,000 business units took place among small businesses, just as during 1944-1947 at least 88 per cent of the approximately 1,000,000 new establishments were small.[12] It is mainly when new entrants into business exceed the demand for their services, or when inadequately prepared individuals enter business to become certain failures, that this flux is properly considered economic waste. Unfortunately, much of the high mortality among small businesses in normal times is of this type. Thus, small business can also be assessed as an area in which assistance is needed to reduce unnecessary failures, with their economic waste, shattered hopes, and, sometimes, injurious personality effects.

For the development of self-reliance, for making men as well as money, small business excels. Small business suits the personality and independent attitude of many. Thousands of individuals who would chafe under the restrictions of employment find business ownership to their liking. It is the channel through which thousands of poor individuals rise to fame and fortune. Small business offers opportunity for self-employment for hundreds of thousands, some with technical and professional training, others with business experience, and large numbers who are outside the employable standards set by many concerns, especially big business. Men past 40 years of age, those with physical handicaps, and others who for various reasons are not attractive to big business as employees find self-employment their principal method of living a useful productive life.

Widows lacking previous business training or experience,

[12] Hillyer, William Hurd, "Small Business Re-Zooms." *Forbes, Magazine of Business,* March 1, 1947, Vol. 59, No. 5, pages 20–21. For further study see Kaplan, A. D. H., *Small Business: Its Place and Problems,* Chapters I and II. New York: McGraw-Hill Book Company, Inc., 1948.

housewives desiring to supplement the wage earner's income, young married couples before family responsibilities keep the wife busy at home, often find small business ventures attractive and profitable. For several years following World War II many of the authors' students were recently married couples who planned to open their own family partnership businesses upon graduation.

Some persons undertake business ownership without having had directly related experience. During 1938 a survey of the former occupations of owner-managers of small businesses in Arkansas gave the following results:[13]

Present Type of Business	*Number Interviewed*	*Previous Occupation* *
Cafe	87	farmer 29, same 9, housewife 9, salesman 8, none 8
Furniture Store	24	farmer 10, salesman 7
General Store	29	farmer 8, salesman 6, none 6
Grocery	201	clerk 63, farmer 44, salesman 30, housewife 17, none 16, same 14
Service Station	120	same 33, farmer 25, none 21, mechanic 10
Hotel	21	housewife 7, railroading 4, farmer 3

* Difference between total for each group in this column and corresponding number in column 2 represents those whose previous occupation was undetermined.

Analysis of results of this survey further discloses that for individuals in three occupations who later became business owner-managers, the chances were over 50 per cent that they would enter lines of business in the following relative order:

Former Occupation	*Probable Kind of Business Ownership*
Farming	grocery store 44, cafe 29, service station 25, barber shop 4, cleaning and pressing establishment 4, hotel 3.

[13] Kelley, Pearce C., "Former Occupations of Small Scale Retailers." *Journal of Marketing*, July, 1940, Vol. 5, No. 1, pages 35–37.

Housewife .....grocery store 17, bakery 9, hotel 7.
No occupation .....service station 21, grocery store 16, cleaning and pressing establishment 4, beauty parlor 3.

There are fields where small business units are better suited economically than are large units. In many industries the relative cost and earnings are more favorable for small than for large plants.[14]

Interdependence of all business

Small business has always been the seed from which big business grows. It is the germinator and perpetuator of cities as well as of big business units.

Small business is the link between the products of giant factories and their ultimate markets. Small industries often make up a large share of the market for power companies. One case is cited where a large utility company sells power to 4,700 small firms out of 5,000 industrial consumers.[15] Large producers of oil, tires, automobile accessories, and rubber products solicit individuals to operate distributing units as their own business. Esso in May, 1947, used radio advertising for this purpose. Goodyear and Goodrich seek independent retail dealer outlets. On a cost basis alone it would not pay big business to establish distributing units as conveniently located as those which small business provides. Small business is necessary to furnish the wide variety of goods and service desired by consumers. In many fields the market is either not large enough or is too unstandardized to attract big business.

Farmers are dependent equally as distributors and as processors upon small business for the marketing of their crops. Small business is more adaptable to local needs and person-

[14] Investigation of Concentration of Economic Power, Temporary National Economic Committee, Monograph No. 13, *Relative Efficiency of Large, Medium-Sized and Small Business*, especially page 14. Washington: U. S. Government Printing Office, 1941.

[15] McCarter, T. N., Jr., "Utility Industries' Interest in the Establishment and Growth of Small Industries." *Edison Electric Bulletin*, June, 1946, Vol. 14, No. 6, pages 191–192, 216.

alities, and is preferred by a great many customers in small towns and in neighborhood stores.

The current interest in small business is the result of many causes, among which the following are important: a growing fear of concentration of economic power, a recognition by big business of its dependence upon many small firms, and a shift in educational emphasis to give greater attention to the problems and needs of small business. A factor of temporary importance during the early post-World War II years was, of course, a desire to help returning service men and former war workers who had a desire to go into business for themselves.

We believe that this interest in the small independent businessman is likely to be permanent. Experience during the war demonstrated the value of subcontracting and close coöperation among all firms in an industry regardless of size. As the Committee for Economic Development states, the basic fact is the interdependence of all business.

Place of Small and of Big Business

In the earlier discussion of the *importance* of small business many topics were mentioned that might be equally well considered as *advantages* of the small enterprise. Big business also has advantages, just as the advantages of one size group are usually the limitations of the other. Most of the advantages of small business resulting from its size have been mentioned; some for big business are the following:

1. Ability to build customer following through extensive advertising, dealer aids, use of brand names, and other sales promotional devices.
2. Ability to withstand more financial strain, such as to continue operations at little or no profit for several years.
3. Ability to provide old age retirement and benefit plans for executives, and other employee benefits.
4. Less need for top notch hand labor due to subdivision of work and use of machines.

5. Ability to keep the channels of future trade open during an emergency shortage period by means of advertising.

6. Often technical advantages in ability to use fuel, power, buildings, and machinery to better advantage and at lower unit cost up to optimum size.

7. Competitive advantage in certain established fields like automobile manufacture (the "Big Three" produced 80 per cent of all pre-war cars).

8. Opportunity to prospect for employees from many sources and to pick the best.

9. Ability to secure preference from suppliers, or from communities seeking to attract new industries.

10. Ability to decentralize operating units and operate branches in most fields occupied by small business.

Offsetting these advantages are certain limitations on big business, such as:

1. Heavy overhead, mostly of a relatively fixed cost type.

2. More likely to be the target for social reforms and government regulations.

3. Impersonal in the eyes of the public and often treated very impersonally.

4. Greater reliance on records and growth of red tape, tending toward a bureaucracy, with increased size.

It is apparent that many of these advantages and limitations are matters of degree rather than absolutes. Our interest in examining these attributes is twofold: (1) to aid in selecting the fields where small business has the greater advantages or lesser disadvantages; and (2) to appreciate the basic facts of the *interdependence of all business.* Before continuing further with our comparison of small and big business it is important to note that the respective position of each is relative also to time and to the stage of technological development. An industry that today is a "natural" for small business operation may be a decade later one of the best examples of big business methods.

Areas of natural advantage by size

Before the end of the nineteenth century it was recognized that the nature of certain industries made them "natural monopolies." Railroads, it was soon found, could not operate under free competition—no one could run his own car over common tracks. Under competition weaker competitors were eliminated, or existing lines merged. In 1890 the Interstate Commerce Commission, which had been established by Congress, regulated the railroads, and the concept of a "natural monopoly" was recognized.

Similar conditions appeared in the public utilities industry. Railroads and public utilities have two characteristics in common: (1) great importance to the health and welfare of the public, and (2) a powerful tendency to become monopolistic in their respective market areas. It is better to grant each company a monopoly of its market, and then to regulate rates and services rendered through a government agency in the public interest, than to attempt to rely on competition in such a situation.

In manufacturing there are some similarities to this size pattern on the cost side, but few, if any, on the demand side. Product differentiation limits the ability of a manufacturer completely to monopolize the market for one kind of product even though further economies of mass production might be possible. The classic example of this was the Model T Ford. Consumers can recognize the products of different manufacturers, or can be led to believe they do, and they buy accordingly. But what consumer could distinguish electricity, gas, or water if produced by competing companies?

On the supply side either of two conditions is conducive to large business units: (1) control of essential raw materials, patented machinery, design, formulae, or processes; and (2) economies of large-scale production. Since the second factor is more basic it deserves further attention. In general, certain fields of production have developed to the point where the advantages of bigness so outweigh those of smallness as to

justify considering them as inherent qualities or characteristics of types of business suitable only to large units. Naturally there will be the inevitable borderline cases, or overlapping, between big and small business. The following tabulations should be considered only as a pattern representative of the average case.

FIELDS WHERE BIG BUSINESS HAS MORE ADVANTAGES

Field	*Some Reasons*
1. All "natural monoplies," railroads, public utilities; water, electric, and gas companies.	Large initial investment required to start, decreasing unit cost; one company can serve a given market at lower cost than two or more but requires public regulation—government grants a monopoly of each market, but regulates in the public interests; product differentiation is absent or of little importance.
2. Manufacture of motor vehicles and some expensive durable consumers' goods like refrigerators.	Several large markets exist demanding a standard product with standard replacement parts and service, at a price competitive in relation to quality and style offered by competitors using the most efficient low cost mass production methods; production machinery and methods already highly developed and refined.
3. Manufacture of frames for automobiles (like O. W. Smith Corporation of Milwaukee), or other highly specialized industries serving only one market.	Where expensive specialized, often single-purpose, machinery has been developed, and therefore market limited. One company can supply entire need for large segment of the available market.
4. Production of steel, oil, rubber, etc.	Large capital investment in plant and equipment; large labor force well unionized; industry "stabilized."

In summary, wherever heavy capital investment is required, where specialized skills are highly developed calling for the employment of a number of technical specialists, where sub-

division of work has been carried to an extreme for low unit labor costs, and under similar conditions characteristic of machine-dominated or mass production methods, the business unit is large. Usually the market demands a standardized product at prices based on the most efficient methods.

Other things being equal, the dis-economies of large-scale operation are likely to make optimum firm size small in industries where the products are for a small specialized group of consumers, are subject to frequent and drastic changes in style, or require craftsmanship rather than standardization. Conversely, highly standardized products not likely to vary greatly in design and complex products which involve assembling operations are most susceptible to large-scale operations.

But in areas in which materials or markets are sparsely distributed, the economies of large-scale operation cannot be realized so that the optimum size of the plant is relatively small. While this does not necessarily mean that the firm must also be small, it does indicate that in such communities small firms can operate efficiently.[16]

The situation in the service fields and in merchandising is quite different from that just discussed for manufacturing. Although the operations performed in many service industries resemble those of manufacturing, the fact that they are *performed upon the person or personal property of the customer* limits the trading area to that reasonably accessible to the plant. In large cities this often results in the service unit in such fields as laundering, car washing and polishing, dyeing plants, and others being fairly large. Likewise for hotels and other service industries catering to tourists, in areas frequented by numerous travelers, many of the business units are very large and often are operated on a chain ownership system with branches in other such areas.

In merchandising great contrasts exist. The trend for several

[16] National Resources Planning Board, *Industrial Location and National Resources*. Washington: U. S. Government Printing Office, December, 1942.

decades has been away from the very large wholesaler toward smaller local wholesale or jobbing units usually operated on an independent ownership basis. Although most fields of wholesaling operate on a slightly decreasing cost basis, with the optimum size quite large, we have today very few large wholesale establishments. Nevertheless, the minimum capital required to operate a wholesale house, even of the less-than-$200,000-volume small business class, is relatively quite large. Consequently books about small business are not usually concerned with wholesaling, except for units of more specialized types, such as merchandise brokers, sales agents, and single-line specialty houses.

Although retailing tends toward constant or increasing costs, we have many very large retail organizations as well as a larger number of very small units than in any other field except agriculture. Two varieties of big business in retailing are (1) the single large store, such as the large city department store, supermarket, and mail order house; and (2) the big organization composed of numerous branches, like chain stores. Rather than representing natural advantages of big business, these organizations reflect the combined result of relatively high costs for securing their large volume of trade, and some economies in buying and integration of wholesale and retail functions. Certainly small merchants are able to compete successfully with even the largest retail concern, although not always on identical items or on a price basis alone.

The areas of natural advantage of small business units may be tabulated as follows:

FIELDS WHERE SMALL BUSINESS HAS MORE ADVANTAGES

	Fields	*Some Reasons*
1.	Service establishments like beauty parlors, barber shops, etc.	Market is usually limited, and equally good service can be obtained near home; expansion is at constant unit cost since labor is the dominant expense and the service individualized.

2. Professional services like free-lance public accounting, advertising art work, personal counseling, etc.	Limited by time of practitioner and his ability to know needs of clients; semi-confidential nature of some of the work.
3. Services like individual reminders, child care, etc.	Little capital required; time and personal factors of operation of great importance; market limited to vicinity.
4. Production of entirely new products, in experimental stage both production- and market-wise.	No specialized machinery yet developed; materials and methods require experimentation; demand uncertain; risk too great for large-scale operations at start.
5. Retail or combined retail and service businesses, like neighborhood stores, economy restaurants located in minor trade areas, etc.	Limited market; advantage of owner's personal knowledge of customers.
6. Highly specialized fields like retail nut stores, souvenir shops.	Total business usually not great enough for large units in one trading area.

Problems of Small Business

To read much of the literature on small business might easily lead to the belief that problems constitute the dominant characteristic of this important segment of our economy. There is no doubt that small business has its problems, just as does big business.

Small business is no more a "bundle of problems" exclusively than is any other type of human activity. Our interest in the problem approach is mainly threefold: (1) to forewarn or caution prospective entrants into the fields; (2) to seek a classification of these problems that will be of practical use to prospective small businessmen; and (3) to suggest certain areas where remedies in the form of public action may be needed.

No doubt some of the problems of small business are purely relative. This makes it difficult to generalize about small business problems, especially since our definitions are rather arbitrary and loose. For this reason it will be necessary to visualize a typical small business—one representative or model in its

class. It seems desirable to attempt a classification of the problems if our threefold purpose as stated is to be effected. The following two-way division appears to meet this need: (1) problems characteristic of most small businesses because of the type of individuals who frequently enter these fields; (2) problems resulting from conditions at any period of time, such as laws unfavorable to the little fellow, discriminatory financial policies, and unfair competition that could be remedied to lessen the burden on small business.

Problems relating to typical small businessmen

In small business the man *is* the business. The typical small businessman lacks the broad, well-rounded experience desirable in modern business. In most cases the business is started by a man experienced in one function, usually either production or selling, and he is likely to slight the other function, as well as accounting, personnel, policy formation, and similar activities. As long as nearly all of these functions are activities in already highly developed fields of individual concentration and specialization, it is obviously impossible for one or two men to be experts in all of them. Nor can they afford to hire a specialist for each function.

It has often been said that the chief problem of the independent businessman is his independence. Small business ownership does attract an independent, self-reliant type of person—one less likely to seek advice and assistance from those of greater experience and know-how. Often the biggest problem is to get the independent to appreciate his need for outside assistance, and then to be willing and able to take the time to profit by it. In an address before the American Association of Collegiate Schools of Business, May, 1947, the Honorable William C. Foster stressed this point in suggesting ways colleges of business could assist the small business population.[17]

[17] Foster, Hon. William C., "What Government and Colleges Can Do for Small Business." Address delivered at the twenty-ninth annual meeting of the American Association of Collegiate Schools of Business, St. Louis, May 16, 1947. Reproduced as a mimeographed News Release

Years of experience with the Distributive Education Program by the authors lend further support to this problem. It is always the small distributors who need the free training that are the hardest to reach.

Prosperous times, such as those following the recent World Wars, attract many entrants into the fields of small business who misinterpret the easy going as a sign of success. Many do not know the price score and are unable to make accurate forecasts. When the inevitable readjustment comes the casualties are heavy. Even their few years of experience are of little help because they do not equip them for operations when the going gets tough. Further aggravating the problem is the fact that many have paid inflated prices for good will, leaseholds, fixtures, and merchandise.

A condition existing in many large cities, often referred to as the "business opportunities racket," helps to increase the number of small business failures. This "racket" is mainly the practice of selling unprofitable businesses to unwary, new enterprisers instead of permitting such firms to go out of existence. Especially in the retail field, a single business unit often wrecks a dozen or more owners through successive sale and resale to a steady stream of newcomers, each confident that he can succeed where others have failed. Naturally the brokers who promote these sales make more commissions the more frequently the business unit changes hands. Sometimes they are not too careful to disclose all the facts, or to inform each new "sucker" as to how many of his predecessors have failed.

Two major reasons have prompted many unqualified persons to undertake business ownership overhastily: a sudden desire for independence, and the appearance of an unexpected business opportunity that must be taken advantage of at once or lost. The usual result in either case is for the would-be businessman to realize too late the amount of managerial ability required for success.

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by the U. S. Department of Commerce, Washington, 1947. Supply exhausted.

Often problems related to incompetence may be traced to the fact that small business ownership for many is an unplanned occurrence. In other words, these individuals are in business as a result of inheriting a going concern, because of some event that left them with a business to salvage, or owing to the necessity of making a living to support the family when an attractive job was not to be had.

The inheritance of a business does not necessarily mean poor management, as illustrated in the following example. A survey of small business owners conducted by the authors disclosed the fact that four had taken over a family enterprise. In each case the individual had grown up with the business. One had worked in the family enterprise for several years before recognizing his need for college training. All four planned their college courses so as to be of greatest benefit to them later as managers of their particular businesses. In one additional case a former student married into a business partnership, and he reports his college training as invaluable. Several cases not included in the survey, known personally to one of the authors, include: (1) former students who majored in marketing so as to be better prepared to take over a family business, which they have since been operating successfully for from five to ten years; and (2) a few recent cases where students purchased a business with parental assistance while still in college and then planned the balance of their courses with this owner-manager objective as a goal. It may be added parenthetically that the incentive of ownership has resulted in a noticeable increase in students' interest in courses relating directly to their future business.

Just before World War II the authors prepared a manual for small-scale retailers based entirely on material digested from retail trade journals. In the process of assembling this material the scarcity of articles dealing with records and accounting became very evident. Correspondence with the editors of most of the publications elicited the following significant bits of information. The editors realized the dire need for infor-

mation and suggestions on these topics, but their previous efforts to include such materials were poorly received. Readers wanted suggestions on spectacular sales promotion plans or other topics of current interest, *provided* they did not involve records and accounting.

Another problem characteristic of small business is the importance of *time* to the owner-manager. With so many essential duties to perform, or to supervise, and only the same amount of time available as is used by each of a number of persons in big business, this is usually the most serious problem of the small businessman.

The great demand made on the owner-manager's time leads to the problem of lack of free time, once the business is in operation, in which to study and improve his business methods through self-development. If he does take the time after attending to all essential business duties, he is likely to be so tired and worried as to experience difficulty in learning effectively. The solution, at least for the small businessman, is adequate preparation in advance before launching out on his own.

In many fields big business concentrates on the products with a steady or predictable demand, leaving to the small operator the slower sellers and more risky items.

Lack of research facilities and access to sources of information on new products, materials, and methods is associated with the independent nature and unorganized status of most fields of small business.

Small business is more sensitive to economic fluctuations than big business. The primary reason is lack of liquid reserves. Often a firm is forced to cease operations just before changed conditions would have made the business profitable. However, firms launched shortly before the upturn of the business cycle may be the most favorably situated. Not only do they start at bargain prices for buildings, equipment, fixtures, materials, and supplies, but, with the right timing, a short period of loss will be quickly compensated for by one of increasing profits.

A questionable problem often stated for small business may be mentioned here, and that is the apparently higher failure rate. Statistics show that the failure rate is highest during the first, and few succeeding years, and then declines to a much lower and more constant rate. Since the vast majority of all businesses in all fields are small at the start, those that survive their first few years tend to increase in size as well as age. Can we be sure whether it is size or age that is the cause of failure? In the same connection: Which is more likely to fail, a new venture with capital of $75,000, or one established for ten years with a capital of only $25,000? [18]

Small business is weaker in coping with vested interests or monopolistic practices, even though some of the latter may be illegal. It is more difficult for the small businessman to secure the best brands and exclusive agencies. Selective selling policies of vendors plus the fact that established dealers often have already secured the favored lines make this a serious problem in starting a new retail store.

The great diversity of most fields of small business, as well as the geographic dispersion of units, makes it very difficult to provide management aids for many kinds of undertakings.

Market analysts and industrial engineers are too expensive for these small operators. One proposal to aid small establishments of this type is to subsidize technical specialist services through public funds.

Small business is at a disadvantage in securing high quality employees. Big business competes for and aggressively seeks out the more promising college graduates, and also young men on the way up in smaller firms. The prestige of big name companies makes it even harder for the little fellow to compete successfully in the labor market. Desirable men who are not influenced by the appeal of big business usually plan to go into business for themselves.

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[18] Economic (Small Business) Series No. 54, U. S. Department of Commerce, *How Long Do Retail and Wholesale Establishments Tend to Survive?* Washington: U. S. Government Printing Office, 1946.

The smaller the business, the greater the tendency to rely upon the owner's knowledge, experience, and limited resources. With increased size comes a recognition of the value of seeking advice and coöperative assistance from others.

Small business is likely to be the victim of schemes or hoaxes more frequently than is big business. Many rackets seem to thrive on the inexperience and gullibility of small businessmen, especially newcomers in the field. Veterans intent on owning their own business were victimized so frequently that the Better Business Bureau published booklets warning them of the more common schemes and rackets.[19]

To compensate for the natural tendency toward overemphasis on self-reliance by the small businessman the following suggestions deserve consideration.

1. No one can be expected to know all things about buying a business. Therefore it is well to hire a competent lawyer, or to discuss your problem with the local bank or other "knowing" individuals or concerns to help determine the true value of the property you are about to purchase.
2. If you know that some day you will inherit a going business, begin now to learn the business by actual work in the establishment and by supplementary training related to that business.
3. Study "required" college courses such as accounting, marketing, and English even more thoroughly than "practical" electives likes salesmanship, advertising, and management.
4. Make a *habit* of seeking advice and discussing your ideas with others.
5. Practice organizing your work (job, studies, and so forth) so as to have "free" time for self-improvement activities and participation in community projects.

Problems due to existing conditions

From time to time changing conditions are accompanied by

[19] *Facts You Should Know About Schemes,* a booklet. Boston: Educational Division, The Better Business Bureau, 1939; revised 1946.

legislation, variations in taxation, unusual economic conditions, and many other developments that often impinge more heavily on small business. It is primarily those amenable to change that we are interested in here.

During World War II two trends that had been in operation for several decades received great impetus, namely: concentration of economic power, and an increased amount of government control over business.[20]

During the war and up to 1945 certain forms of taxation were especially burdensome to small business.[21] Since the tax structure changes from year to year it should be a subject of continuous study by those interested in small business.

For at least three decades adequate financing of small business has been losing ground as compared to big business. In at least three respects small business has a serious financial problem: (1) in securing long-term equity capital, in contrast to short-term working capital loans; (2) in obtaining greater protection from the calling of loans or stoppage of credit during trying times when outside financial aid is most direly needed; and (3) in securing funds in small amounts at lower rates.

It costs just about as much for a banker or other lender to investigate and evaluate a loan application for $1,000 as one for $1,000,000. The former may cost more because the applicant for the large loan is often more helpful in providing significant information. So long as the failure rate is higher for small than for big business, the risk of financing and the resulting costs will be higher, unless subsidized in some way, or at least aided by some development not yet started. This development is entirely possible, either by government subsidy or guarantee of loans, as with F. H. A. mortgages.

[20] Murray, J. E., "Economic Concentration and World War II; Remarks in Presenting Reports of Senate Small Business Committee." *Commercial and Financial Chronicle*, July 11, 1946, Vol. 164, No. 4506, pages 253, 261.

[21] Buehler, Alfred G., "The Taxation of Small Business." *American Economic Review*, May, 1946, Vol. XXXVI, No. 2, pages 250–264.

In concluding the discussion of the problems of small business, it may be helpful to call attention to the fact that big business, too, has certain unique problems. Absentee ownership, inside management, ineffective centralized control of widely dispersed and often diverse activities, and inflexibility in adjusting to local demands are a few of these. It is almost impossible for the giant corporation to maintain the personal touch with its employees, customers, and the public that is practicable for the small businessman. The corporation is truly an impersonal being, not only as it is created by the law, but also in the eyes of many people, who will act toward a large corporation in a manner they would not consider toward the friendly little man. Obviously these are only a few of the many problems associated with the large corporation, but since our concern is the small business this brief listing will serve our purpose.

Conclusions

Small business is represented by the independent, local enterpriser. It has always occupied an important place in our economy, and always will. A large number of relatively small business units is essential if competition is to work effectively. So long as we believe in the system of free private enterprise, we must maintain opportunities for the little fellow to enter business on his own and be able to operate without unfair handicaps. Both small and large businesses have their place and problems. *The important point is the interdependence of all business.* Some understanding of these conditions is important as a background for further analyses of the field of individual business management.

Review and Discussion Questions

1. What other characteristics can you suggest of a small business in addition to the ones mentioned on pages 1–4? Give examples of where you have found these characteristics. Would you want them in your business? Explain.

2. In what field of small business are you interested? What requirements should you meet before you begin this type of business? Base the answer to the second question on your findings from readings or from talking with businessmen.

3. The authors have stated that a truly competitive economy is necessarily predicated upon the continued existence of small business enterprises. Do you believe this to be true? Explain fully the reasons for your answer.

4. If you were faced with the problem of either going into a small business (which was in a well-established field and in an excellent location) as the owner, or going into a big business as a department head with the possibility of working up to near the top, what choice would you make? Give your reasons.

5. In your opinion what small businesses of today will likely be the big businesses of tomorrow? Why?

6. What advantages and limitations on small business, not mentioned in the chapter, can you think of? Discuss each.

7. Suggest additional kinds of business where small units have inherent advantages. Explain.

8. List the advantages small local branches of large organizations have, for: merchandising, manufacturing, and the service fields. How could the independent businessman secure similar advantages without giving up his independent ownership?

9. Can you suggest any advantages of using some measurable factors (such as those of the United States Department of Commerce) to define small business? Discuss.

10. Write a short report on "The Interdependence of All Business."

11. In your opinion is small business more dependent on big business than big business is on the small units? Take either side of the argument and prepare to defend your position in class discussion.

12. Do you think there would be important advantages of using the words "business ownership" instead of "small business" in a study such as we are undertaking? Can you suggest a better term? Discuss.

Chapter II

EMPLOYMENT OR YOUR OWN BUSINESS?

In Chapter I the status and problems of small business were examined as a necessary background for the prospective enterpriser before he makes the final decision as to whether or not he should be his own boss. In the present chapter we will examine the two ways the individual has of making a living—through employment, or by entering business for himself.

As part of the process of planning your future you should compare the advantages and disadvantages of both employment and business ownership with your individual personal traits. If you decide you are the type to operate your own business, then survey the opportunities, risks, and requirements. Finally, before launching out on your own, study the principles and modern practices discussed in the balance of the text. Your chances for future happiness as well as business success will be much greater if you follow the sequence suggested.

Many individuals would rather be employees, especially with large, well-established concerns. Some of the advantages are: security, the prestige that goes with working for a "name" business, old age pensions and benefit plans, greater regularity of income; a more limited area in which knowledge and ability are expected; less annoyance from shifting frequently from one type of work to another; and less worry outside of business hours.

Other advantages of employment are: the absence of risk of capital or personal savings, or of personal reputation for the success of the business; shorter hours, regular vacations, and

pay for overtime; more limited responsibility; less planning of tomorrow's work, and in general a more regular routine life.

Advantages of Business Ownership

Looking at ownership, we find that once established the small business offers security comparable to employment, and for a much longer period of time. One authority, referring to the seeking of employment in big business, believes "this concentration on security is perhaps the greatest enemy this country faces." [1]

There is also the satisfaction of being known in the community as an independent businessman and not as merely an employee who takes his orders from others, as does even the manager of a branch house or chain store.

The small business owner and independent professional man are more familiar with insurance and the importance of saving and investment. They are not subject to the same time limitations on their earning power as are employees who must accept retirement at a certain age because of company policy. Some prefer to get the entire profit from their own efforts, ideas, judgment, and skill, saving or investing as they choose and retiring when they please.

If a person owns his own business, he cannot be fired, except by customers—his real bosses. He need have little fear of petty jealousies, factions, internal politics, or favoritism; instead he has the forces of competition to be met successfully. This may not always be easy, but at least it is usually above board, ethical, and available to all competitors equally or according to their ability.

If an individual has ideas and wants to try them out, he can do so as his own boss to a far greater extent than as an employee. If he likes to pioneer, small business is a natural for him; if he likes to carry a job once started through to a successful completion even if it means working overtime, he

[1] Benton, William, "Young Man Be Your Own Boss." *The Reader's Digest*, September, 1944, Vol. 45, No. 269, pages 47–49.

should enter business for himself. If he enjoys a line of useful work, is good at it, and is not afraid of hard work, he will probably make much more in this type of business for himself and will be happier than he would be working for the other fellow. If he wants to secure all the profits from his efforts and will take the risk of loss, if he wants to do something differently from the way it is being done, or if he is unhappy working for others and feels restrained from the opportunity for self-expression, he should make sure first and then start on his own business. If an individual really wants to go into business for himself but is afraid to start because of the many risks involved, he should plan definitely to do so anyway, waiting only until he has an even chance for success. The large number of today's businesses that passed through several stages of failure during their beginning years include those of F. W. Woolworth and R. H. Macy.

An excellent commentary on the satisfaction resulting from business ownership appeared in a recent survey covering 64 college graduates who had entered business for themselves over a period of 23 years. If entirely free with no financial ties in any business, only two of this group stated that they would take a job instead of again becoming business owners immediately. Even these two would become entrepreneurs again as soon as they had acquired certain desired experience as employees.

As his own boss the individual will have fewer restraints on his actions and will be able to express himself more fully and to develop any creative idea he has to the limit of his ability and resources, no matter how harebrained it may seem to others. Among the bases of modern successful enterprises that were formerly harebrained ideas, we find: the railroad, automobile, telegraph, photography, phonograph, dictaphone, typewriter, calculating machines, electric light and power, metal boats and steamships, radar and atomic energy; also, modern practices such as a one-price store policy, returned-goods priv-

ilege, women in business and professions, manufacture of standard interchangeable parts, honesty in business, the curving of light around corners, the generation of cold heat, and others too numerous to list.

An employee who suggests something new that is not given a trial may be disturbed by the thought that it might have worked if tried. When later the same idea is announced with credit given to his "boss," or even if by a different company, it is quite disappointing. The authors have seen numerous examples of this situation.

It is well known that college graduates in particular frequently have too many ideas for a big company. The presence of a research division tends to aggravate, rather than lessen, this situation because it obstructs the constructive urges of other employees by reducing the firm's need for original ideas and suggestions.[2]

Business ownership gives a person a chance to exercise *all* of his abilities, skill, knowledge, energy, desire for pioneering, and adventure. Chances for recognition are better, socially, politically, and economically. There is no need to share profits, if any, with anyone except the federal, state, and local governments. Of course, a businessman will be expected to make greater contributions to charity and various community activities, and to belong to more associations and possibly more civic clubs. His returns will be more nearly equal to his efforts than if he were employed.

Freedom of action will be greater. If an owner wants to slow down a bit or take a vacation, that is his business. Recently one of the authors had some pictures of his daughter taken at a studio noted for high-quality work. After several weeks he received notice that the pictures were ready, only to be greeted the next day by a sign on the door "Gone Fishing, Open in Two Weeks."

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[2] Converse, P. D., "Should I Start My Own Business?" University of Illinois Special Bulletin, No. 5, April 10, 1945, Vol. 42, No. 34, page 8.

As Professor Converse said about this relief from pressure:

A successful chain store executive lost his health largely because of such pressure, and later started a manufacturing business of his own. This business grew into one of considerable size. He regained his health in spite of the fact that he worked more hours each day than he did as an employee.[3]

The proprietors of many small businesses admit that they could make more money if they would work harder, but they do not want to. From one point of view this is a weakness of small business, since many proprietors, in the absence of any prodding from higher-ups, show a tendency to loaf. From another standpoint, however, this is really a good thing, for life certainly should have a meaning other than continual hard work under pressure.

Since it is the most obvious, as well as the most common, reason for entering business for oneself, the opportunity for greater profit is discussed last. This includes the factors of not working to help pay the salary of high-priced top executives, not sharing profits resulting from one's efforts with absentee stockholders, and the fact that a man is worth more as his own boss than he would be paid by his employer. A survey by the authors of the reasons why eighteen College of Business graduates entered business for themselves disclosed that desire for greater profit was the dominant motive. Nine specifically stated this as the main reason and the balance implied it as too obvious to mention. Professor Converse considers it to be the foremost reason for starting a business,[4] and other authorities usually accord it first place in order of importance. As with most human conduct, the "reason" for going into business rather than employment probably consists of many components, opportunity for greater profits being merely one of the more obvious and less controversial.

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[3] *Ibid.*, page 7.
[4] *Ibid.*, page 6.

Although statistical data dealing with the reasons for business ownership are limited, the results of one recent survey furnish information on this topic, at least for the group included. Replies were obtained from 250 commerce majors of the University of Mississippi who had been graduated from 1923 through 1948. Approximately one-third were business owners. This group stated the following reasons for entering business for themselves:

REASONS FOR ENTERING BUSINESS OWNERSHIP

Reason	*No. stating each reason*	
Desire for independence; to be own boss	20	
To go in business with father	11	
Inherited family enterprise	3	
To expand business started by brother	1	
To locate at or near home	3	
Total personal and family reasons		38
More rapid advancement as own boss	8	
Make more money	7	
Capitalize own experience	4	
Take advantage of a good opening	4	
Steadier and more secure	3	
Unable to find position at satisfactory salary	2	
Total economic reasons		28
Grand Total		66

Although this list emphasizes the importance of personal reasons as factors leading to entrepreneurship, greater profit certainly is apparent as a major motive.

Of this same group of commerce graduates, nine-tenths of those who were employed stated that they wanted their own business some day. These employed persons gave the following reasons why they had not as yet undertaken business ownership:

REASONS GIVEN BY EMPLOYED GROUP

Reason	*Number of Employees*	*Percentage of Total*
Need more capital	68	27.6
Need more experience	56	22.8
Waiting for right opportunity	52	21.2
Not suitable for my type of work	12	4.9
Risk too great	12	4.9
Prefer employment	12	4.9
Worry less as employee	10	4.0
Miscellaneous	24	9.7
Total	246	100.0

Disadvantages of Business Ownership

Attractive as your own business may seem, the attractiveness is not without its limitations. Risk is probably the greatest of these—risk of financial loss, of the loss of your business reputation, and of personal prestige. Actually, loss of business reputation is not great, as most small businesses that do not succeed fold up quietly with plausible excuses given to the public. Usually no serious financial loss results, especially to creditors. Only the supersensitive individual unsuited to business ownership is likely to suffer development of a serious inferiority complex. In a surprisingly large number of cases one or two failures are followed by success that eventually leads to an outstanding business. Again Woolworth and Macy may be cited as examples, although the number is legion.

Most of the alleged disadvantages of business ownership are traceable to: (1) lack of personal aptitude, (2) lack of proper qualifications, and (3) poor judgment, incorrect timing, or choice of the wrong kind of business. A careful study of the field of small business, such as that aspired to in this text, will enable a larger number of individuals to make the right choice for their future and to succeed in direct relation to the accuracy of their decision. If the reader will keep these three causes in mind as we review the usually named disadvantages of entering one's own business, trying to classify each accordingly, we

believe he will convince himself of this more effectively than we could simply by telling him.

The following are usually given as the disadvantages of small business ownership:

1. Greater risks, financial and personal; some may be covered by insurance *if* the owner has a policy, but many he must bear himself. Among the latter group are: errors in forecasting, demand and price changes, obsolescence, changes in government policy, changes in taxation or in international situation, inventions, ideas launched by competitors, changes in traffic routing or rates.
2. Longer hours and more worry.
3. Entire responsibility for all decisions, and for meeting all payroll and other expenses.
4. Irregular income, since all business is subject to continuous ups and downs.
5. Responsibilities to self, family, employees, and creditors.
6. Bosses are not one but several: the public, customers, creditors, the government, and other social groups.
7. Income is small, especially at the beginning.
8. Many agencies, in addition to those already mentioned, will regulate activities and reduce independence. Some are the requirements by insurance companies of minimum standards, the local fire or police departments, health authorities, labor unions, and quite possibly others.

As we review and compare the foregoing arguments, our individual reactions will differ. Differing personal characteristics in terms of courage (or foolhardiness) as against timidity (or conservativeness) will evoke different responses. The thrill of going into business and banking one's capital and reputation against the ability to produce independently may be the determining factor for some. Others, on recognizing the hazards, will conservatively withdraw. All of which prompts the question, "What kind of person does it take to be a good operator in the field of small business?" Certain authorities

believe that only one out of twelve to fifteen individuals has what it takes to be in business for himself.

What It Takes

The selection of an occupation for an individual is much like the selection of a suit of clothes or a dress from a store's assortment. From a long rack of possibilities, several may appear attractive and fashionable, or long-wearing and comfortable. Yet when they are tried on, all but one may prove to be undesirable. The others somehow do not seem to look well or fit properly, and the wearer is discontented with them.

Such is the case of the man or woman who contemplates a vocation—small business is on display, available along with many other possibilities. The question is, will small business, on one's own, prove to be a desirable selection?

Fortunately, there are, as with clothing, ways of finding out beforehand how an occupation will fit, by taking certain simple measurements. These measurements are in terms of the skills, knowledge, and attitudes essential to success. There are certain ones needed for small business.

While we have reviewed the problems and considerations the individual entrepreneur must face as he considers establishing his own business, our discussion may have suggested some of the personal requirements of small business generally. As we briefly consider some of those problems, that is, some of the more obvious reasons for difficulties and failures, we are able to see a little more clearly what kind of a person one must be if small business is to fit him perfectly and comfortably as an occupation.

In business there are ethics, laws, and trade practices to control business activities; but "business is business," and the market place is not a place for sentiment. The person who fails to grasp opportunity fails in business; and the person who characteristically permits others to overrule, override, and overrun him will just as characteristically be ridden, ruled, and run out of the business world. Business is not unethical, but some

businessmen are. The fact of the existence of such business hazards, plus the fact that business is, above all, sometimes cruelly practical, will soon be evident to the naïve beginner.

A decision so important and so complicated as whether or not you should enter business for yourself deserves a multiple approach. In general, the procedure is to study what different authorities consider to be prerequisites for successful business ownership, and then to compare or evaluate yourself in terms of these requirements. In the following pages four groups of requirements are given. Although they overlap to some extent, the duplication is not serious. All four should be used before reaching your final decision.

The first summary refers primarily to general business attitudes conducive to independent operation, and has no direct bearing on the requirements of a business employee or on the tastes, skills, or knowledge applicable to a specific business field such as meat cutting, floriculture, mechanical operation, fashions, or merchandising. What are typical reasons for personal success in small business? Among the most common attributes we may include:

Ability to handle money wisely.
Ability to inspire and instruct others.
Ability to make sound decisions.
Knowledge of modern business methods.
Knowledge of merchandise and materials.
Knowledge of laws and restrictions.
Willingness to accept responsibility.
Willingness to work hard and long.
Willingness to wait for results.

Note that these are all abilities (skills), knowledge, and willingness (attitudes). As previously stated, certain *skills, knowledges,* and *attitudes* are essential to success in any occupation. The above are representative of those required in small business.

The following advice published by the United States Department of Commerce under the caption "Are You the Type?"

may also aid you in deciding whether you should be your own boss.

Your entire mental make-up has a direct and important bearing on whether or not you should go into business for yourself. A practical way to judge this matter of traits is to compare yours with those of the typical independent businessman who succeeds.

First and foremost he's the leader type and gets a big kick out of being independent. He has ambition and initiative, energy and good health. He isn't afraid of hard work.

He likes people and he knows how to get along with all kinds and all ages. He's a firm boss but a fair one.

He thrives on responsibility. He takes the bad breaks and the good breaks in his stride. He has the knack of sizing up a situation accurately and making quick decisions. If his judgment is wrong he isn't sunk. Rather he swallows his medicine and determines not to make the same mistake again.

He is honest and pays his bills promptly. His word is as good as his bond. He is businesslike—a good manager. He watches details and knows at all times the state of his business and where it is headed.

He knows when to borrow money in order to take advantage of cash discounts or quantity buys. He also knows when to expand, when to draw in, when to risk and when not to risk.

He gives his customers their money's worth in goods and services. He studies their likes and dislikes; strives to satisfy them without giving away his profits.

In other words, he keeps his eyes wide open, is smart enough to seize a good bargain and honest enough not to take an unfair advantage of anyone.

Lastly, the successful independent businessman feels a definite sense of responsibility to his community. He has civic pride, takes an active part in cooperative efforts to make his town a better place in which to live and work.[5]

It's a big order. Can you fill it? To those who answer "Yes" the following suggestions are offered:

[5] Industrial (Small Business) Series No. 19, U. S. Department of Commerce, *Establishing and Operating Your Own Business,* pages 3–4. Washington: U. S. Government Printing Office, 1945.

Sit down with yourself for an honest analysis of your own history, your likes and dislikes. What did you do as a boy—deliver groceries after school for regular pay, or run your own lemonade stand, your own paper route, or similar business venture? How did you react? Did you envy other boys who chose the opposite approach to yours? Carry this analysis right down to the time when you began to consider starting your own business. What gave you the idea in the first place? Was it some friend's unexpected success as his own boss? Was it a reaction to taking orders with no chance to talk back, such as many veterans experienced during and after both World Wars? If so, maybe another employer could be found who would be easier to get along with. In some cases at least, an individual's family situation may have a bearing on the right decision. We are not thinking now of family financial status—just of personalities.

Listed below are the 12 personality factors estimated by the Carnegie Foundation as responsible for 85 per cent of an individual's success. Special or technical knowledge of the field accounts for the other 15 per cent. How do you stand?

1. Attitude: pleasant manner toward persons and duties.
2. Initiative: seeing and performing tasks without special orders.
3. Thoroughness: following a task through, not leaving loose ends—accuracy.
4. Concentration: close attention to work at hand.
5. Observation: habit of seeing and noticing.
6. Constructive imagination: perceiving opportunities, creating new ideas, conceiving new ways of doing things.
7. Decision: prompt and confident choice of one course of action from among two or more.
8. Adaptability: prompt and smooth change of plans or policies to meet changed situations.
9. Leadership: combination of knowledge, forcefulness,

enthusiasm, and other qualities that inspire confidence and loyalty.

10. Organizing ability: capacity to create systems, perceive fundamentals, and arrange them in logical and efficient order.

11. Expression: ability to convey ideas clearly and convincingly, by spoken word, writing, gestures, free-hand or mechanical drawing, and so forth.

12. Knowledge: sum total of general information on subjects outside your own job.[6]

Desire to be your own boss is not always sufficient.

Rating scales are used by employers in evaluating prospective new employees. Consider that you are employing yourself to manage your own capital, reputation, and future when you use such a scale. Be honest with yourself. It is your own future you have at stake.

The following list deals with qualities most likely to influence your success as your own boss. Later consideration will be given to selecting a kind of business, evaluation of specific requirements for success that may be acquired, and points to evaluate relating to finances, location, and similar factors. It may be helpful to draw up a blank, listing the qualities that are considered important for success in business. You should rate yourself on each trait, comparing yourself with someone who has that trait in a highly developed form. In addition to rating yourself, you might ask some of your friends to rate you. If they know you intimately and are willing to judge you frankly, this may be very helpful. It should be remembered that many men succeed because they have some traits in a high degree; very few possess a full measure of all these character traits.

Your chart might be like this:

Intelligence	Excellent	Good	Fair	Average	Poor	Very Poor
Initiative	Excellent	Good	Fair	Average	Poor	Very Poor

[6] Stephenson, Howard, "The Art of Being a Boss." *Forbes, Magazine of Business*, January 1, 1945, Vol. 55, No. 1, page 17.

	Excellent	Good	Fair	Average	Poor	Very Poor
Industry						
Aggressiveness						
Perseverance						
Personality						
Tact						
Sincerity						
Enthusiasm						
Leadership						
Ability to Organize Work						
Ability to Handle Details						
Willingness to Assume Responsibility						

Such an analysis will likely show that you are weak in some of the important character traits. Once you are aware of your weaknesses, you can set to work to eliminate them.

Too many prospective enterprisers fail to realize the range of abilities and skills required for success. In response to an inquiry about a course in small business given by the Armed Services at the close of World War II, the following interesting answer was received:

At Shrivenham, we gave the students some factual information about opportunities and possibilities. Most of the boys knew pretty

well what businesses they were interested in, however. Then came the disillusioning part—we went over one by one all of the functions of business. About half of the students finally decided not to start a small business, they had not realized it was necessary to know so much about so many subjects! For those who were serious, we had frequent personal conferences to try to help them with their individual problems. I believe the courses were successful, but the man who did most of the work in that field over there was Professor D'Alton B. Myers, Washington, D. C. His connections with the Department of Commerce Committee on Small Business gave him a wealth of material and experience.[7]

Repeated experience has demonstrated the tendency of too many individuals to enter business for themselves without adequate investigation and preparation. Most college courses and texts take the viewpoints of big business as well as the functional basis for specialization, such as accounting, advertising, or marketing. Our belief is that more attention is needed in dealing with the problems and management of small business as such, opportunities in business ownership, and principles governing the launching of a small enterprise. This is as basic and as broad an area as any of the particular functions, and is on a par with special applications of business principles to fields like industrial management, retail store management, or office management. Surely none of these fields is more important relatively or absolutely than the field of small business that accounts for 98 per cent of all business units, where assistance in understanding and adapting basic principles of good organization and management is so direly needed. Probably as large a percentage of College of Business graduates enter business for themselves as enter any of the functional departments represented by special courses.

Schools or Colleges of Business Administration have been in existence in many universities throughout the country since about 1915. The authors wrote a letter to each of the members

[7] Excerpt from letter of June 17, 1946, by Professor Wayne L. McNaughton, University of California, Los Angeles, California.

of the American Association of Collegiate Schools of Business during 1947-1948 inquiring as to the percentage of their graduates who had gone into business for themselves, and requesting the results of any surveys that had been made. Replies were received from 52 institutions by September, 1948, a very generous response. Sixteen admitted they had no basis for an estimate, 29 submitted estimates by the Dean of the College of Business Administration or the Placement Officer, two furnished estimates accompanied by the observation that the percentage had been increasing, and only five reported any actual surveys or facts upon which to base their figure. The trend toward an increasing percentage of graduates who enter business for themselves was noted by one very large city university and by one of the outstanding graduate schools. Harvard University's Graduate School of Business Administration reported that an elective course in small business management was being taken by about 25 per cent of its students.

Estimates of how many graduates were their own business managers ranged from 4 to 50 per cent, with a modal average of 11 per cent and an arithmetic average of 14.4 per cent. The arithmetic average for six schools where actual facts based on surveys were available was 18 per cent, distributed as follows: 9-10-12-13-30-33.

Based on a survey conducted during 1938, one southwestern institution found the following:

12 per cent were in business for themselves
68 per cent wanted to be in business for themselves
14 per cent did not want to be in business for themselves
6 per cent were undecided.

A survey conducted during 1948–1949 covering 40 per cent of all commerce graduates of a southern state university from 1923 through 1948 showed that:

33 per cent were in business for themselves
80 per cent of those employed wanted their own business

20 per cent of those employed did not want their own business.

The conclusion suggested from these data is that about 15 per cent of the university business graduates go into business for themselves and many more would like to become business owners. An auxiliary conclusion is that more universities should follow up on their graduates if future curricula are best to suit the needs of the students.

Officials in three of the schools made the comment that most of their graduates who later enter business for themselves secure several years of employment experience first. One survey showed that half of those who enter business for themselves do so within five years after graduation.

Figures showing distribution of alumni in small business were available for only three institutions, all state universities of medium size. The percentage of small business alumni for each school by main fields was as follows:

	Per Cent		
School	*A*	*B*	*C*
In retailing	26	45	40
In wholesaling	7	16	4
In manufacturing	7	13	10
In real estate and insurance	29	13	16
Practicing law and accounting	7	3	7
In other service fields	19	10	16
In farming	5	—	7
Total	100	100	100

Since the samples used in each survey were small, these distributions should not be considered as representative, but merely as the only data available on this topic.

In certain cases special courses have been included in the curricula designed to meet the needs of future small businessmen. The following excerpts from an address before the American Association of Collegiate Schools of Business early in 1947 are pertinent:

. . . In regard to your own students, I reiterate my belief that collegiate schools of business have been largely concerned with developing professional and specialized skills for big business. Relatively little has yet been done to raise the prestige of business ownership as a desirable goal or in directing students toward it. Those like myself concerned with the future of small business would be happy to see a further change in the attitude of colleges in that regard. We would like to see a larger proportion of the best leaders of the next generation of students aspire to business ownership and self-employment.

To assist students to know more definitely what type of business they are fitted to enter, colleges might extend their programs for vocational guidance. An assumption still holds, I believe, that big business is the opportunity toward which all students of talent should point. By not encouraging qualified students to enter small business, you appear to have been overlooking a good market for your product and one where that product might develop a greater usefulness than if directed almost exclusively to big business.

. . . By initiating and sponsoring institutes at which representatives from these organizations [vendors and trade associations—*Authors*] can meet to discuss their common problems and exchange ideas the universities and colleges can exert their influence at a point of considerable leverage. Through the trade associations and the suppliers the colleges would be placed in direct contact with men who would otherwise be inaccessible.

As much as anything else, the field of small business needs the prestige and leadership of the business college in developing the many fruitful cooperative endeavors which have proven their value in other economic areas. Periodic gatherings under the college sponsorship of small enterprisers in various lines of business are needed at which time information and ideas can be exchanged and circulated. One important result of such meetings would be the increased public awareness of the contributions of small business to the local economy.[8]

[8] Foster, Hon. William C., "What Government and Colleges Can Do for Small Business." Address delivered at the twenty-ninth annual meeting of the American Association of Collegiate Schools of Business, St. Louis, May 16, 1947. Reproduced as a mimeographed News Release by the U. S. Department of Commerce, Washington, 1947. Supply exhausted.

Plan of Book

Our plan is to deal with small business as such, rather than with either a certain kind of business, or field, like retailing, service station operation, and the like, or with a particular function as applied to small business, such as accounting or sales promotion. We plan to deal with certain fundamentals that are important to any small business, and with problems and principles peculiar to, or at least of relatively greater significance to, small business. A common fallacy that still persists among some businessmen is that "my business is different" and that there is little to be learned by a study of developments made in entirely different fields. Nothing could be further from the truth. Witness the trend of several decades among retail institutions of each type toward adopting and adapting methods and policies perfected by different types of distributors.[9] Even more recently certain department stores and mail order houses have found techniques perfected by industrial management to be suited to the needs of retailing.[10]

Since the text is planned for use in college courses, for employees who are considering their own business as a career, as well as for men already in business, three broad areas are recognized. First is the background for understanding the scope, problems, and importance of small business; second, prospecting for and evaluating opportunities for business ownership; third, the principles and modern methods of organization and management, especially as applicable to the three major fields of small business—merchandising, service establishments, and manufacturing.

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[9] Kelley, Pearce C., *Organization and Management Trends in Retail Distribution*. Ph. D. Thesis, 1930, University of California, Berkeley; unpublished.

[10] For further study see Duncan, Delbert J., and Phillips, Charles F., *Retailing Principles and Methods*, page 619. Chicago: Richard D. Irwin, Inc., 1947.

Fields of Small Business

Using any of the commonly accepted definitions of small business, a few kinds of business would be quickly eliminated from this classification. As already noted, in each field or kind of business it is possible to have a unit that is small relative to others in the field, and yet very large when judged by the usual standards set up for small business. An outstanding example today would be automobile manufacture by minor companies. Of greater practical value in keeping with the purpose of this text is size relative to the average, individual prospective businessman.

Small business, like any heterogeneous group, may be divided into various categories—dependent upon such factors as size, location, volume of business, nature of activities engaged in, goods or services offered. Some classification of these enterprises is desirable. For our purposes, it may be well to consider them from the viewpoint of activities engaged in or functions performed.

According to census figures, there were in 1939 more than 2,750,000 small concerns.[11] To fill the need of the public, the largest number of small businesses always have been in the retail and service trades. The following list shows a few of the more important types of small businesses and the numbers of them required to serve the people of the nation.[12]

Out of every 1,000 business establishments in the United States, approximately:

170 are retail food stores.

90 are eating and drinking establishments.

90 are in the real estate, insurance, or finance fields.

45 are wholesalers of various kinds.

35 are clothing or general merchandise stores.

30 are laundries, and the like.

[11] "What It Takes to Be a Retailer." *Inquiry Reference Service,* U. S. Department of Commerce, March, 1945.

[12] *Ibid.*

70 are filling stations.

60 are motor truck or taxicab businesses.

60 are contractors, and the like.

60 are beauty or barber shops.

20 are shops for shoe repair, shoeshines, and the like.

15 are food manufacturing plants.

15 are drug stores.

15 are printing shops or publishing plants, and the like.

The merchandising businesses have as their objective the selling of goods at a profit. They buy finished products from wholesalers or manufacturers and retail (or wholesale) them to others for consumption (or resale). They are all merchants, whether retailers or wholesalers. Most retail stores are small businesses. Retailers account for 58 per cent of the total of all businesses.

For our purposes any business may be considered as manufacturing that is engaged primarily in receiving materials in one form and, after working on them, distributing them in an altered form. This would include processors of farm products, local craftsmen or artisans, bottling plants, and similar enterprises regardless of size. It would exclude the accepted "service" industries, like laundries, cleaning establishments, and repair shops, where work is performed on goods owned by the customers, and beauty parlors, dentists, and the like, where work is performed on the person of the client.

Manufacturing firms account for only six per cent of the total number of businesses, or 184,000 establishments. A sizable proportion of our manufactured goods is produced by the larger concerns through mass production, which in turn makes possible mass distribution through small outlets, as well as providing markets for numerous small factories.

The service businesses offer trade-specialist services to consumers, merchants, or even to manufacturers. They are staffed by technicians with skills for hire.

There were 719,000 service establishments, hotels, and amusement places at the time of the last census. Personal service establishments, such as barber shops, laundries, and the like,

accounted for 60 per cent of these businesses. Repair services came next with 25 per cent, followed by custom industries (tailors, et cetera) with ten per cent.

As a class the service industries have risen to a position of national importance only since 1920. They were not included in the census until 1933, although many larger units now listed in this category, such as large power laundries, for example, were included previously in the census of manufacturers.

Most of the common types of service establishments perform work on goods owned by the customer or upon the person of the client. Many others perform services of a different kind, such as rendering special advice, but for these their patrons are also willing to pay a fee.

For our purpose a more precise definition of service is important because the very nature of services has an important bearing on factors like policies, location, financing, market, promotion, and other management factors. We are also seeking a better understanding of the status and opportunities of small business in this second largest field. A service may be defined as an intangible economic good, non-reversible or non-returnable, whose value does not depend primarily upon some material article that may, or may not accompany the rendering of the service. It is an economic good because: It requires productive effort of a type that must be paid for directly or indirectly; it has utility or want-satisfying power which users are willing to pay for if necessary; and is available free, if at all, in such limited amounts or inferior quality, as to command a price from users. This limits our definition to the commercial or business service fields.[13] The qualifications are necessary because: (1) many services are offered free of charge in connection with the sale of tangible commodities, such as the retailer's free credit and delivery; and (2) certain other service fields have self-appointed experts. This is where the quality aspect comes in. On the one hand it constitutes the major

[13] The definition would also include professional services, like law and medicine, but these are beyond the scope of this text.

problem of service institutions in these fields, whereas on the other hand it is serious enough to require legal protection for the public in fields like the "practice of medicine" or public accountancy. Giving advice, regardless of the advisor's qualifications, seems to give some people so much pleasure or satisfaction that, unless restrained by law or other devices, they often force their unwanted and incompetent advice on their victims; moreover, they expect no payment.

The second characteristic of a service, namely, that it is non-returnable or non-reversible, is of great importance to the businessmen in the service fields. Some services once rendered may be destroyed and their value consequently eliminated, but they cannot be returned. An example would be a fancy "hair-do" exposed immediately after completion to a deluge or hurricane. Illustrative of the non-returnable characteristic would be a train passenger who, after arrival at the station of departure, changes her mind and decides she does not want to take the trip. Of course the property right evidenced by the ticket, merely a claim good for the transportation service not yet rendered or received, may usually be returned for a refund. Some other passenger may later utilize the opportunity to receive the forfeited transportation service. The professional advice of the railroad agent in this case may have been destroyed, but returning the unused ticket does not return the service the agent rendered.

This is one reason why most service fields operate on a pay-in-advance basis. In recent years two modifications have been made in this policy. One is the promotion of greater use of certain services like tourist travel through the arrangement of pay-later credit plans. The other is a policy of "money back if not satisfied," occasionally used in a few entertainment or advisory service fields. Both examples have their counterparts in the sale of tangible goods. Credit extension is an accepted fact in retailing, as is the returned goods privilege.

Although the value of a true service does not depend primarily upon a tangible article that may in some cases accom-

pany the rendering of the service, it is important to understand the relationships between the service proper, the material object, and the reasons for use of the latter. On the one hand some record or evidence of the transaction may be necessary, or convenient, for the service-rendering agency, while on the other hand such a material object often enhances the value of the service to the client or patron. Professional men often accompany oral advice with either a prescription written in Latin, or a "brief" that elaborates on certain allegedly unique features of the case before stating the suggested remedy.

The convenience or economy aspects are illustrated by the use of tickets entitling the purchaser to a seat on a train, in a theater, or other service. Such a procedure may be necessary to prevent promises to render the service later in excess of the capacity of the train, theater, and so forth. It may be a device to sell particular positions, such as reserved seats, or it may be merely a convenience. It is often desirable to separate the cashier who sells the ticket and receives the money from the ticket collector. It may also be an advantage to the customer who prefers to purchase and pay well in advance for the right to receive the service. Certain repair shops use this device, with something else added, by selling coupon books calling for particular repair services later as needed, or even a "packaged" job. The last named may cover inspections, tune-ups, and all repairs needed to maintain the article in good working order for a specified period of time.

The various service fields, some as diverse as medical care, transportation, and maintenance of the family radio, have found the same management devices useful. These are often devices previously developed in different fields like commodity marketing and manufacturing. This further illustrates the importance of understanding our thesis of the basic fundamentals regardless of their association mainly with a particular business field.

In general, it is not our intention to deal directly with professional and semi-professional service fields, especially not

those that require highly specialized training and have few of the problems and functions, such as financing, selection of location, layout, vendor relations, and the like, typical of other small businesses. In some of these fields, however, certain topics discussed will have a bearing and may be usefully applied. The importance of these fields may be suggested in two ways: by a study of the small business fields entered by College of Business students after graduation, and by an analysis of census data. Data on the former are limited to the results of three surveys presented earlier in the chapter. Census data have been used to compile Table 1 and elsewhere in this chapter to show the importance of small business in each of these three main fields.

Conclusions

Before an individual can make an intelligent choice between employment or entering business for himself he should understand the position and problems of the small businessman, the fields where small business operates most successfully, and the comparative advantages of employment versus business ownership.

The natural tendency of most prospective businessmen is to be overly optimistic and anxious to get started. Many needless failures could be prevented, however, if more time and care were given before actually launching out on a career of business ownership. Because of conditions inherent in the operation of an independent enterprise *it is of great importance to make all possible preparations before actually starting the business.*

Review and Discussion Questions

1. In your opinion, what are the most important advantages of employment as compared to business ownership? Discuss each.

2. What advantages of employment in specific large concerns have their personnel managers claimed? Evaluate each. It is usually desirable even for the student who is a prospective business owner to interview employment representatives who visit universities for the purpose of recruiting graduates.

3. Evaluate the discussion in the chapter concerning the relative security of employment as compared to business ownership.

4. Study the comparisons of mortality data and the discussion in the chapter for small versus big business. How could a more accurate comparison of the degrees of risk in each size group be made?

5. Is it true that most people know whether or not they want to go into business for themselves? Why, or why not? Explain any qualifications to your answer.

6. Do you agree that there is an "own business type," and that all others should not undertake to be their own boss except as a last resort? Discuss.

7. Consult the references given in the chapter and several other books on small business for rating scales or guides intended to help an individual decide whether or not to enter business on his own. Summarize your findings.

8. For some field that is of interest to you, look up the specific requirements for being your own boss as presented in books and pamphlets, especially the "How to Establish and Operate" series by the U. S. Department of Commerce. Be prepared to discuss your findings.

9. In your opinion is it better to enter business for yourself when: (1) you feel the urge to do so; or (2) when a good opportunity appears; or (3) only after you "have what it takes" for success, including adequate finances, a good opening, and all other favorable factors? Discuss.

10. Consult a number of successful small businessmen as to why they started on their own and what they would do differently if given an opportunity to begin again.

11. "The smaller the business, the greater the tendency to rely upon the owner's knowledge, experience and limited resources. With increased size comes a recognition of the value of seeking advice and coöperative assistance from others." Discuss.

12. Secure all the information you can as to the relative security of employment as compared to business ownership, and be prepared to report on your findings and conclusions.

13. If your wife were a very timid, conservative person who wanted you to stay with your present job as an employee of a large

corporation, and an unusually good opportunity developed to go into business for yourself, what would you do? Discuss.

14. If you "have what it takes," why are you performing a greater service to society by establishing your own business than by working for someone else?

15. Examine the leading college texts in any course in business to learn the extent to which small business is considered. What conclusions do you draw?

16. If possible, talk to several employees who formerly were in business for themselves and find out why they changed.

17. Compare small business with consumer coöperatives as possible checks on monopolistic practices of big business.

18. In what fields does small business predominate? Why? Discuss.

19. Suggest applications of material in this chapter to some specific problem faced by a prospective small businessman.

20. Discuss the small business and our present patent system.

21. Does the current interest in small business seem to be increasing or decreasing? Discuss, giving plausible reasons.

22. Consult successful businessmen in fields likely to be of interest to you, as to the advantages and disadvantages of their businesses. Discuss your findings. Compare with answers to Question 10. If you have any ideas of your own as to how the businesses might be improved, include them with your discussion.

23. List methods by which high-quality employees may be obtained by small businesses.

24. Select two businesses in your community, one large and one small. Compare their advantages and disadvantages with respect to each other.

25. List courses you think would be helpful to the prospective small business owner studying in college or evening school. Explain in what ways the courses would be helpful.

26. Explain what is meant by a "natural monopoly." List other "natural monopolies" not mentioned in the text and explain if they are justifiable or not in your opinion.

CHAPTER III

FACTORS IN BUSINESS SUCCESS

Trends in Business Management

Tremendous strides have been made in business management during the past hundred years. The more important trends bearing on small business are summarized first, then each one is discussed in some detail in connection with the main fields of small business. Naturally every trend is not of equal significance in all fields. These major trends are:

1. Increasing size accompanied by greater attention to employee and public relations.
2. Decentralization—management from a distance.
3. Greater interdependence of all business.
4. Closer control and coördination.
5. Increased accuracy of the measurement of operations.
6. "Professionalizing" of management.
7. Expanding use of machinery and technology.
8. Greater reliance on research.

For over half a century business units in many fields increased in size, with a corresponding increase in the use of management methods suited to operating these larger units. Later, in manufacturing and some fields of merchandising, the establishment of branches began. This in turn required special techniques for so-called "management from a distance," or centralized administration with decentralized (branch) management. This latter trend has special significance for the independent small business operator because it shows how the best management principles and methods developed by large concerns can be used in the small unit.

Although the areas of emphasis and methods of application

have varied to some extent from field to field, the general trend has been to seek closer coördination through better direction, supervision, and control over the activities of the business. Improved direction has stressed careful planning and policy formation. Better supervision has resulted from emphasizing the positive approach and developing impersonal supervising aids. Closer control has been developed over an increasing range of functions.

Trends in manufacturing

Prior to 1900 America had no organized training for business, and most business methods were based on rule-of-thumb or the limited experience of the manager. But pioneering efforts were under way in several fields. In industry, notably in the steel industry, a small group of experimenters led by Frederick W. Taylor was seeking the "one best way" to do each job. This movement was later called "scientific management." However, it was not until 1912 that public, and even international, attention was directed to the progress of these early pioneers by the railroad rate hearings of 1911–1912. Cost accounting as an integral tool of managerial control made its debut at this time. Time and motion studies (now called methods studies), planned layout, routing, scheduling, production control, stores control, standardization, and the basic pattern of all modern managerial devices were also introduced as part of this development.

This movement toward greater accuracy of measurement of industrial operations and closer control over an increasing range of activities has been an important trend in management. It spread from the steel industry to other lines of production and later to merchandising and the service fields. Something comparable to a profession of management has developed, as represented by the Society for the Advancement of Management, emphasizing the formulation of management principles, and the American Management Association, concerned more with the application of these principles. A tremendous body

of publications dealing with almost every aspect of management, except its applications to the small business, has been developed. During recent years a beginning, at least, has been made in seeking adaptations of this knowledge to the small enterprise.

The increasing use of machinery in industry has been accompanied by further specialization and subdivision of labor. Standardization has been applied wherever possible. In certain fields mass production methods have been highly developed, notably in the automobile and other durable goods industries and in meat packing. Continuous straight line production has been the goal in these industries. A logical result of such developments has been a tremendous increase in productivity per worker. Output per industrial worker increased steadily until 1939, when a reversal of this trend took place. According to one analyst, from 1939 to 1947 output per worker declined while hourly wages increased.[1] Naturally labor costs increased. To counteract this unfavorable trend, management has endeavored to "sell" itself more aggressively than in the past. Therefore, during this same period industrial management gave increasing attention to relations with both labor and the public, and this is a trend that may be expected to continue. Industry, as well as other areas of business, can well afford to do an improved job of selling itself to employees, the public, and government agencies.

A final major trend in industrial management has been the increasing use of research—both technological and market. During World War II a great many new industrial plants were built under conditions where construction costs were of little concern, but maximum volume of production with a scarce labor supply was of paramount importance. Ideas that might

[1] "A Fair Day's Pay for a Fair Day's Work." *The Management Review*, October, 1947, Vol. XXXVI, No. 10, page 535. Digested from an article by Ralph Kelly in *Dun's Review*, September, 1947, Vol. 55, No. 2233, pages 11 ff.

not have been introduced into factory management for decades of peacetime production were launched within a few years.[2] Although they do not as yet constitute definite management trends, some of these new ideas are certain to start new trends in industrial management.

Trends in merchandising

In distribution, the rise of large-scale retailing, paralleled by the decline in relative importance of wholesaling and the extensive use of national advertising were the outstanding developments affecting management during the period up to World War I. More recently these have been recognized as the logical developments of mass marketing to accompany the rise of mass production, although at the time they were merely the results of profit-seeking businessmen aggressively searching for and promoting new ideas and methods to increase competitive position and resulting profits. However, in each field —national advertising or retailing organized along chain store, department store, or mail order lines—specialization naturally resulted in the development to a high degree of perfection of certain techniques, methods, and policies, of special importance to a given field. Later, from 1920 on, these results of progress were shared by businessmen in other fields.

In wholesaling the powerful position once occupied by a few large firms has been lessened in relative importance owing principally to: the rise of large-scale integrated retailers like chain stores, department stores, and mail order houses; the increased number of small wholesalers located closer to their retail customers; and the increasing importance of fashion or rapid change in many lines of merchandise. For the large wholesalers, and many medium-sized firms, this has resulted in management emphasis on closer working relationships with

[2] Wank, Roland, "Economics Through New Buildings and Plant Layouts." *Organizing for Efficient Production,* Production Series No. 176, page 18. New York: American Management Association, 1948.

retailers, such as, often, the organization of voluntary chains or efforts to reduce operating costs to meet the lower price standards set by integrated retailers.

This brief discussion of management trends in wholesaling is not meant to imply a decline in the total importance of wholesaling. In high fashion lines the wholesaler has lost ground. In most other lines he has merely adjusted organization and management methods in order to meet changed conditions.

Trends in service fields

Although both manufacturing and distribution have developed a body of management principles in their respective fields, this cannot yet be said for the service industries. This may be explained in part by the great diversity of activities included among the "services," but especially because no comprehensive study of the field as a whole has yet been made and the results published. At first glance it may appear that professional services like accounting, law, medicine, or cosmetology have little in common with insurance, commercial amusements, appliance repairing, laundries, drive-yourself auto agencies, or rental, plumbing, and construction. However, research by the authors suggests that much the same over-all pattern may develop here as appeared in both manufacturing and in merchandising. Within each of the well-established service fields, like the operation of laundries, beauty parlors, insurance or accounting services, tourist facilities, and repair services, well-accepted principles and standards have been developed. It seems likely that these basic principles, standards, and policies may be generalized, at least for each of a few broad divisions of the service fields. In each major field the trade or professional association has developed management principles, methods, and operating standards on a par with progress in manufacturing or merchandising. Since no large units operate in the service fields this is a logical development.

Big Business May Be More Efficient

Business is not necessarily more efficient because it is big. Often the over-all or net efficiency is less than that of small units in the same field. However, analysis shows that many large concerns have developed a high degree of effectiveness in certain fundamentals such as the seven "m's" of management: men, money, machines, materials, methods, markets, and minutes. That these results are lessened because of the greater overhead and excessive paper work necessary to operate the big unit does not reduce the usefulness of the development in that many of the techniques can be adopted by, and adapted to, small business.

Efficiency in manufacturing

In manufacturing efficient use of labor results from the large firm's ability to subdivide the work for greater specialization, and from its ability to provide machinery developed especially to increase the productivity of each type of labor. This is true for office work as well as for the common and factory labor, but it is in actual production that the tremendous increase in worker productivity resulting from machine methods has taken place. The trend in many businesses has been toward single purpose machines in spite of the heavy initial cost. In the automobile industry, where models are changed annually, the preference is for general purpose machines even though they are not so efficient.

Capital may be used more efficiently by the large firms as a result of their ability: (1) to employ specialists like economic advisors and investment counsels; (2) to establish better systems of forecasting and budgetary control; and (3) to keep all funds working constantly because of the many opportunities for use, such as in product development, market research, and so on.

The large concern's huge purchasing power makes it easier to buy and use materials more efficiently, usually through purchase according to specification and often on an extended con-

tract basis. Such materials may be carefully engineered to the machine processes to be performed and to requirements of the finished product, which constitutes another advantage. More efficient methods are not an inherent advantage of the largest concerns, but are likely to be sought more aggressively in the medium-sized and very large organizations.

In market research and in market promotion, companies beyond a certain size can be more comprehensive in their surveys. Especially are they in a favorable position to use product differentiation and large-scale promotion through national brand advertising.

The time factor is often utilized to greater advantage by big business. Work is planned and scheduled more carefully; through methods studies and time studies less idle time is permitted; great effort is made to keep employees working.

Notwithstanding all these advantages of large over small business, the former is not necessarily more efficient; it has not been possible to prove it scientifically, but there is reason to believe that small business, well managed, can compete successfully with big business, in all fields except those where expensive machinery dominates the productive process.

Efficiency in merchandising

Efficiency in merchandising is difficult to measure, partly because of the number of rapidly changing variables involved, partly owing to the more intangible nature of marketing activities, and also owing to the important part played by human beings rather than machines. Most marketing functions are still performed "by hand." However, a relatively free competitive economic system has provided us with some guides.

Contrary to popular belief, *all* types of present-day, large-scale retailing started as very small businesses that later expanded. Chain stores were the first to start, but about the last to receive public attention. The history of most present-day chain store organizations is well known. Each was started as a single small store; success there led to the opening of a

second, third, and many more stores. Buying power developed much later. But efficient management and reinvestment of profits started with the first store.

Efficiency of chain store operation in many respects resembles that of mass production. Both make effective use of standardization. Chains concentrate on fast-selling, standard merchandise; they apply standardization to their store fronts, equipment, and layout; even their personnel are somewhat standardized. Large savings are made through standardization.

Field supervisors are on the alert to discover improvements, which are sent to headquarters and then relayed to all stores. Whereas new ideas may die in unorganized independent stores, this loss is not permitted in chains. The following example comes from the experience of one of the authors. In the process of organizing material for the teaching of a course in chain store management it was discovered that one of the most widely used books in the central libraries of many chains was Clyde Bedell's *Seven Keys to Retail Profits,* a book written to teach independent merchants how to compete more successfully with the chain stores!

The ability and willingness to use thoroughly trained, well-qualified specialists wherever their services are needed, and employees of less experience and minimum ability elsewhere, are another important source of chain store efficiency. Large numbers of men and women need work who are not well qualified by training, experience, or native ability, or who lack interest to develop themselves. The wisdom, and often the justification, of using low-paid help may be questioned. However, recommended modern personnel practice tends toward job analysis, classification of jobs according to the skill and ability required, evaluation of each such category according to its relative importance to the firm, and selection of employees who qualify and who are paid accordingly—to do otherwise is economic waste. To overpay an employee gives him a false sense of his importance and lessens his incentive to improve.

Under keen price competition it means job instability and possible unemployment.

Chains often secure lower prices for their merchandise because of one or more of the following reasons: expert buyers, larger volume of purchases of the same merchandise, and integration—or performing for themselves most of the functions performed for the independent retailer by the wholesaler. At least since the passage of the Robinson-Patman Act, uneconomic price concessions resulting from bargaining power and high-volume purchasing have been greatly lessened, if not eliminated. Briefly, this law provides that the difference in prices between large and small orders of similar goods must not exceed the difference in costs of producing, selling, and handling orders of each size.

Dealer coöperatives, voluntary chains, and corporate chain store agency and franchise systems owe their efficiency to the same factors just discussed for chain stores, plus the added incentives that may result from individual ownership of each store, or to the motives prompting the sponsor. In the case of voluntary chains the sponsoring wholesaler has a direct incentive to improve the management of his coöperating retail stores for his own survival. Corporate chains that sponsor agency or franchise stores probably have a combination of the following three major types of incentives for insuring the success of independently owned coöperating merchants: (1) desire for greater market coverage, such as having representation in towns too small for company-owned stores; (2) desire to secure greater volume, which is especially important when the chain manufactures a substantial portion of its merchandise, as does Walgreen's; and (3) desire to hedge against anti-chain store measures and criticism, such as discriminatory taxes or charges of monopoly.

The efficiency of department stores results from their ability to distribute overhead expenses over a large number of departments, to use advertising and other sales promotion effectively, and to capitalize on their reputation and location in the central

shopping area. Relative to the small independent, they can employ more and better trained specialists, can seek out merchandise resources more thoroughly, and can organize plans and policies on a more long-time basis. Like the chains, the larger department stores are integrated and can secure lower prices for their merchandise chiefly through performing some of the wholesale functions and by the use of better buyers. Their "buying power" is often less than that of much smaller specialty stores since it is distributed over such a wide range of producers.

The mail order house is in a unique position in the field of retail distribution. It can utilize many of the methods that make large-scale American industry so efficient, such as methods studies, straight line layout of the warehouse, standardization of procedures, forms, and routines, mechanical handling, and production control, because it operates as a "factory" that fills orders rather than as a customer reception area, like the over-the-counter retail store. Also, the large mail order house uses the most efficient form of mass selling—advertising.

That mail order marketing is not ordinarily a cheap method, and that some strictly mail order houses have found it desirable to open chains of retail stores may be explained as follows. Costs of impersonal selling through catalogues or direct mail tend to be high, and transportation costs on small shipments are usually very high. The time factor of waiting for the arrival of goods ordered by mail is important in that it discourages a great many consumers. Also, the relative inflexibility of pricing, policies, and merchandise selection is greater for strictly mail order concerns.

What does all this discussion mean to the prospective small business owner? American consumers usually compare the quality of a product with the high standards established by large manufacturers, and approve or condemn it accordingly. Chain stores, department stores, and mail order houses have led to an upgrading throughout all retailing.

Big business in both manufacturing and in distribution has

contributed immeasurably to our present high standard of living. A small business must justify its existence in terms of needs and wants, as well as in terms of its ability to furnish these on an equal competitive basis with other concerns, whether large or small.

Efficiency in the service fields

Although the contrasts between large and small units in the service fields are less pronounced than in manufacturing and retailing, there are some contrasts worthy of comment. Large auto laundries and one-day auto paint shops operated in some of the large cities are examples. When the volume of business is large and regular enough for automobile cleaning and repainting, as it is in several of the large cities, work can be subdivided, straight line process layout adopted, and many specialized tools and equipment employed. The relative efficiency of these large units as compared to the small concerns manifests itself in the form of somewhat lower prices, quicker service, and quality of the work performed that is equal to, or sometimes better than, that obtainable in small shops. However, the work is so organized that it is impractical to give special attention to certain jobs where individual care may be needed for satisfactory service.

In one other area of the service fields the large units may be more efficient than the small. Where the task of diagnosing the trouble involves the use of expensive, highly technical equipment, this condition is likely to exist. The most obvious example is the large medical clinic, although similar examples exist among service establishments specializing in the repair of complicated electrical devices such as radio and television sets. Although the latest scientific equipment may be needed to diagnose the trouble in complicated cases, the well-trained practitioner equipped with the normal tools of his occupation can successfully handle the vast majority of service needs in any of these fields.

Interdependence of All Business

The basic reality of modern economic life is the interdependence of all business.[3] All use the same basic elements: money, men, material, space, time; all require management and markets; and all must work together within the law and according to established trade customs and business ethics. Money is a highly flexible and mobile instrument. It functions equally well in small or big business, in financing a drug store or an automobile factory. The same is true of men, materials, space, and time, although to a lesser degree. No modern business is an entity in itself. It must buy from other firms and sell either to different businessmen or to consumers in competition with a great many other businesses.

An interesting discussion could be built around the surprisingly large number of small businesses necessary for the operation of one large firm, as well as concerning the extent to which many large companies are dependent upon small business units for their market. A large automobile factory purchases materials and parts from scores of small- and medium-sized firms. On the marketing side, dealerships are usually held by independent and often small businessmen. In addition, a great many fields typically occupied by small businesses depend upon the automobile industry.[4]

Success Versus Failure

Make or break factors in business—early axioms

The standards of business proficiency have been expressed in proverbs, epigrams, mottoes, and maxims by prophets, sages, poets, and authors since the beginning of time. Most of these

[3] The Research and Policy Committee of the Committee for Economic Development, *Meeting the Special Problems of Small Business,* page 9. Policy report of the Committee for Economic Development, New York, June, 1947.

[4] White, Wilford, "Can Small Business Be Preserved?" *Domestic Commerce,* August, 1945, Vol. 33, No. 8, page 3.

admonitions suggest the importance of previous experience, hard work, expense control, sound judgment, timely methods, constant alertness, and adequate capital.

The principles of business have been developed from the beginning in terms of plain common sense and therefore are not difficult to understand. Their practice, however, is another matter. Knowing what to do is far different from knowing how to do it. Still harder is to do it the best way. The farmer who wrote to the Department of Agriculture, "Please quit sending me any more bulletins, I'm not farming half as well as I know how now," is a case in point.

The following are generally accepted as prerequisite to success in any small business:

1. A genuine business opportunity.
2. Trade experience, or know-how.
3. Adequate capital—enough funds and reliable credit to cover short term and long-run needs. Should include adequate provisions for the usual six months to a year before profits begin—and should be sufficient to allow for at least one serious mistake the first year.
4. Managerial ability—good judgment in handling men, money, goods, and people, responsibly and profitably.

Business opportunity. Too often an idea plus ambition are mistaken for a business opportunity, or maybe a vacant store is so interpreted. A genuine opportunity means a need for the proposed good or service in sufficient volume and at a high enough price to operate at a profit. Of course, the demand will not always be ready and anxiously waiting for the newcomer. Often it will have to be stimulated or developed. Especially will this be true when the embryo businessman has something new to offer.

An indefinite but very large number of businesses fail because they never should have been started. There is no justification for their existence. Notice how thoroughly big business goes

about launching a new product. Laboratory experiments, product analysis, market surveys, and pilot operations are often conducted for several years before the newcomer is announced to the public. Although big business could afford to make a few mistakes, it seldom does, but small business, where a single major error is fatal, makes many.

Trade experience. Obviously if it were contended that personal experience in the actual trade is indispensable, then no novel or unique businesses would ever be created. Many businesses have been successfully started and successfully operated by novices, with little capital and without apparent proof of business acumen. But these are indeed exceptions, for the paths of commerce are strewn with the bones of businesses that started out thus ill-equipped.

Since perhaps no one knows what a beginner's problems will be, he cannot be expected to know them. His ability to anticipate them, to surmount them, to make the best decisions, to "do the right thing at the right time" will depend on his general business experience and how closely this is related to the new business.

In beginning a business in a well-known field, one in which many others are already engaged, the need for experience in the trade is apparent. In retailing, for example, the grocery business has certain well-established practices that make for efficiency in handling goods, reducing expenses, and building good will. In the service occupations there have been developed, for example in the gasoline business, the laundry or dry cleaning trades, and repair shops of most kinds, certain ways of "cutting corners," improving service, and protecting materials and equipment. These would be unknown to the beginner. In small manufacturing establishments certain organizational routines, order-of-work patterns of production flow, and methods of buying and of caring for materials are essential to success and profit. Whatever the business, it remains impossible to overemphasize the need for trade experience.

Enough money to carry through. The beginner will require adequate capital for equipment, fixtures, materials, or merchandise, plus rent and overhead, salaries, and incidentals until he can make a profit. He must make provision for his own and his family's human needs. This topic is covered in greater detail in Chapter VI.

Business acumen—a "must" item. Every individual is more or less business-minded, but most of us are less so. In everyday living as consumers, only a few seem naturally to take a businesslike approach to matters of shopping, banking, property management, the buying of services, and the hiring of domestic workers.

Bankers are of necessity good judges of business aptitude. When reviewing the possibilities of extending a loan to an operating or prospective businessman, the banker will frequently inquire as to his client's personal business habits. He will find significant, perhaps, the fact that overdrafts are frequent in the applicant's checking account record.

A sure way to ruin the business is for the short-funded owner to draw from the business more than it is earning; that is, to draw from operating capital rather than from income.

The man or woman who has no standards of dollar-for-dollar values in goods, services, or manpower will also be a hazardous business operator. The person who is continually being sold "gold bricks" in the form of unneeded frills and useless gadgets cannot be expected to exercise sound judgment in the markets of his trade.

In two recent surveys university graduates in commerce and business administration who had entered business for themselves offered suggestions for prospective owner-managers. The advice given by 64 graduates of one institution, compiled according to the number of times each suggestion was mentioned, follows:

SUGGESTIONS GIVEN FOR PROSPECTIVE NEW BUSINESS OWNERS

Suggestions	*Number of Times Given*
Analyze business first and seek the advice of those already in business	8
Have sufficient capital; outsmart competition	6
Buy with moderation at first, then build stock as business expands; watch competition	5
Be sure the business is suited to you	5
Make a careful analysis of personnel requirements	5
Get experience first	4
Spend long hours on job until the business is well launched.	3
Consult an attorney or C.P.A. on the tax situation before starting a business; study accounting and financing	3
Watch business cycle before making decisions	3
Do not let the public get you down	3
Work hard and continuously	3
Save earnings	2
Do not be too conservative	2
Keep out of debt	2
Choose proper location	2
Choose business pursuit before graduation	2
Start early in life	1
Watch expenses; hire competent help, and manage rather than work	1
Never stop trying to learn more about your business	1
Keep the business modern	1
Be interested in the business	1
Others (mentioned one or two times each)	20
Total number of suggestions	83

Successful entrepreneurs included in the other survey offered the following comments:

1. For young men now starting in business I would suggest that they like the type of business and be able to work harder for themselves than they would for someone else, as they will be their own bosses with no one to drive them. They should check the potentialities of the city, its payrolls, competition, and future, whether progressive or non-progressive. Their location is important for the

type of business they desire. Is there a demand for the services or merchandise the individual has to offer in that locality? His contacts for buying should be established, to replenish his stock. He must have sufficient working capital and not be afraid to pay for first class personnel, as this will pay off in the long run.

2. Do not attempt to operate a new business venture unless you are reasonably certain you know what you are doing. By this I mean, have some experience in the field first. Be sure of your finances, have enough behind you to take care of a slow start or unexpected reverses. Take into consideration proposed location, expected markets, and general economic conditions. You must have courage and you must be willing to work.

3. I do not think any man who wants to work only forty hours a week should enter business for himself.

4. In advising prospective business owners I believe one of the most important things is to have a better than average knowledge of the business you plan to enter. There are few instances where you can acquire the necessary experience and knowledge from books. The most satisfactory way is actually to work in the field you plan to enter, or in one closely related until you can feel reasonably sure of yourself and of the decisions you will have to make. Unless you know your business your chances of success are none too great.

5. From my limited experience and from observation I would say that the average new businessman attempts to operate his new business too conservatively before becoming established. Under competitive conditions I think this is a mistake. However, I would not advocate uncontrolled extravagance. Know what you are doing and know where you are at all times. Work according to plan and figure your moves carefully before you make them. Use a budget and figure probable earnings under the contemplated new program. Do not gamble.

6. My suggestions to prospective business owners are to look well before you leap. By all means try to figure out all of the angles before deciding to enter a particular type of business. I have considered a number of types in which to invest money and have

rejected most of them after thorough investigation. One of the best methods is to get the opinion of established businessmen and bankers. Lawyers frequently have a surprising amount of information of great value. Always determine as nearly as possible the potential amount of business to be done in the line you are investigating. Opportunities which often look inviting on the surface may prove to be pitfalls. If you don't have experience in the business which you are planning to enter, get some before you tie up your money, or locate an experienced man to assist you.

This same group of successful small business owners, all university graduates, representing all three major fields—merchandising, manufacturing, and service—offered the following opinions on topics to be stressed in a course for prospective small business owners.

1. Adequate record keeping; this is definitely a thing most small businesses do not have. Location study, and analysis of the local market, and possibilities thereof, should be thorough.

2. Turnover in relation to profits; proper insurance and liability coverage, and good accounting.

3. Bookkeeping procedures, filing, and keeping accurate records should be stressed. Salesmanship in most businesses is of prime importance, as are problems relating to customer good will. Problems with regard to the financing of a small business are of great importance.

4. Study personnel problems, and accounting for tax purposes. As for the first, no doubt any business owner would agree that, even when unemployment is a national problem, the personnel problem is one of utmost importance to the business owner, and success depends largely on the treatment of it. As for the tax problem, even though the business owner may employ the services of a professional accountant, he should have some knowledge of tax accounting because he must constantly keep the matter in mind in conducting his business.

5. (a) Actual mechanics of how to borrow money—problems of financing, mortgages, insurance requirements, and mandatory coverages (such as workmen's compensation). (b) Outline of taxes, reports, etc. (c) Financing inventories, etc. I would suggest you pick some line of business and run a sample through to show the steps necessary. Stop and have discussions from bankers, insurance men, wholesalers, tax accountants, et cetera, and run through the business and iron out each problem as you come to it. It would be well if some one just starting a business would write down his steps and the class could follow through. *Above all* make the course practical and to h—— with economic theory like Professor ——— used to teach.

6. Corporate tax structures, both state and national distribution from a practical standpoint are important. I believe actual experience could very well go hand in hand with the course. Also I would stress a system of analytical presentation of all angles of operation, of expenses, and also *employee relations.*

7. (a) Control—inventories, finances, personnel, credit. (b) Arrangement of shop or store. (c) Proper salesmanship or dealing with the public.

The little business may some day be a big business. Until it is larger, it had best copy its progressive elders as to behavior. Its elders are successful, or else they would not be in existence—they would have died young long ago. They have followed successful ways of operation and have proven them to be successful. The fledgling should carefully study these proved methods of his successfully operating and growing leaders. In the retail field, according to Department of Commerce figures, almost 60 per cent of the nation's business is done by less than 20 per cent of the stores; similar figures prevail in manufacturing. The moral is evident.

The Way It Is Done

Granted that the small business operator has experience, capital, and judgment, he should be able to organize and establish his business with some degree of success. Keeping it

going will depend on how well he conducts it, once it is well launched. General conclusions may be reached as to how he may conduct it to the best possible advantage—to derive the maximum return from his investment and his effort. The following are drawn in terms of successful principles and practices as applied to large and small businesses alike, but as developed largely by the bigger operators and through which they have generally made their progress:

1. Careful study of markets.
2. Wise planning of activities.
3. Vigilant control of investment, merchandise, personnel, equipment, and buildings, to insure maximum use for production.
4. Adequate expense records.
5. Thoughtful selection of goods.
6. Strategic location with particular reference to the market, but also bearing in mind resources and transportation of goods.
7. Sound policies, unalterable in general objective, but flexible and adjustable to meet obvious business expediencies.
8. Strong working relationships with resources as well as with customers, on a coöperative as well as a competitive basis.
9. Judiciously controlled credit.
10. Customer selection and market concentration.
11. Skillfully selected personnel.
12. A well-planned sales promotion program.

Modern methods in retailing

Perhaps the small retailer, more than any other businessman, can profitably bring his methods up to date and get in step with modern business. Manufacturing generally has made greater progress than distribution in streamlining operations and thus reducing costs. Although this movement has been led by the large manufacturers, their competitive price challenges have entered the markets of all productive enterprises, no matter how small. In contrast, many small stores have never felt genuine competition, owing to their locations in spots lacking attractiveness to chains and other large operators. Yet

efficient methods would have prevented many of their failures, would have insured greater profits for small store owners, and would bolster them against the day when stiff competition becomes a reality.

A typical example was the neighborhood grocer after an arterial highway was rerouted past his door. Business boomed, but from a new class of cash-and-carry trade that interfered with service to his old customers. Soon a modern supermarket opened up across the street and most of his newly acquired customers shifted their patronage. Old customers used his charge and delivery service during bad weather but took their profitable business to the modern "super." An effort to offset lost sales by remaining open nights after competition had closed helped somewhat, but involved excessively long hours.

When the situation looked hopeless a wholesaler's representative suggested a plan of modernization and concentration of purchases with his house under agreements typical of the voluntary chain plan. Shortly after putting the new cash-and-carry, semi-self-service plan into operation in the enlarged, modernized building the grocer was back in the profit-making class again. His intimate knowledge of customers' needs and preferences was put to good use. Close coöperation with the wholesaler in buying and merchandising proved advantageous to both.

This case is only one of many examples of how the present-day merchant or shop owner must adjust himself to the times. Although new ideas are not always successful, the world thrives on change. It may be sound judgment to play safe and go slowly, but when the public clearly indicates its wants, it is the alert merchant's duty to provide services or goods as wanted. Otherwise he cannot long exist.

Although the peak performances in efficient store operation have been achieved by chain retail organizations, those organizations have no monopoly on efficiency, as ample surveys and case histories like the foregoing prove.

Modern methods in the service business

The same principle, of using the proved methods of successful operation as demonstrated over the years by the big operators, applies in any branch of business. The difficulty is that so few small operators will admit their weaknesses and seek the needed information until it is too late. A laundry owner in a small mid-western community was an exception.

The owner had inherited a successful laundry business from his father, who had built it up over a period of thirty years in a town of 6,000. When the young man took over, the business was paying no great profit, supposedly owing to the general depression. As business conditions improved the laundry did not. After he had studied the situation carefully it dawned upon the owner that perhaps he was doing things too carefully and too much as his father had done.

He joined the laundrymen's trade association, from which he gained figures on operating expense that differed so greatly from his own that he was alarmed. He visited a fellow member who was known as a successful operator. After seeing his neighbor's business and restudying his own situation he started making changes.

Within three months he had reduced his operating cost 22 per cent, while his production potentials were increased 18 per cent. He found that he had had poor management controls in different operations; no standards of performance; no idea of relative costs; that accounting for bundles was outmoded; equipment was behind the time; his handling of customer accounts was inefficient and costly. The business is now thriving. Its adjustment to the times did not come from the integrity established by his father, or from industry alone, but combined them with open-mindedness and willingness to adjust to change.

Modern methods in a small factory

A small machine tool factory just outside an eastern metropolitan city had been established during the war, and while on

subcontracted war orders it had been able to maintain a payroll of 36 men and produce an adequate product at a profit. When the war ended, efforts to find peacetime uses for the company's facilities were unsuccessful because prices quoted were too high. Lacking management aid from the prime contractor that had been utilized repeatedly during the period of war production, the owners now secured assistance from a management consultant. Modern methods of inventory and storage control, tool checking, purchasing, and personnel management soon put the company in a favorable competitive position and enabled the management to engage successfully in peacetime production.

The results were only those to be expected from reorganizing in terms of proven methods. Acknowledged improvements included the reduction of operating costs by 17 per cent and the increase of production potentials by 26 per cent, in addition to the improvement in personnel relations and the fact that the plant continued to exist at all. There were principles and methods available that would make this plant a success—the success of others proved their existence, and it was only necessary to seek them out and apply them. Small business generally can profit by such examples.

Our discussion so far should serve to emphasize three outstanding conclusions: (1) competition and changing conditions set standards that the small businessman must and can meet; (2) larger businesses usually have developed methods that can be successfully adopted and adapted by the small operator; and (3) basically, requirements for business success are the same in all fields regardless of the position held or size of the firm.

Risks and Failures

Every business involves risk, although the amount and nature vary with kinds of business, economic conditions, qualifications of the management, and numerous other factors. Pure profits, in economics, represent the return to the entrepreneur for

risk-taking, and they tend to vary according to the amount of risk involved. Since the risk of failure is the greatest non-insurable danger, the following common causes of business failure deserve study:

1. Inefficient management.
2. Insufficient capital.
3. Poor record keeping.
4. Business depression.
5. Competition.
6. Insufficient experience and education.
7. Dishonesty and fraud.
8. Poor business location.
9. Bad debt losses.

Business is a hard competitive struggle and the yearly mortality is high. Nearly as many businesses discontinue each year as start up. In the ten-year period from 1932 to 1941, both inclusive, approximately 3,600,000 enterprises discontinued business, whereas during the same period there were approximately 3,700,000 new enterprises. In normal times more than 1,000 new concerns open their doors each business day and about an equal number close. Mortality rates in the first year of life are high. In retailing, 1 out of 3 new concerns does not survive the first year and 2 out of 3 close their doors within 6 years. In wholesaling and manufacturing, 1 out of 5 concerns discontinues in the first year and 2 out of 3 close within 9 years.

Many and varied reasons are given for failure. But practically the only one recognized in the business world is lack of experience and intelligent management. In the final analysis, management makes or breaks the business enterprise. This fact cannot be stressed too strongly. To repeat it in another way, management ability is the simple reason for the difference between success and failure in the business world.

Some types of risks, such as floods, storms, fires, etc., can be insured against. But other risks of business depend entirely upon the experience and the ability of the management to cope with them. So, although many reasons are given for failures, these usually represent the *occasions* for the failure rather than the *causes*. Had the management been efficient, it would have anticipated and controlled them. For example, the United States Department of Commerce made a study of 487 business establishments which went into bankruptcy in New Jersey. Of the total number of businesses studied, 23.5 per cent kept no books, 29.4 per cent kept inadequate

books, and 39 per cent never took an inventory. Although many of those who failed blamed the failure on a business depression, an analysis of the data indicates that business depression was the occasion rather than the cause of the failure and that inefficient management was the real cause.

The following, taken from a study of 570 cases of businesses that became bankrupt, shows the causes or occasions for failures as expressed in the opinions of the owners of the bankrupt businesses and as expressed by the creditors of the businesses:

Causes or Occasions of Failure	Percentage of Enterprises Affected	
	Owners' Opinion	Creditors' Opinion
Business depression	67.7	29.1
Inefficient management	28.2	58.7
Insufficient capital	48.2	32.9
Adverse domestic and personal factors	35.1	28.1
Bad-debt losses	29.8	17.6
Competition	37.9	9.1
Decline in value of assets	31.6	5.8
Dishonesty and fraud	—	33.7
Excessive overhead expense	24.0	8.9
Too rapid expansion	10.5	7.2
Losses from speculation	11.6	5.8
Poor business location	14.6	2.7
Buying too much on credit	9.5	3.9
Excessive interest charged on borrowed money	11.1	2.1
Unfavorable changes in trading area	11.2	1.9

Certainly a business cannot know where it stands if it does not keep books, and the number of concerns that either keep no books or keep inadequate books or that never take an inventory is extremely high. It shows up repeatedly in various studies of bankruptcies and failures.[5]

Good management takes advantage of all discounts.

In highly competitive years some concerns show that the discount

[5] *Facts Veterans Should Know Before Starting a Business*, a booklet, pages 5–7. Boston: Educational Division, The Better Business Bureau, 1944, revised 1946.

earned on merchandise bills alone equals their net profits. An analyst in the male apparel field during the Great Depression (Thirties) estimated that the difference between profitable and unprofitable operation for the entire industry was less than a trouser leg per capita.[6]

Supporting the usual statement that turnover of business establishments varies inversely with the size of the business unit is the following summary:

DISCONTINUED BUSINESSES AS A PERCENTAGE OF NUMBER OF FIRMS OPERATING AT BEGINNING OF YEAR [7]

	1940	1944
All industries	13.0	6.1
No employees	11.2	8.6
1 to 3 employees	17.8	5.4
4 to 7 employees	9.6	2.6
8 to 19 employees	6.3	3.4
20 to 49 employees	7.6	2.7
50 or more employees	3.6	2.5

Dun's insolvency index is most commonly used to measure the relative importance of business failures each month and year.

The index is expressed as the annual number of failures per 10,000 listed industrial and commercial enterprises. . . . The figures on failures include all industrial and commercial enterprises which are involved in court proceedings or voluntary actions which are likely to end in loss to creditors.

Revisions in the index have been made twice in the past because of changes in the content of the failure record. In the early years real estate companies, holding companies, and such concerns as steamship lines, terminals, amusement places, etc., were included. Elimination of these in 1933 lowered the general level of the index

[6] Sullivan, A. M., "GI's Bonanza or Booby-Trap?" *Dun's Review*, April, 1946, Vol. X, No. 4, pages 2–7.

[7] Paden, Donald W., "Life Span of Discontinued Businesses." *Survey of Current Business*, December, 1945, Vol. 25, No. 12, pages 18–21.

from 2 to 3 points. The figures are given on the new basis only for 1933 and subsequent years.

Previous to 1939, the record did not include voluntary discontinuances with loss to creditors, nor a full count of all attachments, foreclosures, and such, resulting in loss to creditors. The addition of these types of failure raised the level of the index about 16 points. Figures for both the old and the new series are presented in 1939 to provide a link between the two series and to demonstrate the similarity in trend.[8]

Since the pattern of failures seems to be very similar for each recurrence of the different economic periods—wartime, post-wartime, depression, boom, and so on—the annual average index since 1900 is included here.

DUN'S INSOLVENCY INDEX[9]

Year	Average	Year	Average	Year	Average	Year	Average	Year	Average
1900	91.6	1910	83.8	1920	48.3	1930	121.6	1939*	69.6
1901	90.4	1911	88.0	1921	101.9	1931	133.4	1940	63.0
1902	93.1	1912	99.8	1922	119.8	1932	154.1	1941	54.5
1903	94.0	1913	98.1	1923	93.4	1933	100.3	1942	44.6
1904	92.3	1914	117.6	1924	100.0	1934	61.1	1943	16.4
1905	84.9	1915	132.7	1925	100.4	1935	61.7	1944	6.5
1906	76.8	1916	99.7	1926	101.0	1936	47.8	1945	4.2
1907	82.8	1917	80.3	1927	106.4	1937	45.9		
1908	108.2	1918	58.7	1928	108.5	1938	61.1		
1909	87.1	1919	37.4	1929	103.9	1939	53.7		

* Two 1939 figures show change made that year.

The risks of business are only partially reflected in failure statistics because most casualties are not officially recorded, since they involve loss only to the owner. This loss takes forms in addition to the direct loss of capital, whether that of the owner or both proprietor and creditors. It will be advisable to keep this in mind as we turn our attention in the next two chapters

[8] Marketing and Research Service, Dun & Bradstreet, Inc., *Dun's Insolvency Index, 1900–1946.*" New York: March, 1946.

[9] Marketing and Research Service, Dun & Bradstreet, Inc., *Dun's Insolvency Index, 1900–1945.* New York: March, 1946.

to surveying the field of opportunities for a beginning businessman.

Conclusions

Although the fields where big business predominates are relatively few, the large concerns in these fields tend to set the pace, or standards, of public acceptance. *Small business can compete successfully* in all but a minute fraction of the areas of modern business *but must use modern methods to do so.* For the most part these methods have been developed by the large operators.

The principles of business success apply regardless of the size of firm or kind of business. Only the applications or adaptations vary. However, this is one of the facts of modern business that seems to be difficult for many small businessmen to understand. The idea that "my business is different" contains just enough truth to conceal the more fundamental similarities to other businesses. Business individuality as a basis for customer following is needed and justifiable; business isolation is not. *The interdependence of all business is the basic reality of modern times.*

"Nothing risked, nothing gained," aptly summarizes the situation in business. However, risk taking need not result in loss or failure. Careful preparation for business ownership is just as important as for any other major undertaking. To the individual it is probably of much greater importance than preparation for a job or employment.

The position of small business in the mortality picture is often confused. Merely the fact that most failures occur among small firms does not prove that the smallness of the firm was the *cause* of failure. Such spurious reasoning has probably resulted in many competent, but cautious, individuals seeking security in employment rather than as business owner-managers. As the position and importance of the independent businessman becomes better understood this situation is certain to improve.

Review and Discussion Questions

1. Discuss the difficulties involved in developing a body of management principles for the service fields comparable to those developed respectively for merchandising and for manufacturing.

2. Consider each of the seven "m's" of management and discuss how to adapt developments made by big business to the needs of small business.

3. Would the voluntary chain as used in retailing be suitable for any of the service fields? Explain and discuss.

4. Why is mail order marketing not ordinarily an inexpensive method?

5. Discuss fully the interdependence of *all* business.

6. Give several examples of how big business sets the pace for small business in the same field.

7. Look up the number and kinds of small businesses directly connected as sellers to, or distributors for, a few industries dominated by big business, such as: automobile manufacture, public transportation systems, the iron and steel industry. Prepare to report and discuss your findings.

8. Elaborate on the discussion, in this chapter, of businesses that fail because they never should have been started.

9. Would you worry more if employed or if in business for yourself? What conclusions do you draw from your answer?

10. Study the advice given by successful small business owners presented in the chapter and comment on points of agreement and disagreement.

11. To what extent do the suggestions given by these small businessmen agree with, or differ from, advice given in the text? Discuss.

12. In your own words state the authors' thesis regarding modern methods for the small business.

13. Distinguish carefully between the occasions for business failure as opposed to the causes.

14. What use could you make of *Dun's Insolvency Index?*

15. State each of the major characteristics of a service and show

in turn how each affects the policies, problems, and management of service establishments of various kinds.

16. What topics discussed in the chapter are too "theoretical" to be of value to the small businessman? Explain.

17. Why is it impossible, or very difficult, to secure insurance against certain business risks? List the risks in this classification and discuss each.

18. Is ample capital more important in starting a business during prosperous, or during dull times? Explain.

19. Discuss several topics considered in this chapter with as many successful small businessmen as possible, and report your results.

20. Why is a workable definition important for (a) small business, and (b) service businesses?

21. Discuss the factors responsible for the rapid growth and present-day advantages of chain stores.

22. Discuss the ways in which a chain store, large department store, and mail order house are more efficient than the small business.

23. Listed in the chapter are four generally accepted prerequisites for success in small business. To this list add prerequisites you think necessary.

24. How do you account for the fact that the mortality rate is higher among retail businesses than among wholesalers or manufacturers?

25. What reasons can you give that would account for the fact that 58 per cent of all businesses are retail?

26. Does the retailer or the manufacturer render greater economic service? Explain. Which type of business is usually sought by various towns and communities? Explain fully.

Chapter IV

APPRAISING A GOING CONCERN

Once you have decided to enter business for yourself, unless your prospective enterprise is entirely new, you must decide whether to buy a going concern or start a new one. Even if you plan to start an entirely new business it will be worth your time to study methods used in appraising a going concern for possible purchase. In starting a new business you may not be able to secure contracts restricting competition, such as exclusive agency rights, as you can in buying a going concern, but you may investigate the likelihood of such developments for the future. In many other respects the problems connected with justifying a new business will be closely related to the contents of this chapter.

The need for evaluation

Frequently the beginner prefers to buy a business already in operation. In most instances the business will have been offered for sale, but in some cases the prospective purchaser, on seeing a given establishment operating in a certain location, makes an offer. In either case the value of the business must be determined by buyer and seller alike before an agreement can be reached. Both parties are anxious to secure full value in the exchange.

Points to consider in appraisal

A going business, like a building, an automobile, a farm animal, or even a prospective employee, can be appraised with reasonable accuracy. As is the case with any of the above items, the problem is, first, to have a check list of considerations,

and second, to be able to recognize strength and weakness, or advantages and disadvantages as they appear. The great deficiency in amateur business buyers, as with amateurs in any market, is that they, as novices, usually fail to recognize certain vital factors when they are present. Successful analysis of the value of any business requires the following qualifications on the part of the analyst:

1. Enough experience in the trade to recognize obvious points against and points in favor of the business as it stands.
2. Knowledge based on well-kept personal records or other sources of information as to past performance and probable future developments and trends.

Any list of considerations for appraising the average business would include the following questions:

1. Has it been consistently profitable?
2. Is business volume increasing or decreasing? Why?
3. Are overhead expenses in line with the volume of business?
4. If the profit ratio is not satisfactory, could it be improved?
5. Is the inventory well balanced? Is it new and timely?
6. Is the equipment modern, and in good condition?
7. Is the lease satisfactory? When does it expire? Can it be renewed?
8. Is the competitive situation healthy? Is any new competition developing?
9. Are relationships with wholesalers satisfactory? Are there any franchises expiring?
10. What is the buying public's attitude toward the business?
11. What is the business community's attitude toward it?
12. Are there any new or proposed community developments that will affect the business?

13. Is the personnel situation satisfactory? Are key people efficient and willing to remain?

14. Are there any personal, religious, or political reasons why a successor would be unable to carry on this business successfully?

15. Why does the present owner desire to sell?

16. What occupation will the present owner follow when the business is sold?

17. How does this business, in its present condition, compare with one you could start and develop yourself within a reasonable time?

There probably are more such questions that could be asked by the prospective purchaser. Buying a business is a serious matter, involving substantial financial investment as well as having certain other implications in terms of personal satisfaction and occupational enjoyment. A business bought at the wrong price, which despite much work never becomes successful, costs the purchaser and his family far more than the dollars invested and lost.

The more important factors to consider in appraising a business may be grouped under four main headings according to objectives and process of evaluation. These are: profits, tangible assets, intangibles, and estimates. Several aspects of each deserve consideration. With sufficient care both the profit aspects and the tangible assets can be appraised objectively and quite accurately. Intangibles include attitudes of the public and the trade as well as good will. They may be more difficult to appraise accurately, yet they are real and often are of great importance in determining the true value of a going business. Estimates deal either with probable future developments or with comparisons of alternatives, whether to buy or to build "from scratch."

In buying businesses, as in buying houses in which to live, the question always arises, "Is it better to buy or to build?" There are, in almost every case, substantial arguments on both

sides—reasons why, under the circumstances, each alternative has its favorable points. In this connection, a ledger-like pattern for comparing pros and cons might be followed to determine on which side the balance may be:

Arguments for buying an established business	*Arguments for starting an entirely new business*
Proved location	Can select own lines
Resources known	Can plan own layout
Equipment available	Can hire own employees
Stock already selected	Can select own clientele
Established clientele	No precedents to follow

Profits

Profitability

A study of the authentic records of the business will quickly reveal whether or not it has consistently paid its owner a reward for his efforts. The prospective purchaser must weigh the question of whether or not this income would be satisfactory to him and his family, and if not, whether it could be increased. He will want, therefore, to study the records of operating expenses, comparing their percentages with those of efficiently run enterprises, in order to detect opportunities for reduction or extension. Among bankers, suppliers, and lawyers, most of whom deal frequently with problems of business failure, there is a common acceptance of the principle that most failing businesses do so for lack of intelligent management. Those who are accustomed to studying the records of bankruptcies and other discontinuances can as quickly spot the discrepancies causing the failures as a physician diagnoses the common human ailments that cause most illnesses and deaths.

Profit trend of the business

A study of the records of any business will indicate whether or not volume is on the upgrade or downgrade. If it is going up, it is worth while to know which departments or items are

bringing the volume, and whether or not there is profitable volume. If it is going down, a similar determination of areas of lost volume should be made. Many businesses have failed after selling great quantities of goods at such low margins as to make net profits impossible. Some of these have allowed their competitive lines to crowd out their profit lines.

If the volume is decreasing, the question may arise as to whether it is due to failure to keep up with competition, inability to adjust to changing times, or simply lack of energetic sales promotion. A familiarity with the trade plus a few pertinent questions put to bankers, suppliers, and others will usually bring out the facts. The vital question, in the end, is "How profitable is the business, and is the trend toward more volume and more profit, or away from them?" Careful analysis will bring the correct answers.

The expense ratios

For every size and type of business there are generally recognized ratios of expenses to sales that are accepted as proper throughout the trade. Some of these are collected and consolidated by trade organizations, such as the National Retail Hardware Association or the National Association of Retail Grocers. Others are developed by interested manufacturers, as Eli Lilly and Company has done for the druggists, and Butler Brothers for independent variety stores. Figures for manufacturing concerns have been collected by Dun & Bradstreet, Robert Morris and Associates, and others. Operating figures for some businesses have been determined by Westinghouse (radio repairs and appliances), the American Foundry Institute, and the National Association of Dyers and Cleaners. Dun & Bradstreet operating ratios for retail concerns are the standard for this field. Useful figures are also available in texts and government bulletins that may be secured in most public and school libraries.

A study of the figures of any concern offered for sale, compared with standard ratios for the trade, will quickly bring out

any discrepancies. In the course of explanation of these by the seller, the intelligent buyer will quickly become aware of operating problems that may be important factors in helping him make up his mind to buy, or how much to pay for, the business. Some conditions are due simply to poor management. An excessive operating cost may be caused by carelessness, and a less than normal expenditure may indicate laxity in attention to a particularly vital activity that would bring results if properly financed. Frequently if the same amount of money is intelligently spent on one activity, instead of being misspent on another, desirable results in volume and profit promptly appear. The following is a simple illustration of how operating ratios are used in appraising a business.

A grocery store offered for sale has had average annual net sales of $40,000 for the past three years with no appreciable increase or decrease. Analysis of the company's records discloses the following operating ratios expressed as a percentage of net sales, for the preceding three years.

	19—	19—	19—
Total expenses	15.8	16.2	16.5
Wages other than owner's	4.0	4.5	4.9
Rent	3.5	3.5	3.5
Advertising	0.5	0.3	0.1

Dun & Bradstreet standard operating ratios for this kind and size of store for the years covered were as follows:

Total expenses	15.9
Wages other than owner's	4.1
Rent	2.6
Advertising	0.6

Certain comparisons significant to the prospective purchaser may be noted from these ratios. Obviously the rent is too high. Possibly a conference with the landlord would result in a new lease that would bring this expense into line. The payroll has increased steadily. Why? Investigation would probably dis-

close a situation that could be corrected by the new owner, such as carelessness in employing more help than needed, or laxness on the part of certain employees. Further analysis shows that both total expenses and payroll were close to the standard ratios the first year; total expenses increased each year by approximately the same amount as payroll. If the new owner could bring payroll into line, total expenses would be satisfactory. However, if conditions are such that dollar payroll could not be reduced enough to adjust the ratio, there is still another possibility. Notice that total sales remained constant over the three-year period while advertising expense declined from 0.5 per cent to 0.1 per cent. By increasing this item it is quite likely that total sales could be increased enough to bring both payroll and total expense ratios into line.

Even the casual reader will notice the frequency with which "if" was used in the preceding illustration. Operating ratios are standards or guides. Their effective use depends upon the ability of the new owner to change conditions that have caused any ratios to be appreciably different from the standard.

Tangible Assets

The inventory

A wise buyer's stock of goods is made up of timely, fresh, well-balanced selections of materials or merchandise, which in the well-managed store will consist of those items the public wants—in the proper sizes and designs and colors, priced to fit the local buying power and purchasing habits. In a well-run factory there will be a representative collection of raw materials and supplies that will surely be used up within a reasonable period of production. Seldom will quantities of metals, lumber, oils, compounds, or other ingredients be found on hand that are no longer used or for which there is no reasonable expectation of future use. "Close buying" is as essential to profit in one line as in another.

In the mercantile line there is an old saying that "Goods well

bought are half sold." Goods well bought are those for which there is a proved demand, or which the seller wisely buys to meet the requests of customers whom he knows well enough to anticipate their needs.

Every bankruptcy sale brings bad buying to light—one crossroads store in a recently electrified community was found to have six gross of chimneys for kerosene lamps. Another had four dozen pairs of specially constructed, expensive miner's gloves to meet the needs of six local men who were infrequently employed in a mine 12 miles away. Another store had drawer after drawer full of yellowing stiff collars, and numerous boxes of one-piece men's underwear long after their popularity had waned. Not only had they been poorly bought but they had not been "cleared" in time to prevent a substantial loss.

A small factory had forty cases of wooden toy wheels when metal toys had displaced the demand for which they had been bought six years before. Another had hundreds of gallons of a particular shade of green enamel, bought long before the color of a certain railroad signal device for which it was used was required by law to be red. One toy maker persisted in manufacturing gas-fired woodburning outfits when the toy market was enthusiastically promoting an electric set.

One of the classics among thousands of such examples is a grocer who, after an ocean voyage, developed a taste for exotic sea foods that caused him to pile his shelves high with cans, jars, and bottles of marine novelties, of which his agricultural customers would have none. Another is a manufacturer who was smitten with the possibilities of miniature golf, and who had to sell his business at a loss, when the popularity of this sport declined because of the thousands of dollars he had tied up in portable golf courses.

The purchaser of a going business is not particularly concerned with the errors of his predecessor, except as an object lesson. His concern is that he does not become the loser on an

aggregation of "dead" stock that the seller has listed as worth its original value—the loss is rightly the original buyer's, and the new buyer must beware that the loss is not passed on to him. "Age" an inventory before appraising it.

The equipment and fixtures

Because of the rapid mercantile and industrial progress since the early 1920's, it is important that the modern business be equipped with machines and fixtures that are efficient. A row of punch presses that made a substantial profit twenty years ago may not now compete with those that produce several times as many units in the same time, nor can those old machines even be made to produce at the greater speed. Office equipment must be investigated very closely, since obsolete calculating, addressing, or duplicating devices are almost worthless; to use them is generally inefficient, and parts and supplies may be unobtainable. This is particularly true of little-known makes.

Fixtures that dignified the store and pleased the customers a few years ago are now as out of date and uneconomical as carbide lamps for automobiles. A cash register for the bookkeeping requirements of 15 years ago will not usually give the information now required for computing figures for taxation. This entire picture of obsolescence is one that is all too characteristic of the business about to be sold, for in many cases the usefulness of these items, representing a substantial capital investment, has been outlived long ago, and their cost has long since been written off. The owner has delayed so long in replacing them that they have no trade-in value, with the result that now, in considering their replacement, he finds the prices of new equipment to be exorbitant. Hence he decides to sell the business—any financial realization he makes on the fixtures and equipment is now clear profit, an extra bonus on his period of operation.

Other assets

Certain assets in addition to the more obvious physical goods and equipment have a real value to the purchaser. Among these are the following:

Lists.–Mailing lists, general lists of customers, lists of customers interested in certain products and other lists have very definite value. Selective lists may often be sold or rented. A veterinarian's list of wealthy dog owners, for example, could bring a good rental fee from a store introducing a new line of accessories; a custom tailor's list of customers would be worth money to a seller of made-to-order shirts.

Credit Records.–These, if carefully kept, are of high value to the buyer of a business; without them he may lose heavily in granting credit or be forced to pay for credit reference information.

Sales Records.–Carefully kept records that show normal seasonal demands are a valuable insurance against under- or over-stocking.

Franchises.–These have a sale value even if they were granted without cost. Even informal franchises have value if the supplier will continue delivering to the new owner.

Contracts.–Favorable leases and other advantageous contracts are worth real money. In the winding up of many profitable businesses, the sale of leases has produced unexpected profits for the owner.

Incidentally, purchasers of businesses should have their attorneys make sure the foregoing assets are included in the sale. There is at least one instance in which the sales agreement did not include the list of customers; the seller came around the next day and got his own price for the list from the helplessly stymied buyer.[1]

Intangibles

The public's attitude

All of us know of business concerns that have existed for years without ever establishing sufficient good will to be re-

[1] Small Business Aids, No. 2, U. S. Department of Commerce, "Business Assets in Addition to Stock and Good Will." Extracted from "Many Assets in Addition to Stock and Good Will Can Be Built, Increasing Dollars-and-Cents Values of Business Enterprises," by Elmer Roessner. *Small Business Today,* August 3, 1946, New York, McClure Newspaper Syndicate.

garded favorably by the average customer. These stores and shops and manufacturing plants do business, to be sure, but it is done *in spite of* their policies, their goods, their service, their handling of customers. Strong competition would have driven them out of business long ago. Their position in the public mind, from a preference standpoint, is at the bottom of the scale.

This public attitude cannot be changed quickly. "Give a dog a bad name" applies to a business as well. Most observers will agree that it takes far less time to ruin a good name than it does to make a bad one good.

A successful business has good will as an asset. The point of discussion here is that ill will is a liability. Taking over a popular business may bring with it public acceptance that has been built up over a period of many years, and which is therefore valuable. Taking over another that is unpopular may mean that it will take years of promotional effort to remove the taint of unsatisfactory customer relationships, accumulated over as many years, before valuable good will can be acquired.

Because many sellers of businesses seek to place a premium on "good will" that really is ill will, care should be taken to determine whether or not the business in question is selling an asset or a liability. This may be done by questioning unbiased persons, including customers, bankers, and others who will have bases for an opinion. Statements obtained from such individuals may then be compared with the ledger entries to support conclusions regarding the status of the business in the public mind.

This thing called "good will"

According to Webster's Dictionary, good will is "the favor or advantage in the way of custom which a business has acquired beyond the mere value of what it sells." Most text books describe it as a value placed upon certain business benefits and advantages, such as public recognition and patronage, that a given business has acquired through the years and

which, therefore, must be regarded as an appraisable asset when the business is sold. Methods of evaluating good will will vary, whether the business wishes only to show it as an asset on the records, or whether it becomes a factor in the sale of the firm.

The buyer of the business must be very realistic in determining what he can afford to pay for good will. It will reflect itself in the excess of selling price over the objectively appraised value of goods, equipment, and supplies, after liabilities are deducted. Actually it will be the price, above cold appraisal of the balance of assets as against liabilities, paid by the new owner for his old owner's constructive efforts in developing the business to its present condition. The amount to be paid for good will will depend on:

1. How long it would take the new owner to set up a similar business and at what expense and risk.
2. The added amount of income possible through buying a going business as against starting an entirely new one.
3. The relative prices for good will asked for other businesses of similar type with similar advantages.
4. The extent to which the old owner agrees by contract to remain out of the same business within a competitive area.

What is the value of good will on a statement of assets and liabilities? The prospective buyer had best regard it as valueless, as such, rather considering any premium he must pay above true "book value" as (1) compensation to the owner for his losses on beginning mistakes the new buyer himself might have had to make instead, or (2) payment as an investment for the privilege of carrying on an established and profitable business.

In either case the premium paid should be small enough that it can be made up from profits within a relatively short period. Excessive amounts paid for good will are most common where competition for the purchase of a business exists; and frequently, for various reasons, the "other fellow" can stand the

excessive beginning costs better than the enthusiastic but unanalytical novice. Good will, in the usual sense, can be lost overnight; an opportunity, a proved one, may be worth paying for.

The business world's opinions

Occasionally businesses, like people, have dual personalities—one for home use, and one for work and the public. Some enterprises, too, have more than one pattern of behavior—one for customers, and another for employees and business firms. There may be some question as to which personality pattern is most essential in business, but there can be no question as to the ill effects of unsatisfactory working relationships with business houses and workers. The attitude of the average employee is important to business success; the attitudes of suppliers or contemporaries can make or break any business at critical times. A firm that has the reputation of underpaying employees, of overworking them, or of failing to promote the proper individuals is weakened in its operations. The business that has broken contracts, schemed to get advantages, or has generally established itself as a hard bargainer with no sense of coöperation or loyalty is in an unfavorable condition for sale.

Resources and franchises

Every manufacturer and wholesaler has among his accounts many whom he considers for one reason or another to be undesirable. If there are favors to be granted, some customers receive them automatically and others on request, while a third group receives as few "breaks" as possible. This last group represents the marginal customers, or those who the supplier has decided are not worth the effort to keep. In fact, they may eventually be displaced in communities where other outlets promise more satisfactory volume. Occasionally a business owner, knowing that he is soon to lose this resource contact, desires to dispose of his business. This is most frequently true in the case of a franchise or a restricted representation for

strong lines of goods that in the opinion of the suppliers has been abused. The buyer should, in any case, obtain satisfactory assurances, and new contracts if necessary, with the supplier if a franchise is involved.

Why is the business being sold?

When the owner of a business decides to dispose of it, the reasons he presents to the public may be somewhat different from those known to the business world, and both of these may be somewhat different from the actual facts. As a rule, there are numerous contributing factors in business sales as well as in business discontinuances and bankruptcies. There may be considerable difference in emphasis, however, depending on with whom the person most involved is talking. The businessman who is about to lose his contract or franchise for a strong line of merchandise, or who knows of a new law or civic development that will affect him unfavorably, will not tell his prospective purchaser all that he knows. Nor will the man whose business is threatened by intensive competition usually explain such reasons for selling. If he also "needs a rest," or if owing to his wife's illness she needs a change of climate, he may decide to emphasize these reasons to the total exclusion of the really decisive factors.

The seller's personal plans

Although there is no intent here to cause the prospective purchaser of a going concern to feel that all sellers of businesses are subject to questionable ethical and moral principles, "caveat emptor" has through the years been a reliable maxim for buyers of horses, used cars, and going businesses. There is just enough ignorance on the part of the average buyer and just enough avarice on the part of the typical seller to make buying a business somewhat hazardous. True, there are laws against fraud and misrepresentation, but such cases are usually very difficult to prove in court. Also, pride and the desire to

avoid publicity frequently prevent the injured purchaser from taking any legal action.

A few years ago in a small midwestern city an enterprising young man bought what had always been a prosperous men's wear store. The seller took his check and left for Florida to retire. Six months later the new owner received notice to vacate, for the building was to be torn down by order of the state. At about the same time a new clothing store opened across the street, financed and supervised by the former owner of the old store. Strangely enough, also at the same time, another unfortunate event took place. A second new store was opened one block away by the manufacturer of the line of clothing that the purchaser had hoped to distribute at a profit. Needless to say, the new owner suffered considerable loss.

This is not a typical case, but merely an example of what may happen. Most such calamities can be avoided by careful study of leases and franchise contracts and by writing protective clauses into contracts of sale. Any hesitancy on the part of the seller to bind himself against undesirable later behavior or consequences may be regarded as indicative of some danger from that source.

Estimates

Competition

Healthy competition is most desirable where there is an ample market. In manufacturing businesses the nearby presence of a competitor improves labor resources, and the two organizations working together can obtain concessions from railroads, utilities, and others that neither could get alone. Since their markets are not entirely local, the fact that they are near together is not a handicap. In the mercantile field the effect of competition, even in areas where the market is large, will vary according to lines of merchandise carried. In staple goods, such as notions, groceries, drugs, and small hardware, close proximity of large-store competition is often undesirable,

since trade will be limited to the particular area and there may not be enough to go around. In regard to shopping goods, like furniture, appliances, and apparel, the fact that two stores are side by side is in favor of both, for people will go a great distance to buy shopping items and will go more readily if there are two or more stores in which to shop.

Service industries depend entirely upon the local market and share available business with competitors in proportion to the reputation, aggressiveness, and good will of each establishment. Ordinarily the advantages just mentioned resulting from locations near competitors do not apply to service industries; however, the presence of progressive retail stores in the vicinity is usually desirable.

The only dangerous competition in most cases is unscrupulous competition, and that type of business is usually short-lived as compared with longer established, more ethical concerns. Occasionally, however, unethical practices can be carried on over a long enough period to make business impossible for the smaller, legitimate operator. The presence of any such competitors, or the imminence of their presence, should be carefully determined and considered if the business is in a highly competitive trade.

The manpower situation

Businesses generally are made up of four elements—materials, money, machines, and manpower. When a business is being purchased, manpower must be considered as of equal importance with profits and production, for it will usually be desirable to retain certain key people to keep the business on an even keel. New people who are both properly trained and steady workers can seldom be secured readily. The prospective buyer will want to know:

1. Are all duties provided for with qualified people?
2. Will any of these people depart with the old owner?
3. Are there any key individuals among the workers who

will for any reason be unwilling or unable to continue working indefinitely for the organization under new ownership and supervision?

Advice to the Novice

Check and double check

It is recommended practice to make several independent appraisals and then to compare each appraisal with others arrived at through different methods. "Check and double check" is the formula to use.

Unfortunately for the prospective buyer, as was mentioned earlier, something approaching a "business opportunities racket" has developed in many cities. Brokers may advertise and sell the same business time after time to a succession of newcomers, each of whom lasts only long enough to lose his accumulated savings. Naturally this does not mean that all businesses advertised for sale are necessarily "white elephants."

The seller's books should not be taken as proof of sales or profits stated therein. Insist upon seeing the record of bank deposits for at least the past year or for the length of time the business has been operated by the present owner, whichever is shorter. If possible, obtain the deposit records of previous owners in case the present one has been in business only a short time. Ask to see the owner's copy of his income tax return, which any honest seller would be willing to show. Ask to see his insurance policies. Is his coverage in line with assets claimed?

Experienced business buyers often investigate the reputation of the seller, in addition to the public's attitude toward the business. Talking with customers may furnish information of both types.

Next consider the reasons for selling the business. If poor health is mentioned, determine whose health is poor and verify the claim by consulting the physician in charge. Often the druggist can furnish clues to alleged "illness." What does the

owner plan to do after the business is sold? Check his answer by consulting persons in a position to know. If his stated plans meet this test, be sure you receive an agreement in writing that he will not enter the same kind of business as a competitor for some reasonable number of years.

Ask him about any franchises he has for preferred merchandise lines, then verify his statements by writing directly to the firms concerned. Find out if they will continue the franchise if you buy the business, and if they know of any competition about to begin in the district. Also consult the Chamber of Commerce and local bankers on the latter point. If a permit is required to start a business in the town, consult the government officials in charge for clues of new competition.

The city planners may give information about proposed changes in streets or routing of transportation lines that might have a serious effect upon the business in the near future.

An individual should make checks on customers to be sure they are not fakes, and should be suspicious if customer traffic increases every time he appears at the store. He should also do some secret checking for at least one week, talking to any suspicious customers and following up on the information they give him.

There are many other schemes used to defraud innocent buyers, such as falsification of inventory figures, solvency, and sales and other records, to mention only a few. It is well to check with several of the owner's more important merchandise resources to see if all bills are being paid when due and to verify his statement of current balances due to vendors. The prospective businessman should familiarize himself with the provisions of the Bulk Sales Law if one exists in the state and take adequate steps to protect himself against future loss resulting from the protection this law gives to creditors.[2]

[2] For further study see: Rost, O. F., *Going Into Business for Yourself*, pages 77 ff. New York: McGraw-Hill Book Company, Inc., 1945; *Facts You Should Know About Schemes*, a booklet. Boston: Educational Division, the Better Business Bureau, 1939, revised 1946.

Because the buying and selling of going businesses offers so many opportunities for naïve beginners to make expensive errors, and because there are so many difficulties in securing legal satisfaction in case of deception, every precaution should be taken to prevent bad investment. With this thought in mind, we quote selected items from a recently published list of fact-founded admonitions by the Better Business Bureau:

1. *Advance Fee.* If your business needs financing, don't fall for an unscrupulous promoter who offers to arrange a loan if you first pay his expenses. Front-money operators may offer to incorporate your business and assist in selling stock. But, when advance fees have been paid to them or their associates, service usually stops or is found to be worthless.

2. *Business Brokers.* Some business brokers, in acting as agents for sellers of businesses, are irresponsible, unfair to prospective purchasers, avoid all liabilities, and are interested only in collecting a fee. Do not be rushed into a deal. Get all verbal understandings in writing from the seller. Put the deal in escrow with a third, reputable, disinterested party. Before you sign an agreement to purchase, have all papers checked by your attorney and all books and records showing earning capacity, past profits, inventory, equipment, obligations, etc., checked by an accountant.

3. *Buy-Back Contracts.* Buy-back contracts, like money-back guarantees, are no better than the guarantors. They are frequently worthless promises made by dishonest promoters.

4. *Job Investments.* Invariably large earnings or a better than average weekly salary are offered to those who will "invest" in the business of a promoter who misrepresents.

5. *Listing Fee.* This is a variation of the Advance Fee Scheme. The fake business broker gets you to pay a fee for listing your name with him for finding the type of business you wish to engage in. Listing fees are sometimes disguised as expenses for advertising or circularizing prospects.

6. *New Promotions.* Decide whether you can afford to lose before you invest in any new enterprise. A large number of new enterprises fail.

7. *Partner Wanted.* Partner-wanted propositions are sometimes

nothing but deceptive frauds to get your investment in a supposedly profitable business claiming the need of new funds. In a partnership each partner is responsible for all the debts of the firm. *Know* your partner.

8. *Patents and Inventions.* Investments in new inventions, patents, or patent litigation ventures are usually risky speculations and sometimes frauds.

9. *Territorial Rights.* Should a high-pressure promoter lure you with the right to sell his product in exclusive territory, reserve your decision until you possess the facts. Some promoters misrepresent their products to get quantity orders and often sell several people the same territorial rights.[3]

Although there are many opportunities to mislead or defraud an inexperienced business buyer, a man who really knows the field places more weight on his ability to analyze the market, judge the competitive situation, uncover adverse future developments, and estimate the profits he could make from the business, than upon the present owner's reasons for selling. Naturally precautions are taken to protect the new owner's interests if the business is purchased.

Conclusions

Buying a going business is risky at best. One may not secure all the benefits anticipated, even if they are honestly presented by the seller, but a person will inherit all ill will and other handicaps the business has acquired. Check and double check all important points and do not be rushed into a decision to purchase on inadequate information. *Once the business is purchased, it is yours for "better or worse."*

Review and Discussion Questions

1. List all the sources of information you could use to double check a seller's statement as to the value of machinery, or fixtures and equipment.

[3] *Facts Veterans Should Know Before Starting a Business,* a booklet, pages 8–9. Boston: Educational Division, The Better Business Bureau, 1944, revised 1946.

2. How could the amount of insurance carried by a seller be used as a guide by a prospective business buyer?

3. List the various ways a dishonest seller could create the impression of having a larger volume of business than he actually has. For each method, suggest how you could check on it.

4. Make a few tests of your ability to appraise certain going concerns. Include one or two that are offered for sale, then follow up later on what actually happened.

5. What precautions should be taken if the business offered for sale is a partnership?

6. Examine the provisions of the Bulk Sales Laws to see how the buyer should protect himself.

7. Make at least one test case of the comparative costs of buying a going business and starting a new, but similar, concern.

8. How would you evaluate the premium to be paid for "good will" because of a favorable lease? an exclusive agency franchise?

9. How could you appraise the amount of good will (or ill will) attributable entirely to the owner's personality and personal conduct?

10. Suggest and discuss topics connected with buying a going business that are not covered in this chapter.

11. Explain carefully how appraising a going business for possible purchase could serve as a guide in helping you to justify the launching of a new business.

12. Review the advantages in favor of buying a going business, and of starting your own business; then elaborate on each list including the disadvantages of each plan.

13. In general, which is more risky, buying an established firm or starting a new one in the same field? Discuss.

14. Name the less obvious situations where going into business for yourself requires starting a new concern rather than buying one already in operation.

15. Of what schemes for defrauding prospective small businessmen, not mentioned in this chapter, have you heard?

16. In what ways not mentioned in the text could you anticipate important changes likely to affect the future of a business, such as:

new city ordinances, rerouting of highways or other transportation, new competition, and shifts in customer demand? Discuss each.

17. Visit a merchant in your vicinity who bought his business and one who built his business. Find out from each why he thinks he did the wiser thing, and discuss your findings.

18. What is meant by "close buying"? Why is it essential to profit in a business?

19. In what ways can Dun & Bradstreet operating expense ratios and merchandising ratios as well as those put out by interested manufacturers help the buyer in deciding whether to buy a business?

20. How should "caveat emptor" apply to the buyer of a concern?

21. Explain why the presence of a nearby competitor is undesirable in some cases while it is desirable in others. Be specific.

22. You are considering buying a particular retail store. On several occasions when you visited the store there were no customers present but business became very active soon after your arrival. Discuss what you would do.

23. A clothing store is offered for sale at what appears to be a reasonable price. The owner says he needs a rest and has been advised to seek a drier climate. Discuss what you would do.

24. You know of a business that has been operated by three brothers for a long period of time. Since the owners are well along in years you think they would be willing to retire. Explain what you would do if the business looks like a good one to you.

25. Opinions as to the value of a business offered for sale differ as follows: The owner asks $15,000 for it; the local banker says it is worth from $15,000 to $17,000; and representatives of two wholesale houses who call on the owner both agree that not over $12,000 should be paid for it. As prospective purchaser, what would you do?

Chapter V

JUSTIFYING THE NEW BUSINESS

Many small businesses are successfully started "from scratch." It is our purpose in this chapter to examine the justification of a new business; that is, our immediate interest is to make sure that our proposed business venture is sound. A genuine business opportunity may be defined as a need for the proposed good or service in sufficient volume at a high enough price and low enough cost to operate at a profit.

As we will see later, every successful business has a set of policies that state the reasons for its existence and how it will operate. Justifying an idea as a genuine business opportunity furnishes the basis for the general policy, at least as far as the aim or purpose of the business is concerned.

Another subject closely related to that of the present chapter is selection of the business location. Often a genuine business opportunity is uncovered as a result of making a location study. This close relationship will be more apparent later when we consider the new business that is justifiable because of locational shifts. For simplicity of treatment, however, the present chapter emphasizes evaluation of the proposed idea for a new business irrespective of how the idea is discovered, leaving to Chapter VII, "Selecting the Profitable Location," discussion of the process of choosing a location for a particular business.

Most situations involving justification will require action in one of three major categories: appraising the need for another business similar to those already established, testing an idea for a new type of business, or shopping to discover a genuine business opportunity. The last represents the typical situation

of a young, prospective small businessman who has decided he "has what it takes" to be on his own but has not yet decided what kind of business to start or where to begin.

Another Similar Business

There are two typical situations in which another business similar to those already present may be justified: in an expanded market, and in the presence of inefficient management of existing firms. Communities grow, sometimes very rapidly. Such expansion of the local market opens up opportunities, for more retail stores and service businesses in particular. Manufacturing, except for the handicrafts based exclusively on a local market, is affected less by community expansion, although increased total (as opposed to local) demand for a given manufactured product affords similar opportunities if the industry has not already reached the mass production stage.

Four means are used, usually together, to determine whether or not there is room for another small business in a given community as a result of an expanded market. Three are based on statistics or averages, the other on personal investigation. From census data the investigator can calculate the number of businesses of each kind per given unit—say 10,000—of population, either for a particular state or for the entire country. The situation in any town can then be compared with this average. A slightly different approach involves being guided by figures prepared by experts in each field based on known requirements of their kind of business. Several agencies furnish data on the number of persons in a trading area required to support a business of a given type. The third statistical measure, when data are available, is some index number of sales potential, such as per capita consumption for one line of goods like tobacco products, or consumer purchasing power which correlates quite closely with general retail sales. These data and sources of them are discussed in Chapter VII, "Selecting the Profitable Location." It is better to use several methods when the data needed are available.

Assume that a community of 150,000 persons has 14 stores of the type a young man is interested in starting; census data show an average of one store for 9,000 population. Experts calculate that this type of business requires an average of 10,500 in the trading area. Apparently there is such a slim margin that another store would be quite a risk. This is where additional guides are needed. If an index of sales potential shows the town to be well above average, this may be sufficient justification. More important for most lines of small business is the fourth method, the personal investigation. Assume for the foregoing example that this method reveals an increase in population from 120,000 to 150,000 during the past few years; no new stores in this line have been opened, and those already in existence are rushed and apparently very prosperous. The conclusion is obvious. Select a location carefully and get started.

The second situation—poor management of similar enterprises—justifying another business requires first hand familiarity with the local situation. Some of the usual symptoms will be evident if it exists: high prices, extensive out-of-town consumer buying, poorly-kept stores, shoddy merchandise, incompetent clerks, slow service and poor quality of workmanship in service establishments, high business turnover, lack of customer loyalty, prevalence of consumer gripes, and exaggerated advertising. Where these conditions abound, there is a "natural" for a progressive, alert newcomer. This is the situation that has given birth to our newer forms of large-scale, modern retail and service businesses. No need exists to worry about stores per 10,000 population or similar averages in a situation like this —there may already be twice as many outlets as the national average, yet one good store is needed. Consumer surveys, if available, are often useful in such a situation to reassure the new enterpriser that his disapproval of the management of existing stores is shared by the local population and evidenced by its buying habits.

Consumer surveys

Reliable consumer surveys are likely to be expensive for the prospective small businessman to undertake. Sometimes small, well-selected samples, adequately supplemented by other methods, will suffice.

Often independent surveys of consumer buying are made in the community by organizations such as schools, clubs, and chambers of commerce. For example, a survey of the buying habits of women who shop in Fayetteville, Arkansas, drug and department stores was made by students in retail store management of the University of Arkansas under the direction of one of the authors. Trained student interviewers secured returns from 231 women who shop in Fayetteville, 11 of whom were selected at random from the rural homes; the remaining 220 were random samples secured from three groups in equal proportion. Each group approximately represents one of the three income levels within the city. The following tables give a representative sample of some of the findings from this survey:

TABLE 3

PREFERENCE OF FAYETTEVILLE WOMEN FOR DRUG AND DEPARTMENT STORES

DRUG STORES (Per cent preferring Stores A–F)		DEPARTMENT STORES (Per cent preferring Stores G–L)	
Store	*Per Cent*	*Store*	*Per Cent*
F	44	G	44
D	18	L	34
E	18	K	12
A	9	J	9
C	7	H	0.5
B	4	I	0.5

A study of Table 3 by a person planning to go into the drug or department store business in this community would reveal who would be his chief competitors. A study of Table 4 discloses the reasons for preference of particular drug or depart-

ment stores, and would indicate to the newcomer the appeals that should be used to attract trade to his store.

TABLE 4

REASONS FOR PREFERRING EACH OF THESE STORES

DRUG STORES (Per cent giving named reasons for preference)		DEPARTMENT STORES (Per cent giving named reasons for preference)	
	Per Cent		*Per Cent*
Friendship	50	Merchandise	48
Merchandise	32	Friendship	23
Price	12	Price	21
Credit	6	Credit	8

From such a consumer survey an analysis should be made of the reasons certain businesses acquire patronage. In a particular business one may plan to draw trade by making needed goods available, especially popular goods and exclusive brands. He should determine the potential demand for his product and study his competition. Perhaps he plans to offer unusual value in terms of price. Here he must consider the factors of buying at low prices and operating at low cost in order to be successful. The offer of services of repair or maintenance may be the drawing point, however, but he must know whether there is a need for such special services and whether he will have a sufficient volume of business to support them. Unusual customer services may help a business to attract patronage, but what the customers prefer and what they will be willing to pay for must be considered.

The amount of out-of-town consumer buying and the reasons people travel to shop should be studied. Capturing this out-of-town trade might be the justification of a business. In a study made at the University of Arkansas School of Business Administration many reasons were given by Fayetteville women for making purchases out of town. However, these reasons can all be classified into four groups, only the first of which is shown with subdivisions in Table 5.

TABLE 5 [1]

REASONS FOR BUYING OUT OF TOWN

Reason Given	*Times Mentioned*
Merchandise not available in local stores	20
Better selection in larger city stores	19
Other advantages of larger stores	3
Total due to advantages of large city	52
Total due to price and quality advantages	57
Total due to accidental circumstances (on trips, etc.)	27
Total due to miscellaneous reasons	3

A few years ago a survey was conducted in Oregon to determine from consumers why they purchased out of town. The chief reasons given were: [2]

- A belief in lower prices
- A better assortment of merchandise
- Stronger appealing out-of-town newspaper advertisements
- More and better service
- More liberal credit terms
- Nationally advertised goods
- More attractive stores
- Greater dependability and promptness
- Friendships
- More courteous sales people
- Newer goods
- Shopping incidentally while on business or seeking pleasure

Both surveys show a belief in lower prices, a better assortment of merchandise, and the general appeal of shopping in the larger city to be the chief reasons for out-of-town buying.

Seeking Justification for a Unique Idea

From a virtually infinite number of sources individuals secure ideas for a new business, including from deliberate search for business opportunities as discussed in our third group. Some people are abundantly endowed with imagination. They

[1] Kelley, Pearce C., "Buying Habits of Fayetteville Women." *Arkansas Business Bulletin,* The School of Business Administration, University of Arkansas, January 9, 1933, Vol. 1, Supplement, page 4.

[2] Comish, N. H., *Small Scale Retailing,* page 143. Portland, Oregon: Binfords and Mort, 1946.

have one idea after another for new enterprises they think should be started. There is no limit to the novelty, variety, or range of soundness of these ideas, from radio-controlled baby carriages to noiseless soup consuming gadgets. Some may be practical from a technical standpoint but impractical either in terms of use value or cost-price relationships. So long as the enterprise is merely in the dream stage and not yet a business possibility, it is beyond our concern here. This field belongs to inventors, not to businessmen. Many ideas are based on known facts and may seem practical until put to the test of justification: Does it promise a sufficient volume of business at a high enough price and low enough cost to yield a profit?

There are two broad groups of ideas in need of justification: those for a radically new business, and those representing a new combination or adaptation of businesses already in existence. Examples of the former might be based on some new discovery or invention; one of the latter is a recently announced restaurant in New York City that combines service in order of arrival with entertainment and advertising. As soon as a customer takes a seat a number is automatically lighted showing the order in which he is to be served, and simultaneously an individual, commercially sponsored moving picture starts its showing for his exclusive attention.[3]

Usually it will be easier to justify the need for a new project based on a combination of two existing types of business or an adaptation of some kind now operating than for one based on a radically new idea. If average business judgment is used in selecting types of business to combine, or adaptations to be offered are decided upon only after an analysis of customer needs, the chances for success are good. Of course, as before, the test of volume, costs, and price must still be met in every case. This situation may be summarized for the prospective businessman under the following five headings:

[3] Committee on Consumer Relations in Advertising, "Lunch Counter Patrons Watch Ads on Screen." *Consumer News Digest*, October, 1947, page 7.

1. He can offer a new service to the community.
2. He can offer a new line of goods to the community.
3. He can offer a new service with an established line of goods.
4. He can offer a new line of goods with established services.
5. He can offer a new line of goods and new kind of service. One approach is to test the proposed business in the light of known consumer motivation.

What the public wants

The study of buying motives may well be considered as vital to the establishment of a business. Certainly if the people in the community in which the concern is to be established have no particular motivation for buying certain goods, or, if those motives or their relative strengths are unknown, selling, displaying, and advertising efforts will be wasted.

People want many things, and nearly everyone wants the same things, although in varying degrees, to satisfy his needs of living. The presence of many individuals with similar preferences in the same community makes it a good or a poor market for specific goods and services.

Buying motives, as generally listed, include the following satisfactions that people seek, thus determining their needs, which usually can be met with business offerings of goods or services:

Comfort—the desire for physical or mental ease and well-being.
Convenience—the desire for a minimum of effort, for saving of time and energy.
Security—the desire to know that the future is predetermined with their welfare assured.
Prestige—recognition of the individual as personally outstanding or a member of a desirable group.
Health—the desire to look and feel physically fit.
Economy—the desire to secure full value for each penny spent, to save money.

There are many other reasons why people buy things, including the desire to gain and hold the affections of others, the desire to belong to the crowd, the desire for recreation and amusement, and so on. The six that have been listed, however, will serve as a guide for our discussion of buying motives as influencing the justification of a business within any community or market.

Groups and communities differ. Certainly a traditionally low-paid group would respond to any offering stressing *economy;* they might forego the *convenience* and *comfort* of certain services to achieve this *economy.* Others will buy exotic and otherwise unusual goods to secure *prestige,* which may be more important to them than *economy.* These preferences will differ among people of different incomes and ages and sexes. If the good or the service contemplated offers *health* or *security* with *economy* as well, then the prospective operator will find ample business volume in communities containing many older people living on limited incomes.

Market analysis

A second method of judging the value of a new idea, especially when representing an adaptation or combination of existing products or services, is to make a market analysis.

Market analysis is not a practice limited to large organizations. The businessman contemplating the establishment of a small concern also has a job of market analysis to do. To him, this job of analyzing his potentials is vital, whether (1) as to what a given community wants so that he can offer the right thing, or (2) as to which community wants the thing or service he is capable of offering.

Such analytical procedure is customary in large businesses, where it prevents many misplaced stores and shops and plants. The thousands of dollars spent for this purpose are considered good investments. The lack of such precautionary measures is one important reason for small business failures. When we consider the fact that the "little fellow" often loses all of his

resources, when the larger firm would lose only a fraction, the importance to small business of preliminary studies is more fully realized.

The absence in small business of adequate studies concerning consumer needs, location, sales appeals, and similar factors is doubtless due to (1) the lack of trained specialists among small operators, (2) the lack of funds and time for adequate programs of research, and (3) the small operator's impatience and stubbornness that are natural corollaries of his economic independence.

With particular reference to the third item, it is unfortunate that the beginner in business on his own is inclined frequently to choose the business *he likes,* and the goods or production methods or standards of service *he likes,* and the location *he likes* without enough objective thinking in terms of what the *customer likes and wants and is willing to buy.* In fact, it is the objectivity or impersonal, "cold" business thinking, the result of serious deliberation, which is the strength of big business; the lack of the same element is one of the greatest weaknesses of most small businesses, where the individual's preferences and enthusiasm may jeopardize his otherwise sound business judgment.

Market analysis is not necessarily complex. It is essentially logical. There are many variations of a basic pattern or procedure, but in general they will follow a scientific approach involving steps such as the following:

1. State the problem or question clearly.
2. Get the facts; insist on adequate information.
3. Organize and study the facts as secured.
4. Develop possible actions; review pros and cons for each.
5. Select the best procedure, and start using it. Adjust as required.
6. Observe progress alertly and adjust as necessary.
7. Use results.

The problem of market analysis for the manufacturer of a set product for which he seeks a market will be different from that of the producer who seeks to find out what the public

wants in design and performance and then makes his product accordingly. The procedure, however, will be similar in both cases.

Let us assume that a manufacturer has available various types of woodworking machinery with which he could, given designs and plans, make any one of many wooden items—even items with which he is not now familiar. He has previously turned out toys, but demand for them is slackening; he fears he may have to stop making them altogether. His question is one of finding employment for his machinery and manpower. He will not want to change the equipment or the people involved, but he can choose his materials and his product. The problem thus is to choose the product, under the conditions described.

Getting the facts

He goes about getting information with a series of questions such as:

1. Is there any product I have previously made for which there is now a demand?
2. What requests for goods that I could make have I had recently?
3. What items now made of other materials might be made either better or cheaper of wood?
4. What items are my competitors making and selling?
5. For what items that I can make are stores and wholesalers being asked?
6. Is there any other material that can be handled like wood, which I might use to make new items?
7. What are the actual facts as to why my old product is not selling as it did?

To get the facts he wants with which to answer these questions, he consults: (1) his own records, (2) retail buyers, (3) wholesale buyers, (4) trade journals, (5) trade associations, and (6) users of various products.

Organizing the facts for study

After the various facts are organized, and eliminations of irrelevant and uninteresting findings have been made, he notes these results of his study:

1. He has had requests for:
   a. Other kinds of toys.
   b. Improvements in toys he has made.
   c. Toys of other materials.
   d. Miscellaneous kitchen items.
2. The toys he has been making are too bulky and heavy.
3. The sides of many of the toys he has made have split.
4. A new kind of wallboard is replacing wood in kitchen equipment.
5. One manufacturer is making toys of a kind of cardboard that is lighter than wood, but is not sturdy enough.
6. Retail and wholesale buyers could sell his wooden toys if they were lighter and sturdier.
7. He has many friends and a good reputation in the toy field.
8. His status-of-sale and discount arrangements are not so good as those of his competitors.

Reviewing the possibilities

After studying the findings of his records, interviews, questionnaires, and correspondence, he finds that the following possibilities present themselves:

1. He can start making kitchenware instead of toys.
2. He can make kitchenware to supplement his toy business.
3. He can make a new kind of toy, of wallboard.
4. He can make the same toys, with improvements as required.
5. He can sell his goods on terms to meet competition.

Reviewing each possibility for making the best use of his facilities and his employees and its effect on his customers and his profits, he decides to improve his regular line, add a few new toys, and adjust his terms. He builds his business plans accordingly. He feels that since he knows the toy business,

has an established reputation in it, and knows the people to whom he sells, he had better not try the kitchenware. He adjusts his terms to meet competition and starts out on his new program. Now, as always, his trouble is that toys are seasonal. Soon, however, he finds that he can make and sell a beach toy of wallboard and tin that will give him a summer business. He also discovers an export possibility through the U. S. Department of Commerce.

Trying out the plans

After six months he has settled down to routine business, with a year-round program that keeps his plant busy. One final adjustment is to contract for two years' full production of his major item, the entire output to be sold to a large mail order chain. This transaction will give him broad distribution, does not cost him much to sell, and assures steady production and income for a long period. Contact with the buyer for this mail order chain came about in the course of his inquiries about his product and prospects.

Surveying Business Opportunities

This is one of the most intriguing of our three situations, especially for the younger prospective businessman. Even though he has made a tentative selection of a kind of business to enter, the survey approach may prove valuable either as a test of his present idea or in suggesting more promising alternatives.

To discover an opportunity for starting a new business, seven methods of approach are suggested. You may think of others, but these will serve to illustrate the process.

1. Start with what you are prepared or equipped to offer. What can you do with your preparation and equipment? Who wants the products or services you could offer? In what form? Where? When? How? At what price and volume?

2. Analyze expansion trends of a community, suburb, and industry. Study communities in different stages of development, such as larger cities and smaller towns. What businesses exist in the cities that the town will soon need? Compare classified sections of the telephone directories or business directories. Make personal observations. The same approach can be made by comparing communities in different sections of the country.

A study of the community might reveal particular enterprises that are needed. Perhaps there is no sporting goods store in the town and the population is sufficient to support one. Or a particular service may be needed. Find out why people go out of the community to have certain services performed. Perhaps what is needed is improvement of existing business establishments. Furthermore, a study of existing businesses in the community might suggest a new business that would dovetail with them—perhaps a small manufacturing industry making products local businesses have to import.

One of the most significant trends affecting modern business is that of population moving to the suburbs. The result is that new and active shopping centers have been growing up on the outskirts of the big towns. Even smaller cities are finding it desirable to plan for a more decentralized growth, with new neighborhoods being developed as "semi-self-contained" entities each served to a considerable degree by its own community shopping and service center. It may be important for a prospective businessman to watch developments of large-scale housing projects. These will create new business opportunities, but will also cancel some of the present ones. Another trend to watch is the establishment of roadside stores, not only those that sell produce but marketers of home furnishings, appliances, auto accessories, and other types of merchandise.[4]

A further study of industries in the community may lead to

[4] Margolius, Sidney, *A Fresh Start—Plain Facts About Small Business*, page 47. New York: The Beechhurst Press, 1946.

other ideas for a small business. The use of waste products or by-products of other industries offers many opportunities in the manufacturing field. Examples of products using waste materials are Celotex, made from sugar cane stalks, and pressed wood, made from sawdust. In a lumbering area opportunities may exist to use bark or other parts of trees considered waste. In a citrus fruit area the peelings of fruit might be made into a profitable product. Certain plastics can be made from waste or by-products.

The use of local products or raw materials in industry is becoming increasingly important. In an agricultural region find out who is processing the commodities that local farmers grow. If this processing is not done locally, find out why. A few small business opportunities in an agricultural region might include frozen food packaging, the packaging of produce by means other than refrigeration, or dehydration of foods. In a predominantly forested region there might be opportunities in the chemical treatment of wood, in charcoal and wood distillates, in pulp mills and paper mills, in toys, in handicrafts, or in Christmas greens. Plywood fabrication is another industry upon which there has been much emphasis because of prefabricated housing and new uses of such wood in product manufacturing.

In an agricultural area there may be a need for custom built farm equipment, for a parts and service agency for farm machinery, for apiarists', dairymen's, and poultrymen's supplies, or for rental and operation of farm machinery. In an industrial region opportunities may exist in the operation of small shops for custom welding, in custom built shop equipment, in research laboratories for industrial use, in machine tool service and repair, or in materials, parts, or containers for the local industries.

New outlets for manufacturers or wholesalers may be needed in a particular area. It might be well to contact the maker of a new product, with a good future, having few outlets at the

present. Wholesalers are a good source of information regarding needed outlets in their trading area.

3. Analyze each market: children, newlyweds, home seekers, businessmen, professional men, single women, home owners, bachelors, students, working women, older people. The presence of these and many similar groups in every community constitutes markets within the market. Consider how the occupation or other characteristics of the group may give rise to the need for special goods and services. A large majority of working girls might welcome a personal shopping, meal planning, housekeeping, or similar service.

Jobs related to family or personal living that are of necessity neglected perhaps will provide opportunities in the service field. Reminder services for appointments, birthdays, anniversaries, and similar occasions; or labor-saving services, such as paying the family's monthly bills and yard or house maintenance, would be examples. Services to professional men might include coöperative buying of supplies; office layout counsel; specialized employment service; secretarial or accounting, tax, and social security service; or servicing, renting, and repairing recreational equipment. Supervision of recreation, speech correction by experts, care of children with transportation provided, and bicycle and scooter rental services, are but a few services that can be made attractive to mothers of small children.

The small businessman might get in touch with retailers, wholesalers, manufacturers, and institutions to see what products they have to import. He could find out why these products are not manufactured locally. After a definite need in the community for your type of business has been established, the population trend and major type of industry in the community should be considered. Preference should be given to a growing town that has stable industries.

4. Find out the dislikes, complaints, problems, jobs that are avoided, and so forth for each class of businessmen and

for other groups like housewives and professional women, with reference to goods and services available to them in the community. If consumer buying habit surveys are available, these may suggest consumer complaints to be investigated further.

5. Study the existing products, merchandise, assortments, stores, service establishments, and other business offerings for possible improvements or combinations that would make for greater convenience, comfort, utility, or other desirable factors. Opportunities may exist even though people are not complaining and may not even have thought of some improvement.

6. Observe people's habits of living: leisure time activities, hobbies, amusements, recreation, modes of transportation, methods for care of the home and business premises, group meetings, and the like, with an eye to possible business opportunities. Is a catering service, or box lunch or packaged picnic outfit supply needed? Naturally these are only illustrative suggestions.

Why not put idle equipment into use? Occasionally owners of partially used, high-cost equipment will help set up an individual in a separate business. Or leased departments or concessions may be obtained in retail stores or markets.

Hobbies have often led to ideas for a small business. A photography shop might be needed in a community, or a small machine shop specializing in custom made tools or miniature locomotives might be profitable. In a tourist region opportunities may exist to retail local handicrafts, or to provide especially good cabin developments and eating places. Appeals to special tastes may lead to ideas for small business.

Otto F. Reiss offers a numbers of methods of developing new ideas. He says, "Why not ask yourself why a thing is the way it is today—why not change it by making it larger or smaller or by changing its shape?" [5] He suggests taking a cue

[5] Reiss, Otto F., *How to Develop Profitable Ideas.* New York: Prentice-Hall, Inc., 1945.

from the past and adding a new twist to a product or service. Or the combination of two things might lead to a profitable idea. Study emotions and habits of people. Many want to own useful things, and a study of public facilities like those at municipal parks that could be furnished to people as their own might lead to a good opportunity. The discovery of unuttered desires and the satisfaction of them has proven itself to be a profitable idea.

7. Capitalize on some trend by getting in on the ground floor. Demand is dynamic, always changing. Certain periods of our economic history have seen the rise of entirely new industries—several of major importance, such as the automobile, radio, and aviation. Many more have been of lesser importance, sometimes fairly short-lived, but have provided opportunities for small business to expand while enjoying the higher profits of the early years. For some years following World War II many such new industries developed.

To carry out some of the foregoing suggestions may necessitate keeping an idea file, considerable clipping of news items on new developments, visiting and talking with people, doing a little "snooping" and note taking, or other procedures such as these. It may take time and lead to several false starts before the big idea is discovered. But it should be fun and good training, and will provide a waiting period while you accumulate adequate finances and make connections of considerable future value. Remember, test each idea by the standards of justification—volume, costs, and profits—as well as by those of Chapter VI, "Financing and Organizing the Business," before making your final decision.

Conclusions

The objective of all business is to give the public what it wants, at a profit. Everyone generally wants the same things. Buying motives thus are well established. Different people like

different things to different degrees, however, and in many cases competition already has taken care of certain needs.

The newcomer's concern is with the unfulfilled needs as related to what he wants to offer and is able to offer at a profit. His procedure in testing an idea for a business must equal, in the detail of analysis, that of his big business rivals and contemporaries. The approach consists merely of getting the facts, studying them, making a decision, alertly following it up and changing it as required.

This procedure is the salvation of the beginner, for the lack of it represents the greatest weakness of all small business; with it, the other advantages claimed by the large-scale operators are easily offset by the human elements of personality and personal service so characteristic of the little fellow. Whenever possible, check results arrived at by one method against those derived from a different and independent procedure.

Review and Discussion Questions

1. Distinguish carefully between justifying and appraising a business. Show any interrelationships.

2. Study the seven ways used to survey opportunities for a new business and see if you can suggest additional different, yet practical, methods.

3. How would you expect justifying a business to be related to financing and organizing a business?

4. Which is more important for most prospective small businessmen, appraising or justifying a business? Discuss.

5. Suggest some idea for an entirely new business and apply the pertinent sections of this chapter to justify it or to reject the idea.

6. Select one of the seven methods of surveying business opportunities and try it out until you have uncovered at least one idea that meets the test of justification.

7. Analyze the test of justification given in this chapter and show certain ways in which it is unsatisfactory. Then suggest a better test.

8. Discuss the proper division between justification and establishing the business policies.

9. Cite examples from business history where the founder would have had difficulty in justifying the new business at the time. Discuss.

10. Show how some of the guides and methods useful in appraising a business for possible purchase would be useful in justifying a proposed new business.

11. Give several examples of how the inherent characteristics of *small* business would preclude the justification of certain types of business ideas. Discuss.

12. Make a market analysis in preparation for establishing a candy store in your community. A small radio station. A house cleaning and maintenance service.

13. How can a small businessman with limited capital make a consumer survey?

14. From Department of Commerce publications, or other sources, select some new product or idea for a business not already established in your community. Discuss it with several businessmen, then describe what else you would do before concluding that the possible new business is, or is not, justifiable. Be specific in all cases.

15. If there is a suburban shopping center in your home town, find what types of stores and shops are included in this center. Is there a demand for another type of store or shop? Talk to the owners of the various businesses on their opinions as to whether another kind of store or shop is needed. Discuss your findings and draw your own conclusions.

16. What types of stores are generally included in a suburban shopping center? Are there major differences in the types of stores in centers patronized by: low income groups? middle income groups? high income groups? Explain.

17. What is meant by "cold" business thinking as applied in the text? To what extent should it be avoided by the small businessman?

18. Visit a local retailer and find in which of the three income groups his store has the greatest percentage of customers. Discuss

your findings, and from observation decide how his store could be made to appeal to another group. Should it?

19. Compile a list of all waste materials in your community that might possibly serve as the basis of new enterprises. For any that seem promising investigate the future supply and possible uses. Report your findings and recommendations.

Chapter VI

FINANCING AND ORGANIZING THE BUSINESS

Before any business is actually started the amount of capital needed should be determined as accurately as possible and the form of organization—individual proprietorship, partnership, or corporation—decided upon. Financial needs and the form of organization to use are subjects so intimately related that they will be considered together.

Many topics discussed in this chapter, such as rent, turnover and other ratios, discounts, location, management, and credit and other policies, are treated more extensively elsewhere in the book. Whether financing and organization should be considered this early in the over-all treatment of the small business or deferred until the end, after all other aspects have been considered, is debatable. Certainly a prospective small businessman should postpone final decision regarding both financing and organizing until he is thoroughly familiar with all the subjects discussed in this text.

Capital and profits

Capital as we are using the term means command over purchasing power, the total of owned and borrowed funds plus credit accepted. Thus for a business that requires beginning capital of $15,000 the owner may have $8,000, secure a bank loan of $4,000, and obtain goods worth $3,000 on credit from suppliers, equipment dealers, and others. Often it is not necessary to borrow the full amount at once, but a line of credit equal to the maximum amount required should be established to be used as needed. Usually the owner's equity should be

about two-thirds of the total capital required, but this is an arbitrary and somewhat conservative rule.

Capital must be regarded as a business tool requiring skill in its use. Those who have no capital of their own must borrow it and pay a fee in the form of interest. When a businessman considers the use of capital, he bears in mind: *first*, that its use should yield, with his efforts, an income or profit; *second*, that if it is not actually borrowed but is granted in credit instead, he must expect to pay a fee accordingly; *third*, that the interest rate will increase as decreasing collateral or assurance of success increases the lender's risk; *fourth*, that whether or not his venture is profitable, the use of funds, even his own, is a business expense; and *fifth*, that if the capital is his own, someone else would have paid him for its use if he had not used it himself.

Insufficient capital with which to start is one of the most important factors leading to failure in small business. Some beginners lack cash reserves to meet unexpected expenses during the first year. Others do not plan all their expenses carefully and find their capital gone before they have adequately set up their business. Still others go out of business partly because they are unable to take advantage of cash, quantity, and other discounts.[1]

All money invested in a business, whether in fixtures, equipment, stock, or expenses, is expected to result in a profit. Careful management by the owner-operator should make this capital in the small business yield a higher rate of return than could be obtained from investment in government or corporate securities having a guaranteed rate of interest.

Capital and its uses

Fixed capital is money invested in the following:

[1] For further study see Industrial (Small Business) Series No. 19, U. S. Department of Commerce, *Establishing and Operating Your Own Business*, pages 11–14. Washington: U. S. Government Printing Office, 1945.

1. Land and buildings
2. Machinery and/or equipment
3. Fixtures

Working capital is invested in items of this type:

1. Stocked fuel, supplies
2. Materials or merchandise
3. Wages
4. Rent
5. Advertising and sales promotion
6. Living expenses (for the beginner)

Intermediate capital is money invested in goods in process. The relative requirements of fixed and working capital will vary. The retail store's ratio of working capital to total assets will differ from that of the service business, and that of a factory will be still different.

In determining capital needs the small businessman must allow for a reasonable period, usually from three to six months, before income from the business will cover regular monthly expenses, and he must include in his estimated needs a minimum salary or drawing account sufficient to provide for his living expenses. A budget should be prepared even before the final decision to start the business is made. Great care should be exercised to include all expenses and needs for capital, including taxes and other less obvious requirements.

Determining the amount of funds required for starting any business is difficult because many contingent factors usually surround the beginner. The man's specific business experience, his market contacts, the community's needs, and the amount of pioneering necessary all affect financial requirements. Whereas one man who goes into an undeveloped trading area with little experience and limited contacts may require a certain amount of capital, the experienced operator may "know the ropes" well enough to start profitably on half as much.

Capital Requirements for the Small Merchandising Business

In the following discussion of capital needs it will be assumed that the land and building are rented rather than purchased and constructed. Not only is this true for most beginning small businesses, but it is recommended practice in the vast majority of cases.

"The smaller the capital, the greater the risk"—this might well be the axiom of small business. Certainly it applies to retailing or wholesaling on a small scale. The man who begins on a small personal investment with limited backing is working against many obstacles, including these:

1. Because he will be unable to afford employees, he must run the store alone. His duties will include all store work, everything from sweeping out to keeping the store's records. This means long hours, little opportunity to leave the store, and calamity if he becomes ill.
2. Because he will be operating against stiff competition, customer credit may be a problem that requires careful handling. The added capital required for a credit business may deprive him of funds needed to pay for new goods or for goods already bought on credit.
3. The small store cannot afford to invest much in fixtures, for this money is kept out of essential working capital. Five hundred dollars spent for an unnecessary showcase represents so much money that could otherwise be invested and reinvested in goods, time after time, for profit.
4. The rental agreement should include provision for the landlord to do remodeling when needed, because the small operator's need for capital is so great that none of it can be spared for misuse as fixed capital in improvements if the landlord can be made to provide them. It is better to pay a small amount more per month for rent.
5. The average beginner will be so short of capital during the first few months or even for the first year or more that he

will need very lenient terms from his creditors, especially suppliers. These represent a part of his provisions for working capital, because for all practical purposes he is borrowing this money from them. He will be fortunate, indeed, if he can secure long-term credit without heavy interest penalties.

Assume that the entrepreneur has some personal funds, some good experience working for someone else, and the desire to avoid much experimental and groundbreaking work before his business can become established and profitable. In the case of a store, he might go about setting up his financial needs in this way:

Question:	*Answer:*	
1. How much income does he wish to be making when the business is established?	1. Assume $4,000	
2. At the percentage rate of net profit common in this business, what volume must he "do"?	2. @ 8 per cent..$50,000	
3. At the common rate of turnover in this business, what stock must he carry?	3. @ 4 times.....$12,500	
4. At the common rate of margin, what will this opening stock of merchandise cost him?	4. @ 30 per cent.	$ 8,750
5. How much will he require as a maximum in store fixtures and equipment?	5. (Estimate)	$ 5,000
6. How much should he set aside for pre-opening expenses such as advertising and miscellaneous essential but unanticipated expenses?	6. (Estimate)	$ 1,500
7. For what contingencies should he set aside added funds? How much?	7. Peak merchandise needs ..... $1,250 Cash funds, reserve for personal and business emergencies 1,000	
		$17,500

Added to these requirements and calling for several thousand more dollars would be rent, wages, and other current expenses for at least one turnover period—in this case, three months. Enough cash should be on hand or readily available to pay these unavoidable operating expenses, leaving a maximum of working capital for stock adjustment and replacement. In this case these items might call for the following amounts:

Rent	three months	@	$200	$600
Wages	" "	@	250	750
Advertising	" "	@	50	150
Miscellaneous expense	" "	@	100	300
				$1,800

This example assumes that a particular kind of store is under consideration. The standard operating ratios used are those typical of the field of limited-price variety goods.[2]

A different approach to determining capital needs proceeds on the assumption that only a limited number of appropriate sites will be available to the beginner who would like to open a particular kind of store. Each site may be had at a fixed annual rental. Since this is the only known fact, the first step is to calculate the necessary annual sales, using the standard operating rent ratio for the line of business selected. If further investigation shows this volume to be a reasonable possibility and to offer a satisfactory prospective income, the determination of capital needs is carried out in a manner similar to that described in the previous example.[3]

A retail store's greatest investment is usually in its merchandise. The stock of a retail store or wholesale house will frequently represent many times greater an investment than its fixtures and sometimes more than its building space. Complete lines of many kinds of goods call for a substantial invest-

[2] Appendix B shows a work sheet prepared by the U. S. Department of Commerce for estimating initial capital requirements for a shoe store. Similar work sheets are available for other kinds of small business.

[3] For further study see Hahn, Lew, *How to Start a Small Store.* New York: National Retail Dry Goods Association, 1945.

ment. However, daily cash receipts from customers permit circulating capital to flow back into the business constantly with no long delays. Granting credit delays this flow to the extent of the credit terms, requiring further funds for investment in goods sold but not paid for.

Wages and other overhead items do not represent an investment of so large a proportion as in most manufacturing trades. In manufacturing the goods are made and their form is changed as they are fashioned or processed; in merchandising they are merely stored and handled as they are sold.

Capital requirements vary widely according to the kind of merchandise handled, price zone or income group of customers, managerial ability and trade connections of the merchant, location of the store, economic conditions and the general price level, time required to establish the business on a self-supporting basis, attitude of the enterpriser toward risk-taking, and many other factors in particular cases. Some lines of retailing, such as newsstands and gift and art shops, may be established with very small initial capital. Others, such as building materials and hardware, automotive, and shoe stores usually require relatively heavy initial capital. Within one line of merchandise the initial capital required for the elaborate fixtures, expensive location, liberal customer services, and other requirements needed to attract the fastidious upper class trade may easily result in initial capital requirements far in excess of those considered satisfactory for less exacting lower income customers.

Economic conditions and price levels existing at different times within the past few decades have caused initial retail capital under otherwise similar conditions to vary by over 200 per cent from the lowest to the highest. In view of conditions such as these, it is obviously impossible to present an example of initial capital requirement in dollars that would be accurate as a standard for any individual situation. However, the procedure for determining capital needs, operating expense and

merchandise ratios used in the computations, acceptable distribution of initial investment, and similar factors remain fairly constant for each line of business regardless of variations in conditions such as those just mentioned. It would be difficult to overemphasize the point that *it is the method and ratios used, not the dollar results* given in the examples that are the *only* important considerations.

The specific capital requirements must be determined for each new enterprise according to the guides and qualifications offered in this chapter. In the following example the most reliable guides available and the advice of competent authorities in the field have been utilized. The results have been carefully checked with the latest reliable survey reports. A conservative attitude toward distribution of initial equity capital has been taken; this results in slightly larger inventory investment (current assets) than surveys show to be representative of recently established stores in this line. Also, somewhat larger reserves are suggested than might be necessary in individual cases. A general merchandise store operating under approximately average conditions has been selected because of the widespread interest in this kind of store and the availability of recent data and authoritative opinions regarding this line of business.[4]

Assume an enterpriser with experience and trade connections has approximately $10,000 to invest in his business and a suitable location and store building available at an annual rental of $1,200 with a satisfactory lease and renewal option. After consulting his prospective wholesaler, equipment manufacturers, local banker, and business friends as well as published sources of data in the field, his resulting estimates might be like the following:

[4] For further study see: "The Financing of New Trade Enterprises." Prepared and copyrighted by Dun & Bradstreet, Inc., from data of the Office of Business Economics, U. S. Department of Commerce, 1949; and Miller, Nelson A., *Establishing and Operating a Variety and General Merchandise Store*, pages 57–61. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 35, 1946.

Potential sales during beginning years: $30,000 annually, or $2,500 monthly; rent is therefore consistent with the four per cent ratio in the field. At a merchandise turnover of three times a year, average inventory would be $10,000 at retail or approximately $6,800 at cost, assuming a gross margin ratio of 32 per cent. His major wholesaler suggests a balance beginning inventory that could be purchased for $6,000, leaving $800 reserve or open to buy for reorders and to adjust stocks to current demand once the store is in operation. Merchandise could be reordered and received on an average of twice a month and regular 30-day credit terms would be available. Thus the desired average inventory once purchased could be maintained from current sales and trade credit. It would also be consistent with an acceptable standard of approximately 65 per cent of total investment in inventory.

Fixtures and equipment may be purchased for $2,500, payable one-fourth down and the balance in 18 equal monthly instalments, carrying charges included in the initial price. This amount is likewise consistent with recommended practice of spending from 20 to 30 per cent of initial investment on fixed assets. Total operating expenses at the standard ratio of 25 per cent would be $625 a month. Thus the gross margin of $800 would cover monthly expenses of $625, instalments on equipment of $105, and a balance of $70 over and above the proprietor's drawing account of $200. Deducting $20 reserve for taxes would leave $50 surplus for reinvestment in the business during the first 18 months and $165 per month after that.

Distribution of initial investment may be summarized as follows:

Beginning inventory at cost (open to buy: $800)	$6,000
Down payment on fixtures and equipment	625
License, insurance, and opening expenses (estimate)	300
Operating expenses, one month	625

Reserves:		
Merchandise reorders	$800	
Expenses, two months	1250	
Cash	400	2,450
Total initial investment		$10,000

Use of operating ratios

Although operating ratios have been developed for most established fields of business, they are probably used most extensively in retailing. These are averages or standards calculated from the experience of thousands of businessmen in the same field. They are useful to the beginner in determining his capital requirements for different items of expense, in estimating sales necessary to justify some fixed expense like rent, and as guides in operating the business once it is established. The beginning businessman should familiarize himself with the standard operating ratios in his particular field.[5]

Capital Requirements for the Small Factory

The approach to financing a small factory, which differs somewhat from the approach to financing a store, must be based on potential earning power, for unlike the retail store it seldom has reclaimable assets in the form of merchandise. For this reason the enterpriser's funds and those he may borrow are subject to a greater hazard. Money paid out for labor, overhead, and partly processed materials cannot be recovered readily in case of default or other difficulty. In this connection three things are generally true of a manufacturing business:

1. Real worth—that is, market value or desirability from an

[5] For further study see, in addition to Chapter XVI: Mitchell, Walter L., Jr., *Standard Ratios for Retailing.* New York: Dun & Bradstreet, Inc., 1940; Comish, N. H., "Retail Store Operating Results as Guides for Small Merchants." *Journal of Marketing,* July, 1946, Vol. XI, No. 1, pages 62–63; Cotton, Anne Dienstl, "How Prospective Retailers Can Use Operating Ratios." *Domestic Commerce,* October, 1946, Vol. 34, No. 10, pages 22–25.

investment viewpoint—will depend almost entirely on its earnings, actual or potential. Obviously it cannot depend on its assets as collateral, for used machines, expended labor, and half-processed materials have little market value. Many raw materials have little value because of transportation costs and limited markets.

2. First capital, therefore, will necessarily come from those who have created the business and who may expect to participate in its earnings. The general public is hesitant about investing in an unknown quantity. Only after the project has proved successful will they seek to "get in on a good thing."

3. The length of time required for processing will be a large factor in determining working capital requirements. This fact is of greatest importance when the business is first started, growing less vital as sales become frequent and cash income becomes regular and dependable.

The factory's financing

The man who would set up a manufacturing establishment might use the following procedure in determining his financial needs:

1. How much income must he have to make this venture worth-while?	1. Assume $4,000
2. At the percentage rate of net profit possible in this business, what volume must he "do"?	2. @ 8 per cent, $50,000
3. How many pieces or units must he produce to net $4,000?	3. If the piece sells @ 25¢, @ 2¢ (8 per cent) net profit per piece, 200,000 units.
4. How many machines will it take to produce 200,000 units in the course of a year?	4. 4 machines @ $1,500–$6,000 2 " @ 750– 1,500 4 " @ 500– 2,000 2 " @ 250– 500
5. How much of a supply of materials will be required, assuming turnover of four?	5. Enough for 50,000 units—with supplies.... 2,000

6.	How much will wages be for one complete turn of 50,000 units?	6. Three months for eight men 4,500
7.	How much rental for three months?	7. (Estimated) 200
8.	How much for sales expense?	8. (Estimated) 1,000
9.	How much for office expense?	9. (Estimated) 300
10.	How much should be set aside for unexpected incidentals?	10. 1,000
11.	How much for personal expenses?	11. 1,000
		$20,000

The difference, it will be observed, between the expenditures for this manufacturing business and those of the limited-price variety store previously described is that the major item of the former is equipment that will take depreciation over ten years, whereas the store's major investment is in goods to be sold within three months. Obviously the financial requirements of the two are similar; yet to the potential creditor there might be a great difference in preference, depending on the nature of the goods compared with the machines or with the proposed product. Such considerations are typical of those that interest creditors, whether they be suppliers, bankers, or other sources of financial assistance.

As a rule a factory will have a large portion of its capital invested in fixed items such as land, buildings, and machinery. Raw materials are frequently a minor investment item, there being a fast and constant turnover. The major investment of this circulating capital may be in labor and carrying charges on materials during long periods of processing; as the length of time required for processing increases, the need for funds for working capital is expanded. It is necessary to know how long operations will take to begin to show a profit and how much capital should be allowed to meet wages, depreciation, inventory, the owner's salary, and the like up to that time. Pro-

visions should be made to have the necessary working capital to carry operations along in many cases for at least six to twelve months to cover all contingencies until the business is established. A boat builder, for example, building only a few large boats each year, would tie up considerable funds in labor, materials, and overhead before he could sell and receive payment for his product.

The advantages and disadvantages of buying instead of renting the plant or equipment should be considered.

In establishing a small manufacturing business one can either pay cash for the initial stock of materials, parts, and supplies or seek to establish credit immediately. Credit obtained for these items will greatly reduce the initial working capital needed. A small manufacturer should consider whether it would be cheaper to manufacture his own components, considering cost of equipment, space, capital tied up, and so forth, or to buy all parts and merely assemble them. Purchase of components may reduce fixed and working capital requirements. A well-established plant may be able to sell him parts for assembly at a lower cost than he can produce them.

The kinds of insurance needed for a particular business—fire, other disaster, public liability, workmen's compensation, use and occupancy, comprehensive coverage, and so forth—and how much each will cost should be considered.[6]

Differences in the capital requirements of small factories can be illustrated by examples of a factory with small capital needs and one with average capital needs in comparison to its volume of business.

Small-scale candymaking is a manufacturing industry in which the initial capital requirements are modest. An investment of several hundred dollars might provide sufficient equip-

[6] *One Hundred Questions to Be Considered in Establishing a Small Manufacturing Business.* Prepared by Manufacturing Management Section, Management Service Division, Office of Small Business. Washington: U. S. Department of Commerce, June, 1946.

ment to meet the needs of a beginner in a one-man candy shop. Dealers in used equipment for candymaking indicate that as little as $250 would be enough to cover the cost of equipment for making simple types of candy. A minimum outlay along these lines would include an expenditure of about $60 for two used kettles, $40 for heating equipment, $40 for trays, $60 or $75 for a marble cooling slab, and $50 to $100 for utensils and small items. A beginner in the candymaking business might do better to confine his operations to his own home kitchen, where he may have less than a hundred dollars invested in equipment, materials, and packaging supplies, rather than risk and lose capital in a venture in which he discovers his own lack of qualifications too late. Such an arrangement might not only save him from unwise investment but actually net him higher profits than he would make by attempting to establish a larger concern with greater capital requirements and higher overhead. He could thus experiment with various types of candy, increase his skill, and even put aside money to invest later in a shop designed according to carefully considered plans.[7]

A small sawmill will require more initial capital than a candymaking enterprise but less than some other businesses. The following example is intended to illustrate important factors to consider rather than to suggest the actual dollar amount of capital that would be required. It is assumed that the owner has secured the necessary experience and trade contacts, will do some of the work in the mill as well as selling, and will be content to live on the modest drawing account provided. It is further assumed that lumber will be air-dried for three months and then sold for cash. Wages, cost of logs, and other items will vary in different parts of the country; these figures are used for illustrative purposes only and should be adjusted to local conditions:

[7] Dudik, G. F., *Establishing and Operating a Confectionary-Tobacco Store*, page 38. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 48, 1946.

Cost of logs—3,000 board feet a day at $20 per thousand for 78 working days in three months	$4,680
Cost of sawmill and slab saw (secondhand)	300
Cost of power unit for mill (secondhand)	200
Tools and miscellaneous	125
Gasoline and oil for power for 78 working days	200
Payroll—3 men at $6 each per day for 78 days	1,404
Owner's drawing account for three months	600
Cash reserve	500
Overhead:	
Compensation insurance (minimum policy in advance)	150
Unemployment insurance (3 per cent on payroll, payable quarterly)	15
Social security (1 per cent on payroll, payable quarterly)	42
Total capital necessary before starting in business	$8,216

The greatest expense is the cost of logs for three months before there is any income from the sale of lumber. In the case of a bank loan for part of the capital, the bank will insist that the mill take out fire insurance. No clerical expense has been included on the assumption that some member of the family will donate his time to the business while it is getting started. Whether an allowance for trucking expense on lumber sold should be included will depend on the location of buyers and terms upon which sales are made.[8]

Capital Requirements for the Service Establishment

The problems of financing the service business will depend on which characteristics predominate—those of the merchandising or those of the manufacturing business. To the extent that it carries goods for resale it will call for funds with which to buy them; to the extent that it sells labor or machine work it will require capital for equipment and wages in much the same manner as a factory.

These considerations may be observed: (1) The fact that most service businesses are operated on a cash basis reduces

[8] Muller, J. L., *Establishing and Operating a Small Sawmill Business*, pages 24–25. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 20, 1945.

their capital requirements. (2) Because the average service business renders its service in a comparatively short period of time, no great amount of capital may be required for investment in labor and overhead between the time the job is brought in and the time it is called for. (3) A service business, because it may depend on machine operation, may justify larger expenditures in equipment to save expensive manpower. A machine that will save one man's work may cost considerably less than what that man's wages would be over a relatively short period of time.

The usual type of service business shares features of both store and factory. The launderer, dry cleaner, or repairman has little or no capital invested in goods, since the objects he works on are the property of his customers. His service is to process his customer's goods while in his hands. His building, machinery, and fixtures call for fixed capital. Procedures for estimating operating expenses, length of time for which these should be provided for from initial capital, license and tax requirements, and cash reserve will be similar to those described for retailing and manufacturing and need not be repeated in the following examples.

For a bookkeeping service a minimum of investment in furniture, equipment, and supplies is advisable. Later on, after the accountant has become established, he can acquire a typewriter, adding machine, filing cabinets, and other equipment, and he can rent and furnish an office out of accumulated and current earnings. It is possible to start operations from his own home or to rent desk space in an office for as little as $10 a month. Announcements, business cards, stationery, envelopes, and a few other miscellaneous supplies may be all that is needed in the way of organization expenses.

The accountant will need some capital in the very beginning, however, because he cannot expect to get a sufficient income from his practice for some time. Typically, an accountant does not have any clients when he first establishes his office. He should therefore have enough money in the bank to pay his

living expenses for at least six months. Before starting he should make a budget of capital requirements. He should list each item of organization expenses; make a careful estimate of his operating expenses; and, most important of all, budget necessary living expenses for at least six months. Of course, this budget will vary with each person, depending on such factors as the amount he is accustomed to spending, his location, and how many clients he has in the beginning. The total amount might be $500 for one individual and $1,000 for another.[9]

A trucking business has average capital requirements. One of the most common trucking services in most localities is drayage. This includes general hauling for various types of businesses and the pickup and delivery of freight. If a man has between $2,000 and $3,000 in addition to the equity he holds in his truck, he should be able to establish a small trucking business successfully. It will be necessary to have a garage for the truck and equipment for the office. Operating expenses will include such items as repairs, drivers' and helpers' wages, gasoline and other fuel, lubricating oil, traffic needs, advertising, insurance, office salaries and expenses, depreciation, taxes, licenses, and rent of property. It is desirable for the operator to carry a small supply of replacement parts, especially those that can be installed without taking the truck to a repair shop. The trucker should have a sufficiently large supply of tires to enable him to match tires properly on his truck. In purchasing office supplies he must determine what stationery will be used and what forms will be ordered to report requests for trucking service and what service has been performed.

To a large extent truck operators can protect themselves against the financial impact of highway accidents by means of insurance. At the present time all but five states require truck operators to carry from $5,000 to $10,000 for public liability and

[9] Sevin, Charles H., *Establishing and Operating a Bookkeeping Service*, pages 8–9. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 41, 1946.

from $1,000 to $5,000 for property damage. Local operating requirements, where they exist, usually amount to the payment of license fees.[10]

Summary of Variations in Capital Requirements

A summary of reasons for low and high capital requirements of small business in the retail, manufacturing, and service fields is listed in the following table:

Low Capital Requirements	*High Capital Requirements*
Retail	
1. Low initial investment in merchandise.	1. Heavy investments in merchandise for complete stock.
2. Low rental district.	2. High rental district (shopping area).
3. No credit extended—or very little.	3. Full credit privileges.
4. Little newspaper advertising.	4. Extensive newspaper advertising.
5. No customer services such as delivery.	5. Extensive customer services.
6. Small investment in fixtures and equipment.	6. Heavy investment in fixtures and equipment.
Manufacturing	
1. Small initial investment in machinery and equipment.	1. Heavy initial investment in machinery and equipment.
2. Unskilled labor—low labor costs.	2. Highly skilled labor — high labor costs.
3. Low cost materials.	3. High cost materials.
4. Little office work.	4. Much record keeping and other office work entailing trained office employees and much office equipment.
5. Low insurance coverage.	5. High insurance.
Service	
1. Small initial investment in machinery and equipment.	1. Heavy initial investment in machinery and equipment.
2. Low rental district.	2. High rental district.
3. No delivery to customers.	3. Delivery to customers.
4. Small investment in materials and supplies.	4. Heavy investment in materials and supplies.

[10] Nelson, J. C., *Establishing and Operating a Trucking Business*, pages 13, 18. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 52, 1946.

In all three fields the length of time required to secure sales in sufficient volume to meet normal expenses will influence capital requirements. A business that is radically different may take longer for pioneer work than a new business unit in a familiar field.

Sources of Funds

Once the question as to the amount of capital required to launch the enterprise is answered, the next question concerns its source. Before discussing the sources of funds it is desirable to consider financial needs and certain types of financing because of the bearing each of these has on the sources from which funds are obtained. Three types of financial needs exist: those for initial capital, for working capital once the firm is in operation, and for expansion. Initial capital includes that necessary to get the business started and enough to keep it going until returns from operations provide sufficient funds to meet normal recurring expenses. That is, initial capital includes the beginning operating or working capital. As the volume of business increases, as it ordinarily does during the early months of operation, the amount of working capital needed tends to increase until the normal level of operations is reached. Whether this additional capital is provided for initially, is obtained from profits, or is obtained from other sources depends upon the conditions in each enterprise. Fluctuating demands for working capital, such as those resulting from peak seasons of operation, are usually met by short-term borrowing from commercial banks. In most cases capital for expansion in the small business comes from profits retained from previous operations, although these may be supplemented by funds obtained from other sources. No such simple statements can be made regarding how the other financial needs of small businessmen are met.

Two types of capital are recognized, equity and borrowed. Equity capital is that invested in the business with no legal

obligation to return the principal or to pay interest upon it. It is ownership capital, although in the small family-sponsored enterprise the ownership aspect is often relinquished or donated by the contributor (frequently a parent or close relative of the proprietor) to the beginning entrepreneur. Borrowed capital implies the obligation to return the principal together with some interest or other compensation for the use of the funds. In the small business this distinction between equity and borrowed capital is often blurred. Investigators have found that loans made to beginning businessmen by relatives or close friends sometimes resemble investment in the enterprise. No definite time for repayment is set; interest charges are deferred until some indefinite future date when the business can afford such payments. In most cases, however, borrowed funds used to supplement initial owner-equity capital, even when obtained from relatives and friends, are secured with the intention that both principal and interest will eventually be repaid.[11]

Closely resembling the two types of capital just discussed are the methods of financing. Three methods may be distinguished: equity financing, long-term borrowing, and short-term borrowing. A fourth method sometimes included, trade financing, is probably better considered in connection with the sources of funds.

The sources of capital for small businesses may be divided into five groups:

1. The owner and his associates, including his family and friends, who may or may not become partners or shareholders in the venture.
2. Partners and shareholders of a corporation.
3. Representatives of banks or other established lending institutions whose business includes making loans to business organizations.

[11] Litterer, Oscar F., *Where Does Small Business Obtain Its Capital?* Minneapolis, Minnesota: Federal Reserve Bank, December, 1948.

4. Members of the trade, including suppliers of materials, such as manufacturers and wholesalers; and, in some instances, customers who prepay their contracts.

5. Miscellaneous, including other businesses, local capitalists, securities markets, community pools or groups, and various governmental agencies.

It is easier to list the common sources than it is to assess the importance of each in providing funds for small business. Most of the publications dealing with the financial problems and needs of the independent enterpriser treat the subject in general terms and furnish little if any factual data. The following discussion is based on recent surveys that, although limited in scope, probably represent the most detailed and accurate picture available of financing beginning small businesses.

Data on the sources of initial capital and form of organization used were obtained from 44 commerce graduates of the University of Mississippi who had entered business for themselves during a period of over 20 years prior to 1949. In some cases new businesses were started; in others the respondents entered going concerns. Ten provided all the initial capital from their own funds. Five of these started in business as proprietors, four entered or formed partnerships, and one entered a corporation. The distribution of the remaining entrepreneurs according to the proportion of initial capital provided from their own funds was as follows: one furnished 80 per cent, three from 51 to 75 per cent, ten from 26 to 50 per cent, thirteen from 10 to 25 per cent, and seven had no initial capital of their own. The distribution of these individuals according to capital contributions, form of organization, and sources of funds used is presented in Table 6. Banks were used most frequently, seven times for proprietorships and three times for partnerships. Although relatives and friends were used four times each for proprietorships and partnerships, they

TABLE 6[12]

SOURCES OF INITIAL CAPITAL AND FORMS OF ORGANIZATION USED BY MISSISSIPPI ENTREPRENEURS

Per Cent of Initial Capital Furnished by Enterpriser	Distribution by Form of Organization and Sources Used for Remainder of Initial Capital								
	Proprietorship			*Partnership*			*Corporation*		
	No.	Source of Funds	%	No.	Source of Funds	%	No.	Source of Funds	%
80	1	Relatives	20						
51–75	1	Banks	25	1	Partners	30			
				1	Friends	33⅓			
26–50	2	Banks	60	3	Partners	50	1	Stockholders	50
	1	Banks	50	2	Partners	66⅔			
				1	Banks	60			
10–25	1	Relatives	50	1	Partners	80	1	Stockholders	90
		Banks	40	1	Partners	75	1	Stockholders	75
	1	Relatives	50	1	Partners	25	1	Stockholders	50
		Banks	25		Banks	50		Relatives	25
	1	Relatives	25	1	Partners	11			
		Banks	50		Banks	27			
	1	Banks	90		Suppliers	36			
	1	Suppliers	90		Relatives and Friends	15			
				1	Relatives	75			
None				4	Relatives	100			
				3	Partners	100			

[12] Compiled from Kelley, Pearce C., *What Commerce Majors Do After Graduation.* Special Studies Series, Bureau of Business Research, University of Mississippi, University, Mississippi, 1949.

contributed larger proportions of beginning capital in the case of partnerships.[13]

A study based on personal interviews with top executives of 122 small firms located in the Ninth Federal Reserve district was conducted during 1948. Well-established as well as new firms were selected, with greater stress placed on the latter. Ten concerns had been in business less than one year. Forms of organization included 29 individual proprietorships, 40 partnerships, 49 corporations, and 4 coöperatives. By major fields of small business the survey included 65 manufacturing concerns, 38 retail, 13 wholesale, and 6 service establishments. The large number of manufacturing firms was considered necessary because initial financing of such organizations was found to be more complex than in the other fields. The study dealt mainly with sources used to secure the initial capital either to start a new business or to buy out a going concern.

The survey showed that 73 per cent of the beginning enterprisers provided some of the initial capital from their own funds. In 19 per cent of the cases relatives and close friends contributed to original equity capital but generally in limited amounts. Local capitalists and other businesses were used by concerns that needed relatively large amounts of initial capital. In the retail field the majority of beginning proprietors had some capital of their own, although relatives and friends contributed a larger proportion of total initial capital than did the proprietors themselves. In part this was accounted for by the fact that many wealthy farmers set their sons and daughters up in businesses of their own. Wholesale concerns were financed mainly by individuals who had made their money in the lumber industry. Relatives and friends were unimportant as a source of funds. The security markets were found to be insignificant as far as financing small business is concerned.

In the aggregate, initial capital of $5,400,000 was made up as

[13] Kelley, Pearce C., *What Commerce Majors Do After Graduation.* Special Studies Series, Bureau of Business Research, University of Mississippi, University, Mississippi, 1949.

follows: 93 per cent equity financing, 5.3 per cent long-term borrowing, and 1.7 per cent short-term borrowing. Slightly over 50 per cent of the long-term loans were secured from banks, the remainder coming mainly from relatives, friends, and equipment suppliers. Over 50 per cent of the short-term loans were secured from commercial banks and a small amount from finance companies. Trade credit was used to finance inventories. The primary source of equity capital was personal savings; that for expansion came mainly from reinvested profits. Local capital pools were not significant as a source of capital for small enterprises.[14]

A third study was based on 1,000 new retail and wholesale concerns started between 1945 and 1947. All firms included were completely new; no "buy-outs" were included. Also, no one-man concerns were included in the survey. Data on sources and distribution of initial capital were analyzed and presented by Dun & Bradstreet from information obtained by the Office of Business Economics, U. S. Department of Commerce. It was found that average initial investments of $9,500 in retailing and $22,000 in wholesaling were about double the prewar level. The smaller the enterprise, the greater was the proportion of initial capital invested in equipment and the smaller the proportion in inventories. Smaller concerns secured a higher rate of capital turnover than did the larger firms.

Only three per cent of the firms used loans guaranteed by the Veterans Administration for initial capital. Personal savings constituted the major source of funds. One-fourth secured bank loans amounting to an average of 12 per cent of initial capital, or $3,900.[15] The major findings of this study are presented in Table 7.

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[14] Litterer, Oscar F., *Where Does Small Business Obtain Its Capital?* Minneapolis, Minnesota: Federal Reserve Bank, December, 1948.

[15] "The Financing of New Trade Enterprises." Prepared and copyrighted by Dun & Bradstreet, Inc., from data of the Office of Business Economics, U. S. Department of Commerce, 1949.

TABLE 7 [16]

SOURCES AND DISTRIBUTION OF INITIAL CAPITAL OF NEW RETAIL AND WHOLESALE CONCERNS

Sources of Funds	% Retail	% Wholesale
Personal Savings	56.1	38.1
Bank Loans	14.1	9.8
Suppliers	10.1 (60 days)	18.2
Capital Stock	7.1	21.9
Mortgage Loans	2.0	0.5
Others	10.6	11.5
Distribution of Funds	**Retail**	**Wholesale**
Inventories	28.8	41.4
Equity	27.2	12.4
Plant	22.7	14.1
Others	21.3	32.1

Borrowing from friends and relatives

Traditionally beginning businessmen have gone to relatives and friends for financial assistance. In most cases they have done so because of close personal ties rather than because these sources had large surplus funds. Although this approach is considered poor business practice and is often based on erroneous assumptions, it may be necessary in many cases. Business and family or social relationships should not be mixed if the most desirable results are to be obtained.

Business is necessarily somewhat impersonal. For the operator who would be independent, relatives and friends are poor sources of funds because of their very intimacy. Securing funds from intimates builds a highly personal financial relationship that conflicts with both independence and business. The businessman whose backing requires him to weigh personal considerations constantly is in a weak position when he makes decisions for the business itself. Furthermore, these financial

[16] Compiled from "The Financing of New Trade Enterprises." Prepared and copyrighted by Dun & Bradstreet, Inc., from data of the Office of Business Economics, U. S. Department of Commerce, 1949.

associates frequently feel called upon to assert their proprietary interests by offering advice or even by insisting that certain business actions be taken, and their recommendations may not be in harmony with the wishes and objectives of the proprietor.

The tendency of beginners to go to relatives and other close associates for financial backing is frequently based on a sense of inferiority that causes the beginner to fear asking a banker or supplier for the same help. He seems to feel that only someone who knows him will have enough confidence in him or be a good enough friend of his to do him the favor of lending him funds.

These are erroneous assumptions. A *business* loan should be a *business* transaction, not a favor. One's friends and relatives may be more easily convinced of the possibilities involved, but they are seldom in a position to pass sound business judgment. The evaluation given the proposed enterprise by a business organization will be based on expert knowledge and experience and will be constructive and therefore valuable to the beginner. In the lending institution's efforts to place its trust wisely the new operator will find assistance in properly planning and soundly establishing his enterprise.

In spite of the objections to securing funds from relatives and friends, these sources may be the only ones available to the beginning small businessman, especially for equity capital and long-term loans. Once the business is established, it should not be necessary to resort to these sources for short-term financing.

Financing through partnership or incorporation

Sometimes forming a partnership or even a closed corporation is one way of securing financial aid from close acquaintances. A partnership is the association of two or more individuals who pool their capital for the purpose of operating a business. All partners may invest money only, but one or more usually becomes active in running the business.

Forming either a partnership or a corporation provides the opportunity of getting funds from more people and may result

in securing enough capital to start the business properly. In the small business the chief difference between securing equity capital from friends or relatives and forming a partnership or corporation for this purpose is that in the latter case persons providing the funds become co-owners and share in any profits the business may make. Securing adequate equity capital may be difficult no matter what method is used. Forming a partnership or a corporation has the added advantage of making it possible to associate with others who have more experience. The main disadvantage is that a small concern frequently does not have enough business at first to support more than one owner. Because of the liability that may result, it is always essential to know the background of prospective partners thoroughly. Forms of organization are discussed in greater detail later in the chapter.

Financing through lending institutions

Commercial banks represent the main type of lending agency used by small businessmen for borrowed capital.[17] They receive money from individuals and businesses for deposit in savings and checking accounts. These funds are then invested in government bonds or loaned to companies or individuals for productive purposes. Some banks have consumer loan departments and many more make small loans to consumers in a manner similar to business loans. Actually a great many small loans made to individuals as personal loans are used for small business financing. The bank's first responsibility is to protect the safety of depositors' funds entrusted to its care. Of almost equivalent importance are the bank's functions of financing and facilitating business activities. Through a complex and closely regulated system commercial banks may expand or

[17] For a discussion of cases involving the problems and costs (to the banks) of financing small business see Rosa, Robert V., "Small Business Problems Indicated by the Industrial Loan Experience of the Federal Reserve Bank of New York." *Journal of Finance,* April, 1947, Vol. 2, No. 1, pages 91–100.

contract credit and thus regulate the amount of commercial capital available.

Many banks belong to the Federal Reserve System; others are chartered and regulated by the individual states. Some have affiliations with banks in other communities and may be able to arrange loans for enterprisers that the local bank itself is not in a position to handle.

Commercial banks are a primary source for loan rather than equity capital. Although short-term loans for less than a year predominate, many banks make long-term loans ranging from one to ten years with an average maturity of about five years. These term loans, four-fifths of which are secured by collateral, constitute one of the best ways for the small businessman to supplement his equity capital if he is not among the fortunate few who have interested relatives or friends willing to contribute with "no strings attached."

Bank loans are of two major types, character (or unsecured) and collateral—that is, secured by certain assets having a value well in excess of the amount of the loan. Although character loans tend to be for shorter periods and smaller amounts than collateral loans, so much depends upon the individual borrower that exceptions to this generalization are easy to find. A person with proved managerial ability, an excellent reputation, and a good business proposition may receive a character loan for several thousand dollars on a long-term favorable interest basis in the same bank where another, less well-known individual is obliged at the same time to put up collateral worth $500 to secure a short-term loan of $200 at the bank's maximum rate of interest. A recent survey of small business loans found this element of managerial ability to be a dominant factor in financing through bank loans.[18]

Banks also make special types of loans, one of which is the instalment loan, ranging in amount from $100 to $3,000 or more. Most instalment loans are repayable monthly, with a

[18] Litterer, Oscar F., *Where Does Small Business Obtain Its Capital?* Minneapolis, Minnnesota: Federal Reserve Bank, December, 1948.

maturity of one year or less. Another variety is loans secured by accounts receivable, which may be on a notification or non-notification basis. On the former the bank notifies the borrower's accounts and undertakes to collect from them. On the latter the borrower's customers may never know their accounts were assigned unless they fail to make payment as agreed. In such a case the bank is likely to notify the delinquent debtor and to assist in making collection. A third variety of loan is one secured by warehouse or field warehouse stocks. These are common for manufacturers and for some dealers in furniture and heavy equipment. A fourth type is the equipment loan, which may often be obtained on more favorable terms from the local bank than from the equipment manufacturer or supplier. And finally, mortgage loans are sometimes made on the basis of either chattel mortgages or personal or business property or real estate mortgages, which may in turn be real estate owned by the business unit or by the individual enterpriser apart from his business.

The following standards are considered important by bankers when making loans to small businessmen:

1. The character of the applicant; he should be an excellent moral risk.
2. The managerial ability of the applicant.
3. The productive nature of the loan, as evidenced by the past record for an established business or the banker's appraisal of profit prospects for a new venture.
4. The collateral offered to insure repayment in case the expected profits do not materialize or to protect the lender whenever the borrower's reputation has not been well established.

In making decisions regarding loan applications, the banker needs reliable facts. Usually the balance sheet and profit and loss statement will be requested for a going concern or, in the case of a new venture, a prospectus stating estimated sales,

expenses, and anticipated profits. The use to which funds obtained will be put is always an important consideration.[19]

Since collateral is so often required to obtain bank loans, the small businessman should understand the nature of assets considered to be good collateral. These are usually "quick assets," or property that can be converted readily into its money value. Other things that the enterpriser often pays good money for may be poor collateral for bank loans. Among these would be items such as the following:

1. Specially made machines, equipment, fixtures, or built-in construction not salable to others in the same or similar trades. Examples: canning, wrapping, labeling, or processing machines; store or restaurant fixtures built to fit particular spaces; wall decorations and floor designs.

2. Stationery, signs, wrapping paper, souvenirs, or other items carrying the name of the concern for which they were purchased and therefore salable to others at only a fraction of their cost, if at all.

3. Style merchandise or other goods likely to become outmoded; supplies or materials used in a declining industry or to meet a passing need. Examples: cast-iron items that are being replaced by aluminum; kerosene lamps and equipment; makeshift or temporary substitutes.

4. Partly finished products, such as mechanical parts and materials intended for particular assemblies, and even completed assemblies for which a market has ceased to exist. Examples: metal parts made to specifications for one buyer; automobile foot accelerators after they have become standard equipment on all cars.

Borrowed capital may be essential for many small businessmen to enter or continue in business. In other cases it might be the best way to increase profits. It should be considered as

[19] For further study see Francis, Gerald M., *The Small Businessman and His Bank*. Washington: U. S. Department of Commerce, Economic (Small Business) Series No. 64, 1947.

another factor of production to be used when and in the amount needed. There are generally accepted guides in each line of business as to the proper ratio of long- and short-term loans to owner equity and other standards. The beginner may secure advice on these ratios for his business from his banker, accountant, or trade association. There appear to be no well-established guides to the proper cost of borrowed capital. Costs vary widely and in most cases tend to be high and even excessive for the small business. By comparison with other costs, however, they may appear unimportant and are frequently not given serious consideration by the small enterpriser. This condition can often be improved if the small businessman will select his banker carefully and work closely with him. The U. S. Department of Commerce offers the following advice on this topic:

1. Choose a banker who possesses character and leadership—one who is willing to assume a risk, providing there is a reasonable assurance of repayment.
2. Choose a progressive banker—one who is alert to current industrial trends, willing to make loans for new products and more efficient processes. Such a banker knows that, in the world of rapid change, risk is a matter of careful analysis, not merely of traditional soundness.
3. Choose a banker who is interested in your line of business. Some bankers tend to specialize in certain types of businesses and may not be especially interested in your line.
4. Choose a banker who stresses an attitude of friendliness to small business.
5. Choose a banker who has confidence in the future of your community and thus is willing to invest in it.
6. Choose a bank quoting reasonable rates.[20]

A prospective new businessman should select a reputable local bank and establish a business or checking account. He

[20] Dockeray, James C., *The Small-Business Man and Sources of Loans,* pages 6–7. Washington: U. S. Department of Commerce, Economic (Small Business) Series No. 69, 1948.

should talk to a bank official and discuss his new business, telling the bank official why he expects to be successful. It is up to the businessman to build up his credit reputation by keeping a balance ample to cover the bank's minimum requirements and by handling deposits and withdrawals carefully. A personal checking account in the bank will help. If he keeps above the minimum requirements and puts a regular amount in a savings account, the banker will assume that he i a better credit risk than an individual who does not do thes things. It is important to have a line of credit with the banl even before it is needed.

In many communities there are industrial banks and small loan, personal finance, or consumer finance companies. Such agencies usually make loans of $300 or less on the basis of cosigner notes or other dependable security. Although the cost and trouble associated with such loans may be greater than that for loans from commercial banks, in certain cases it may be desirable to secure loans from these institutions.

There are many additional lending agencies available to the small enterpriser, such as commercial credit companies that make loans on manufacturers' or wholesalers' accounts receivable, sales finance companies that specialize in buying dealers' instalment account paper at a discount, and others for special types of loans.[21]

Trade financing

Trade financing is essentially a method of buying materials, merchandise, or equipment on credit. Equipment manufacturers and dealers know that the average small businessman is not financially able to pay cash for expensive installations and may have difficulty in securing local bank loans for this purpose. All major companies have financing plans to stimulate the sale of their equipment. Usually a down payment of from 20 to 30

[21] For further study see Dockeray, James C., *The Small-Business Man and Sources of Loans*, pages 16–18. Washington: U. S. Department of Commerce, Economic (Small Business) Series No. 69, 1948.

per cent is required with the remainder to be paid in monthly instalments over a period of one to two years or more. The seller is adequately protected by a chattel mortgage, conditional sales contract, or similar device, and carrying charges, although often not disclosed separately, tend to be fairly high. Although efficient modern equipment in many cases is a good investment even if purchased at fairly high credit costs, the tendency of many beginning enterprisers to overspend in this way and to commit themselves to relatively heavy fixed monthly payments warrants advice against careless use of this type of equity financing.

Credit from resources for the purchase of materials, merchandise, and supplies is the most common and most widely used type of financing in the small enterprise. It often provides a major part of the small businessman's working capital needs, especially in the retail fields. The beginner should exercise judgment in selecting his resources and not be influenced unduly by liberal credit terms. Overacceptance of credit from resources is often a factor in business failures. Careless buying may so involve the organization that further credit becomes impossible, required goods cannot be obtained, assortments become inadequate, volume is lost, and the business "starves." The wise business operator is careful of his credit and his stocks, and the wise supplier is cautious in his selling, but many instances are on record where both are shown to have become neglectful and careless, having taken too much for granted for too long.

Miscellaneous sources of funds

It is sometimes possible for an enterpriser to find other businesses that would profit by financing his venture. This may happen when a manufacturer is seeking a dealer outlet in a certain town; when a chain store, mail order house, or large manufacturer wants a particular article produced that the small businessman could manufacture; and when the established industries in a community feel the need for a new enterprise,

such as a specialized repair shop or other type of facilitating industry. Many small businesses have been started in one of these ways.

In recent years several communities have established funds or pools to help finance industries seeking locations, but most of these have been unavailable to the beginning small business. Certain exceptions to this include Louisville, Kentucky; Gary, Indiana; and the Mississippi BAWI (Balance Agriculture With Industry) plan. The last-named has helped small businesses by enabling local communities to issue bonds for financing the enterprise and by furnishing technical advisory services to the small enterpriser. The Gary Foundation record is reported in Chapter VII. Some financial assistance has been given by a few of these community and state organizations to assist local industries to carry out expansion programs.

Three agencies of the federal government have aided in financing some small businesses: Veterans Administration, Reconstruction Finance Corporation, and Federal Housing Administration. Actual loans to small enterprisers are made by established lending institutions and repayment insured or guaranteed by the government agency concerned. Loans guaranteed by the Veterans Administration have been overpublicized as "GI" Loans. Those guaranteed by the R. F. C. appear to have been of greater relative importance and probably have enabled several small businesses to secure financial assistance that would not otherwise have been obtained at reasonable rates. Although in theory this type of financing appears to be a boon to small businessmen, experience so far shows it to be relatively unimportant. The fact that the maximum rate of interest that may be charged on guaranteed loans is lower than usual rates may be a possible explanation.[22]

The emphasis in this chapter has been on providing adequate capital for a new small business. Specific figures mentioned

[22] For further study see Dockeray, James C., *The Small-Business Man and Sources of Loans*, pages 21–24. Washington: U. S. Department of Commerce, Economic (Small Business) Series No. 69, 1948.

have, of course, been for purposes of illustration and might be quite different in years with a different price level or under other conditions, although percentage distribution and operating ratios will be fairly constant. "Lag" items are an important exception to this generalization, especially during periods of pronounced changes in the level of retail prices. For example, rent could decrease from five to four per cent of sales with an increase of 25 per cent in the retail price level.

Although the analytical procedure presented is the sound approach to be recommended in a vast majority of cases, another viewpoint that deserves mention permits starting a business with less capital than the minimum usually considered necessary for success. There are a few businessmen, including several successful small businessmen, who believe it is all right to start in business when one has the idea, desire, and opportunity, even with less capital than the estimated minimum. They admit the going will be hard but claim the experience will be worth the effort and the limited funds available will be used much more carefully than if the business were adequately financed. They further observe that if one keeps waiting for a safe margin of finances his opportunities may be lost or other conditions may later prevent him from starting on his own. They cite many examples of successful businesses that were grossly undercapitalized at the start.

The authors hold no brief for or against this viewpoint except to admit a measure of truth for each of the claims. Certainly overcapitalization is not to be recommended. Also, it is probably better in rare cases to be opportunistic and, if it is "now or never," to make the plunge. But at least one should do so with his eyes wide open and be willing to accept the greater risks and harder work required.

As mentioned earlier, a partnership or corporation may be formed primarily to secure additional capital that may be needed. In the case of the partnership an additional objective may be to secure the knowledge or experience of the partner taken in, and a corporation has certain advantages in limiting

the liability of the owners. Often management aid is needed by the small businessman as badly as additional capital. For these reasons forms of organization are discussed next.

Selecting the Form of Organization

In deciding what form of organization to adopt, several aspects should be considered. Since each has both advantages and limitations, a good plan is to weigh these in the light of one's needs and objectives. At least the following aspects deserve consideration: (1) A need for additional funds may sometimes be met better by forming a partnership or corporation than by borrowing or using mercantile credit. However, either of the forms of organization means sharing profits as well as risks and losses. (2) A need for certain managerial abilities or experience may be met by taking in one or more partners possessing the requisite qualities. An alternate method of securing these benefits without sharing ownership would be to affiliate with a voluntary chain or similar organization in the retail and service fields. In either case the additional abilities are secured at the expense of sharing authority and placing some restrictions upon one's "independence." (3) The choice of organization form to use may be influenced by the desire to achieve such objectives as limiting liability, distributing the risks involved, and taking advantage of the tax structure in operation at the time and place where the business is to be started. Federal and state income tax laws may make one form of organization superior to others for the small businessman; profits from a corporation, for example, may be taxed doubly, once as corporate profits and again as individual income, whereas the proprietorship or partnership may be exempt from this double taxation. Sometimes one form of organization is given advantages by particular laws or regulations such as those limiting the power of a corporation to engage in certain activities open to the proprietorship or partnership.

All these points should be considered before deciding on the

best form of organization to use, although the final decision will probably be a compromise based upon weighing the relative importance of certain needs against the limitations of each suitable form of organization. The person in business must be familiar with these pros and cons for his own welfare and protection in order to take full advantage of his rights and at the same time avoid undesirable consequences due to his ignorance of his exact status. For these reasons it may be desirable to review these three types of organization.

The single proprietorship

The simplest way to go into business is to rent space, buy goods and equipment, and start working. Except where federal, state, or local licenses or permits are required, only that is necessary for the single proprietorship. This form of organization has numerous advantages:

1. Organization entails no formality.
2. Owner has perfect freedom of operation. When business decisions are made or moves taken, it is not necessary to get the consent of anyone else in the organization.
3. All profits are the property of the owner and need not be shared with anyone else.
4. The proprietor's income is not subject to social security deductions and taxes.
5. Earnings may be retained in the business for its improvement and expansion.
6. Business losses are deductible from personal income when federal income tax is determined.
7. As compared with the partnership:
   (a) Liability is limited to the owner's errors or obligations.
   (b) There is no danger of loss resulting from the death or withdrawal of a partner.
8. As compared with the corporation:
   (a) No double tax when profits are distributed.

(b) No excess profits tax.
(c) No capital stock tax.
(d) No corporate reports or inspections.
(e) No restrictions on the nature of business.
(f) No penalty for retaining earnings in the business.

There are, however, certain disadvantages in the one-owner type of organization:

1. The many abilities required for successful business operation (selling, bookkeeping, production methods, administration, and so forth) are seldom all possessed by one person.
2. Limited personal assets do not encourage lenders and cannot always provide the required capital to meet unusual needs.
3. In case of business failure the owner's personal assets, including home, automobile, and other properties, are subject to claim by creditors.

The partnership

Certain conditions accrue when a partnership is formed, some favorable and some definitely undesirable. Arguments in favor of the partnership include the following:

1. "Two heads are better than one." Two viewpoints, although they clash, may result in a very desirable compromise.
2. Personal abilities are complemented. The salesman and the bookkeeper, with different personalities and abilities, may succeed together when neither could alone.
3. Added capital is made available by combining the assets of two or more partners and less borrowing is necessary.
4. Business losses are deductible from the personal income of each partner for income tax purposes.
5. As compared with the corporation:
   (a) There are no excess profits taxes, no state taxes, no capital stock tax, and no double tax on dividends.
   (b) Income may be divided through "family partner-

ship" or on bases other than investment, such as talents or time spent in this business.

(c) Partners' "salary" is not subject to payroll taxes.

(d) No penalty results from retaining earnings in the business.

Among the disadvantages of the partnership are:

1. Each partner is liable for all debts incurred by the business.

2. Each partner is responsible for the action of all other partners that creates an obligation for the business.

3. The partnership is automatically dissolved by the death or voluntary withdrawal of a partner.

4. Profits must be shared among the partners.

The corporation

The corporation is a legal form of organization made possible by state laws that govern the provisions under which its charter, or authorization to operate as a business entity, is granted. Since the corporation is a creation of the law, it is impersonal and exists without reference to the particular individuals who may share its ownership and direct its activities.

To form a corporation three or more persons file with the Secretary of State or the State Securities Commission an application accompanied by the articles of incorporation. The latter give the essential information concerning the purpose and limitations of the corporation and its name, address, territory of operations, temporary directors or incorporators, address of headquarters, and date of annual meeting. Prior to this, organization plans must be worked out with the assistance of a corporation lawyer. Upon meeting the requirements of the state's corporation law, including the payment of necessary fees, the corporation is issued a corporation charter that brings it into existence.

The corporation is owned by its stockholders, who may number from three to hundreds of thousands. Ownership is

evidenced by shares of stock given in return for capital invested. As a general rule, holders of common stock have one vote for each share of stock owned. They elect the directors, who are responsible for formulating policies, electing officers, and directing the business within the limits of the corporation's charter. The usual corporate officers are: president, vice-president, secretary, and treasurer. In addition the corporation may employ executives and personnel necessary to operate the business. Acts of the corporation's officers, executives, and other employees are acts of the corporation, not of the individuals, provided they do not exceed duly authorized limits. With rare exceptions, the liability of each stockholder is limited to the amount of capital stock subscribed for. If this is paid for in full, no additional liability exists, but any unpaid balance on stock purchased is a liability.

It can be seen from this brief description that the corporation is a powerful device for securing control over large amounts of capital and at the same time limiting the financial liability of each owner. Advantages may be summarized as follows:

1. Legal liability of owners or stockholders for suits for personal injury or other activities connected with operating the business is limited to the amount of funds invested in the business.
2. The corporation is long-lived, being able to continue in existence up to the time limit granted in its charter, whereas the proprietorship ceases with the death of the owner and a partnership with the death of any partner.
3. Capital may be accumulated from many sources: sale of common or preferred stock, loans made by issuing bonds, exchange of assets, and reservation of profits from the business.
4. Ownership in a corporation is easily transferred merely by sale or exchange of stock and entry of the new ownership on the books of the corporation. Permission of other stockholders is not required except in rare cases of separate contractual agreements.

5. Management of the business may be concentrated even though ownership is widespread.

6. A large number of owners may obtain for the corporation a considerable amount of free publicity and good will.

A corporation has certain disadvantages, however:

1. Its activities are limited to those specifically granted in the charter. A firm incorporated to engage in the retail dry goods business could not legally handle groceries or engage in manufacturing unless "catch all" clauses granting almost unlimited scope had been included in the charter.

2. Its geographical area of operations is limited to the state granting its charter until permission is secured from each state in which it desires to operate. This means also that additional license fees must be paid and regulations observed.

3. If active management is employed in lieu of owner-management, the personal interest and incentive associated with ownership are lessened.

4. The corporation must make numerous reports for taxation and other purposes to each state in which it does business.

5. Federal and state regulation of corporations has been increasing for some time.

6. A corporation is subject to more taxes than is the proprietorship or partnership.

7. More paper work for reports and records is necessary, and the amount increases greatly as the corporation grows in size.

8. In the small corporation the advantage of limited liability is often circumvented in the case of business debts by the custom of requiring major stockholders to guarantee or endorse notes due to banks and to major merchandise suppliers.

Conclusions

Although there is no one best way to finance or to organize a business under all conditions, *great care should be exercised in determining capital needs, proper sources from which ad-*

ditional funds are to be secured, and the form of organization that best suits the particular circumstances. Remember that personalities and attitudes as well as character and ability play a large part in determining the success of a partnership.

Review and Discussion Questions

1. List the advantages and disadvantages of securing additional initial capital through: forming a partnership, making bank loans, borrowing from friends, obtaining vendor credit.

2. Is it possible in your state to secure funds from a "silent partner" who takes no active part in running the business? Discuss this plan.

3. Compare the merits and difficulties of securing additional capital for a new business from friends through borrowing and through the sale of stock in a corporation.

4. Why is the method of determining capital needs by starting with a fixed amount for rent, as described in the chapter, more appropriate for a retail store than for a small factory or service business? Show how you could adapt this method to the determination of capital needs for a factory or service business.

5. What are the advantages and limitations of using operating ratios in analyzing capital needs?

6. Select some kind of small business and after consulting businessmen and other sources of information prepare a prospectus of capital requirements to start business.

7. For the same business prepare a tentative financial budget covering the first six months of operation.

8. Locate an established business as nearly like your foregoing example as possible and prepare a budget for it covering the same six calendar months. Discuss your budget with the owner and study any discrepancies he notes.

9. Why is it desirable to put all terms of a partnership agreement in writing?

10. What provisions for possible future expansion should be made in the articles of incorporation? Should these be as broad as possible, or is it better to limit the business to certain fields of activity? Discuss.

11. For a new business in an established field, why is it desirable in calculating capital needs to use operating ratios of other concerns instead of estimates made by yourself and friends?

12. Since standard operating ratios within one line of business vary according to the profitableness of the firms, how would you decide which ratios to use? Discuss.

13. Under what circumstances could you justify a ratio for your prospective business well above the standard in the field for each of the following:

(1) rent or occupancy expense for (a) a retail store, (b) a factory, (c) a service establishment?

(2) total payroll, excluding withdrawals of owners?

(3) bad debt losses for (a) a retail store, (b) a factory?

14. Discuss the thesis that it is a good idea to go into business for yourself when circumstances are right even though your finances are below those considered necessary.

15. Review the sources of funds for small business mentioned in this chapter and suggest and discuss additional sources.

16. Under what conditions would the need for additional abilities be more important in determining the best type of organization than need for additional capital, assuming the latter to be present in any case? Discuss.

17. "The smaller the capital, the greater the risk." Why?

18. Explain the difference between fixed capital, working capital, and intermediate capital.

19. What is meant by "venture capital"? Do you consider it a sound basis for a loan?

20. Consider the advantages and disadvantages given in the text for the single proprietorship, the partnership, and the corporation. Explain fully which of the three forms of organization you think would be most beneficial to you.

21. Which would be better, to discuss forms of organization for the small business in connection with financing or in connection with government regulations and taxes? Discuss.

22. List the factors that go into determining the amount of capital necessary for one to go into business.

Chapter VII

SELECTING THE PROFITABLE LOCATION

In most lines of business good location is a dominant factor governing success or failure. Even if the best location is not essential to success, the better it is, the fewer are the handicaps that must be overcome to achieve profitable operations. Location is the least mobile or adjustable of all factors. Rent or occupancy expense is normally the most fixed of the various overhead expenses; for many small businesses, especially in the retail field, it is also the largest or second largest item of expense.

Location is closely related to business policies and to many of the personal aspects of the small business. Before selecting a location it is desirable to formulate the basic policies or objectives of the business, because of the bearing they will have upon selecting the most profitable place. A small business once located, however, may be obliged, if there is a change in the factors affecting the site, to alter its policies or else move to a new location. Careful selection at the start will reduce the danger of this inconvenience, which usually involves extra expense and probably some loss.

The selection of a location usually involves four steps: (1) selection of the region, (2) selection of the town, (3) selection of the area or section within the town, and (4) selection of the specific site. Of course, certain of these steps may be skipped in particular cases where the small businessman has already decided on a particular town or neighborhood. But even when only one site is under consideration, the procedures for evaluation outlined in this chapter should be helpful in reaching the correct decision.

In selecting the location for a small business, personal factors are of far greater importance than they are for the large concern. Pragmatically they may limit the individual's range of choice to his immediate environment, either because of his lack of knowledge of more distant locations, or because he does not have the necessary time or funds to investigate a wider area. Of much greater importance are the highly personal factors that lead to deliberate choice. Some of these are:

1. A desire to locate among friends and acquaintances. Sometimes the opposite desire, to locate where one is unknown, prevails.
2. A personal preference for one region or part of the country for various subjective reasons.
3. A need to locate in a particular climate because of health.
4. A desire to be near family or relatives.
5. An opportunity to take advantage of established trade connections in a particular territory.
6. The desirability of being able to give personal supervision to other property or interests in which one may have a present or prospective future investment. Often it is the wife's interests, preferences, or connections, like many of those just enumerated, that influence the selection of a region or a particular town in which to locate. The domination of personal factors in determining the location of many small businesses is another way in which the small business field is unique.

Although it is often considered risky to go into business in a particular town solely because one is well known there, sound business reasons often favor such a decision. Credit is easier to obtain where the entrepreneur has already established a good reputation. Friends and acquaintances will give good word-of-mouth publicity, but the beginner should not count too heavily on receiving their patronage *merely* because of friendship. The native's intimate knowledge of the community's people, their buying habits, their likes and dislikes, and other characteristics of trends and developments to be expected in the

near future, and of other useful facts may be an asset that a total stranger would acquire with difficulty.

Towns and cities vary greatly as to desirability of locations for different kinds and sizes of businesses. Ordinarily the small businessman will be faced with either of two basic types of problems: (1) comparing the merits of a number of possible towns or cities within which to locate his particular kind of business, or (2) deciding whether or not a given town is a good place in which to enter one of a few closely related kinds of business. Usually the same selection procedures will be followed in either case.

Selecting the region and town is relatively more important in terms of economic factors for the small factory or wholesale concern than for most retail and service establishments. Conversely, choosing the district and site within a particular town is usually of major importance to the small retail store or shop. Special considerations that are important in each of these four main fields will be discussed later.

In most cases various towns under consideration will be evaluated in terms of economic factors, population, competition, living conditions, and any special location requirements. As an aid in rating the first four considerations a check list such as that shown on pages 176 to 178 may be used. This rating type of check list would be especially useful in the case of retail stores and service establishments. The small businessman should be sufficiently familiar with the specific location requirements for his particular kind of business to rate each item on the list in terms of his needs. The list is merely a guide to use in choosing the one town among several that has the best over-all combination of desirable location factors and the fewest undesirable ones.

In using the check list for rating, the following comments should be helpful. The "industry" or productive resources present in each town are analyzed first in terms of three broad types—farming, manufacturing, or trading. Some cities may be predominantly political centers, and, as such, trade would

CHECK LIST FOR GUIDANCE IN SELECTING A CITY OR TOWN FOR A BUSINESS LOCATION [1]

FACTORS UPON WHICH THE LOCATION IS BEING RATED	RATING			
	1 *Excellent*	2 *Good*	3 *Fair*	4 *Poor*
Indicate your appraisal by check-mark in proper column. Descriptions following numbers in parentheses may serve as a guide in making appraisals.				
Economic considerations:				
Industry (farming – manufacturing–trading)				
Trend—(1) Highly satisfactory (2) growing (3) stationary, or (4) declining				
Permanency—(1) Old and well-established (2) old and reviving (3) new and promising, or (4) recent and uncertain				
Diversification—(1) Many varied (2) many same (3) few varied, or (4) entirely dependent on one industry				
Stability—(1) Constant (2) satisfactory (3) average, or (4) subject to wide fluctuations				
Seasonality—(1) Little or no seasonal change (2) mild seasonal change (3) periodical (every few years) seasonal fluctuations				
Future—(1) most promising, (2) satisfactory, (3) uncertain, or (4) poor outlook				

[1] Trimble, P. C., *Establishing and Operating a Dry Cleaning Business*, pages 29–30. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 33, June, 1946.

CHECK LIST FOR GUIDANCE IN SELECTING A CITY OR TOWN FOR A BUSINESS LOCATION (*Continued*)

FACTORS UPON WHICH THE LOCATION IS BEING RATED	RATING			
	1 *Excellent*	2 *Good*	3 *Fair*	4 *Poor*
Nature of surrounding area—If in a small city this may be important. Is surrounding area prosperous or marginal? Barren or highly productive? (Rate 1, 2, 3, or 4).....				
Population:				
Income distribution—(1) Mostly wealthy (2) well distributed (3) mostly middle incomes (4) poor				
Trend—(1) Growing (2) large and stable (3) small and stable or (4) declining				
Living status—(1) Own home (2) pay substantial rent (3) pay moderate rent, or (4) pay low rent				
Competition:				
Have you canvassed the neighborhood to see how much business activity there is and how it would affect your business?...				
Number of competing plants or stores—(1) few (2) average number (3) many, or (4) too many				
Type of management—(1) Not progressive (2) average (3) above average, or (4) alert and aggressive				
Presence of chains—(1) No chains (2) a few chains (3) average number, or (4) many well-established chains				

CHECK LIST FOR GUIDANCE IN SELECTING A CITY OR TOWN FOR A BUSINESS LOCATION (*Continued*)

FACTORS UPON WHICH THE LOCATION IS BEING RATED	RATING			
	1 *Excellent*	2 *Good*	3 *Fair*	4 *Poor*
Type of competing plants and stores—(1) Unattractive (2) average (3) Are the competitors old and well-established? (4) Are the people going out of the community for goods that they could buy at home? (5) Have other businesses similar to yours failed in that community?				
The town or community as a place to live:				
Character of city—Are homes clean and neat or shabby, rundown, and unpainted? Are lawns, cars, streets and parks neat, modern, and attractive? Are the transportation facilities, professional services, banking facilities, and the like adequate? Are the civic associations aggressive?				
Facilities and climate (rate 1, 2, 3, or 4):				
Schools				
Churches				
Medical and dental services..				
Amusements				
Climate				
Residents—Would they be congenial, your kind of people, etc.? (rate 1, 2, 3, or 4)				

be the major economic activity. Such a city probably would be subject, like a resort or school town, to large seasonal

fluctuations. These would be rated under this characteristic of the industry.

Breakdowns used under "competition" should be rated with at least two things in mind. First, the direct effect of competition on the particular kind of business would be considered. Many lines of business do well if located in a market or shopping center with the right type of competitors. Retail stores that handle shopping goods or general merchandise sold to customers who live in a large trading area surrounding the town are examples. Small wholesalers or manufacturers who are not dependent on the local market, such as dry goods wholesalers and furniture makers, also find that healthy competition attracts buyers from out of town as well as suppliers' representatives. In contrast to this, the small grocery wholesaler intent on serving the local market would view the presence of many alert competitors as undesirable.

The second aspect of competition to be considered is the small businessman's own ability and ambition. Where an inexperienced and less ambitious individual might rate progressive strong competition undesirable, an experienced, well-qualified, ambitious person might welcome such a situation as assurance of a healthy condition likely to make for greater permanence and stability. He would count on being able to get his fair share of the business.

The Retail Location

Although in retailing the major location problems of the small businessman center around the selection of the best site within a town, some consideration should be given to the choice of the town, especially with reference to its size and general character. Also, since certain types of retail districts, such as suburban shopping centers, are found only in the larger cities, an examination of the main classes of towns and what each offers in retail locations is the logical starting point.

Policies concerning the clientele desired and customer services to be offered will influence both selection of the town and

the site within it. Important factors to consider include income levels, buying habits and preferences of the customers, and the character of existing stores. In general, high-priced merchandise requires a trading area of above-average income, a more refined or exclusive shopping district, and the presence of suitable environment or "atmosphere." Certain merchandising policies may dictate the need for special locations. An example is concentration on a restricted line of goods that has appeal to highly specialized groups because of taste, racial or religious beliefs, or similar factors that vary from the average town's composition.

Once the policies are formulated and the region selected, the next job is to appraise the present and future prospects of each town under consideration. Wholesalers and manufacturers can often help, as can agencies of the federal, state, or local governments, chambers of commerce, local banks, building and loan associations, and real estate agencies. The activities of the larger chain stores in establishing, or closing, branches in the town can serve as an indirect but usually reliable indicator. A personal investigation should be made of the town to compare it with others as well as to select the area and possible sites within it. At this time the check list referred to at the beginning of the chapter should be used.

Statistics showing the breakdown of family expenditures are available for the United States as a whole and are classified by type of community, location, occupation, size of family, and size of money income. These data may be obtained from the Bureau of Labor Statistics of the U. S. Department of Labor, and the Bureau of Human Nutrition and Home Economics of the U. S. Department of Agriculture.

Buying habits vary in different communities. Necessities in one district may be luxuries in another, even though incomes may be approximately the same in both. New communities, for example, containing many beautiful residences, may be the poorest locations

for stores, because the potential customers are unable to buy freely while meeting mortgage payments on their new homes.[2]

TABLE 8[3]

RETAIL STORE—POPULATION RELATIONSHIPS

KIND OF BUSINESS	No. of inhabitants per store	No. of stores per 10,000 inhabitants
Art and antique	13,371	0.748
Automobile	6,673	1.49
Automobile accessory	3,270	3.06
Bakery	2,548	3.92
Boot and shoe	3,346	2.99
Building material	6,960	1.44
Clothing and furnishings, men's ready-to-wear	2,397	4.17
Clothing, women's	4,063	2.46
Department	53,486	0.187
Drug	1,154	6.47
Dry goods and notions	2,065	4.84
Electrical appliance and supply	9,057	1.10
Florist	6,686	1.50
Furniture and house furnishings	2,388	4.19
Gasoline and oil	1,643	6.09
General	90,569	0.11
Grocery, delicatessen	325	30.08
Hardware	2,748	3.64
Jewelry	4,958	2.02
Paint, oil, varnish, and glass	11,772	0.849
Photographic supply and camera	63,483	0.158
Radio	18,309	0.546
Restaurants	813	12.30
Sporting goods	44,985	0.222
Stationery, book, magazine, paper, paper goods	6,402	1.56
Toy and game	83,860	0.119
Variety	18,610	0.537

[2] Small Business Aids, No. 287, U. S. Department of Commerce, "Specific Things to Consider in Choosing a Store Location." Extracted from "Store Location," one of the 17 booklets in the handbook, *Better Retailing*, 1941, page 18. Dayton, Ohio: National Cash Register Company.

[3] Small Business Aids, No. 274, U. S. Department of Commerce,

The selected list in Table 8 illustrates the relationship of population and kind of store for an average town in New York State.

The size of a trading area, for a community or for a store, will depend largely on competition, especially from neighboring towns or trading areas. Competition in either case will express itself in lower prices or better quality, wider assortments or greater services. In general, as towns increase in size their trading areas increase at a much greater rate than the town's population.

The kind of work pursued by the majority of the local population is an important factor in selecting a community in which to locate. A suburban area made up largely of professional leaders and business executives contrasts notably with a densely populated district located on the "wrong side of the tracks."

Both the amounts of money paid to workers in different occupations, and the regularity and frequency of payments, differ. Some communities serving farmers must expect to grant long-term credit; others do a week-to-week credit business, because their customers are paid weekly. The cash business volume of many communities fluctuates abruptly with the regular pay days of establishments in which sizeable groups of citizens are employed.

Preference should be given to a growing town. A rare opportunity would be needed to compensate for a static population or one that shows a declining trend. We have reference here to fundamental, long-time trends. It is always possible that with enlightened civic leadership and favorable conditions —especially something like the rerouting of a major highway— a static or declining town may stage a rebirth.

"Picking a Location for a Small Business," 1947. Condensed from *Picking a Location for a Small Business.* Albany, State of New York Department of Commerce, Small Business Series No. 3.

Size of town

For the small businessman the size of the town to be selected deserves study. The type of business may limit his choice of town size. Some kinds of stores, such as photographic supply houses, usually require a town no smaller than 50,000. Drug, stationery, and variety stores ordinarily supply customer needs for photo equipment in towns smaller than 50,000.

There are certain trades that are naturals for the small town. For each of the following more than 40 per cent of the nation's total business was done in towns under 5,000 population:

Type of Business	*Per Cent of National Sales*
General stores	92
Hay, grain, and feed stores	63
Farm implement, tractor, hardware dealers	60
Farm and garden supply stores	49
Filling stations	42
Dry goods and small merchandise stores	41
Hardware stores	41

Variety stores, lunch counters and stands, drug stores, and liquor stores appear to do equally well in both small and large communities. On the other hand, large department stores, delicatessens, optical shops, and individual stores for the sale of office and school supplies, cameras, photographic supplies, fruits and vegetables, furs, books, and cigars are likely to be missing from the small town Main Street. Most of the merchandise handled by the above businesses, however, is found in the smaller town but in different kinds of stores.[4]

Although payroll is normally the largest item of expense in all retail stores, many small-scale retailers, at least at the start, actually hire few, if any, employees. This moves rent up to first place in terms of expense items that must be paid. Data assembled by Dun & Bradstreet, by sizes of town and store

[4] Miller, Nelson A., "Small Town a Most Important Market." *Domestic Commerce*, August, 1944, Vol. 32, No. 8, page 3.

sales volume groups, show that for 33 major lines of business in almost all cases occupancy expense increases as a percentage of net sales from the smaller to the larger towns. This is true for each group of stores classified according to sales volume. Also, for each trade, the rent percentage decreases with increased volume for each city size group.[5]

When the kind of business is not an important factor influencing the size of town, there still may be other considerations. From time to time there are periods when the importance of smaller towns increases. This may occur for any of a number of reasons, such as decentralization of industry, increased public interest in small communities in general, or the prosperous conditions of a great many small towns resulting from a high level of farm incomes. As noted earlier, business expenses in most small towns are still low both on an absolute and a relative basis.

There are at least two more ways in which the size of the town should be considered. All of the larger chain organizations have a minimum size limit such as 5,000 for towns in which they will locate. This spells two opportunities to the small businessman.

1. For the strictly independent merchant it means that he will not be forced to meet direct local chain store competition. It gives him a chance to study chain methods and other examples of modern big city retailing in larger communities and bring them to the small town, to his own, and the residents', advantage. The reason chains do not open their own stores in towns below a minimum size is based on the volume needed to support the higher total necessary expenses of a company-owned store. Thus the progressive independent is given reasonable assurance of his protected position. This does not mean that chain store competition is bad and should be

[5] For the tables of occupancy expenses and other details see Mitchell, Walter L., Jr., *Standard Ratios for Retailing*. New York: Dun & Bradstreet, Inc., 1940.

avoided in all cases. It is rather a question of each type, independent or chain, capitalizing on its respective inherent advantages. Where an independent has direct chain competition, he is more likely to succeed if he fits his operations into those of the chain, rather than attempting to meet the chain on its strongest grounds. Where no chain competition is present, the field is wide open for the independent, who may later expand into his own chain store system.

2. The second opportunity arises where a small businessman would like to affiliate with a large and successful merchandising organization such as one of the chains or large manufacturers in the automobile tire and accessory fields. Several corporate chains, like Walgreen's, Western Auto Supply, and Schulte-United, have agency or franchise plans for independent merchants in small communities. These voluntaries have developed a system of selecting locations for affiliated stores that is comparable to corporate chain methods. The "Location Survey Outline," a questionnaire used by one well-known organization, is presented as Appendix C.

Selecting the district within a town

In large cities there may be only one important central shopping district, but frequently there are several such districts, usually adjacent to one another, and each noted for a particular price range or kind of goods, such as the general department and specialty store district, women's department and specialty store district, women's apparel district, men's clothing district, and others. Each central area will have one or more streets parallel to the main street and several at right angles to it. The latter are the secondary retail areas. Most of the centrally located, smaller retail stores and some service establishments will be found here.

Leading out from the central district will be "string" streets connecting this district with various sources of customer traffic. Some of these streets are main traffic arteries. Specialized dis-

tricts with stores and shops catering to automobile traffic grow up along these traffic lanes, frequently for many blocks outward from the central district. "Automobile row" is likely to be close to the central district, with automobile tire and accessory stores next, followed by drive-in food and other convenience goods stores farther out.

In addition to the central districts, there will be outlying or suburban shopping centers that have been growing in importance for several decades. Then there are the neighborhood or convenience goods districts. A substantial portion of the total retail sales in the large city is completed outside the central shopping area, and the proportion of the number of stores in the outlying districts is even greater.[6] This is part of a general American decentralization tendency. The import of such tendencies already has been noted. On the average, in retail stores total expenses may be seven per cent lower outside the central shopping districts.

Usually the rent-paying capacity of the proposed line of business will determine whether one can afford to locate in a central retail district. Certain lines of business, such as cigar, drug, shoe, and dime stores; women's apparel and men's hat stores; auto accessories, food service, barber shops, and department stores, are able to stay in the high rent group. Furniture and furnishings, hardware, and food stores generally must stay in the low rent group. Table 9 lists important characteristics of stores suitable to each district.

In selecting a district within a city, factors in addition to the rent-paying capacity of the kind of business deserve attention. The more important ones are the nature of the merchandise to be carried, clientele desired, and volume size of the store to be operated. The last may manifest itself as a preference for a large volume, or a size limit imposed by financial resources.

Nature of merchandise to be carried. According to customer

[6] Bureau of the Census, U. S. Department of Commerce, "Intra-City Business Census Statistics for Philadelphia." Washington: U. S. Government Printing Office, 1937.

TABLE 9[1]

FACTORS INFLUENCING RENT RATIOS

High Rent	*Low Rent*
1. High value of merchandise in proportion to bulk.	1. Low value of merchandise in proportion to bulk.
2. Window display highly important.	2. Large amount of floor space for interior display.
3. High rate of turn-over.	3. Low rate of turn-over.
4. Low margin of gross profit.	4. High margin of gross profit.
5. Pick-up and convenience lines of goods sold.	5. Shopping lines sold in addition.
6. Appeal to transient trade.	6. Established clientele.
7. Little newspaper advertising.	7. Much advertising and soliciting.
8. Price and convenience stressed.	8. Uses features of various kinds to attract customers.
9. Low overhead.	9. High overhead.

buying habits that affect store location, merchandise may be classified as convenience goods, shopping goods, or so-called "specialties." Specialties are in reality high unit-value articles that are well advertised and have a strong customer following.

In general, convenience goods stores locate wherever a sufficient number of potential customers have quick and easy access to the store. Usually they are large-volume units able to justify the high rents demanded for such sites. This may be on streets of heavy transient traffic, in outlying shopping centers, in well-populated neighborhoods, in industrial or other business areas, as well as in the downtown shopping center. Food stores, notions and variety stores, small drug stores, and similar enterprises often do better outside the larger shopping centers and closer to the homes of their customers.

Shopping goods require a location in one of the shopping districts. This may be the central area or one of the suburban or outlying shopping districts.

Class of trade desired. Class of trade desired influences the

[1] Canoyer, Helen G., *Selecting a Store Location*, page 13. Washington: U. S. Department of Commerce, Economic Series No. 56, 1946.

choice of retail district in either of two ways, with reference to income class, or according to some special occupational grouping. In most cities certain districts are more "exclusive" than others. The central shopping district, at least, usually has three fairly well-defined sections, each patronized primarily by high-, medium-, or low-income classes respectively. Some of the more common occupational groups that often have retail sub-districts are: financial and business executives, office workers, hotel guests, and students in various types of schools.

Volume size of store. The volume size of the store to be operated has a direct bearing on selecting the retail district. Usually only large-volume stores, for each line of merchandise, can locate in the central shopping district. For the fairly small-volume stores it may be preferable to choose a central or secondary district in a smaller town rather than the relatively poor districts available in the larger cities. For example, assume the volume will be limited to sales of $20,000 a year, as determined by the merchant's financial resources. If the standard operating ratios for rent in this merchant's line are five per cent of sales in large cities and four per cent in smaller towns, the top rental that could be paid per month would be $83.33 in the city or $66.67 in the smaller town. In many small towns this rental would be sufficient for a desirable location in the central retail district, whereas $83.33 per month would necessitate location in a neighborhood or very minor district in the big city.

Specialization by type of merchandise carried tends to be greater in the central district. The "women's" side and the "men's" side of the street are usually well defined. The individual who desires to locate in such a district must be able to justify the higher overhead characteristic of the location. He should have the advantage of merchandising experience, ample capital, and command of buying sources to a higher degree than the neighborhood storekeeper, for not only must he compete with other stores selling the same or similar goods; he also

must vie for the consumer's dollar with all other kinds of stores.[8]

Naturally the number and variety of retail districts decreases with the size of the town. In small towns there may be only one shopping district with a few grocery stores scattered around in neighborhood locations.

Selecting the retail site

Probably in no other field of business is the best site as important a factor in determining the success of a business as it is in retailing. Some studies have found poor location to be among the chief causes of retail failures.[9] Since the typical store depends for profit upon a sufficient number of customers coming into it or telephoning their orders for delivery within an economical radius, customer accessibility is an all-important consideration. Retail customers are creatures of shopping habits that are not easily changed.

Some merchants utilize shopping traffic where they find it; others try to attract shoppers to their stores by means of advertising. Rent and advertising expenses are often so closely related in the retail business that their relationships should be understood. We are now referring to expenses incurred for advertising in media outside of the store. This qualification is necessary here because the current tendency is to regard a store's windows as its most valuable advertising medium.

Rent is a payment for the opportunity to make a profit by selling merchandise. The highest rents are paid for locations having the greatest volume of profitable shopper traffic. Competition for these locations tends to keep the rent up to the maximum that can be paid for their most effective use by the most efficient businessmen. A profitable business may be oper-

[8] Small Business Aids, No. 274, U. S. Department of Commerce, "Picking a Location for a Small Business," 1947. Condensed from *Picking a Location for a Small Business*. Albany, State of New York Department of Commerce, Small Business Series No. 3, page 1.

[9] Canoyer, Helen G., *Selecting a Store Location*, page 1. Washington: U. S. Department of Commerce, Economic Series No. 56, 1946.

ated in these so-called "100 per cent" locations without expenditure for external advertising. The classic example of this is the location of chain variety stores. For years these chains have followed the location policy of selecting sites in the line of customer shopping traffic built up and maintained by the larger department stores through their established reputations and continuous advertising. The variety stores, however, do little external advertising.[10]

By contrast to variety stores, consider a specialty store, such as an apparel retailer, furniture, house furnishing, or even a hardware or complete food store located close to the large department stores or variety chains. Sufficient business can usually be obtained from the regular shopping traffic passing the store. These stores often find it pays to advertise, however; first, because they carry shopping goods that are suitable to advertising; second, because their central location makes possible effective use of the low-cost-per-reader mass media like newspapers; and third, because they can often "ride the tail" of department store advertising. Shoppers coming to town anyway will often respond to these advertisements; they will be customers who might not make a special trip downtown in response solely to the smaller store's advertisement.

Next consider one of these specialty stores located several blocks from the central shopping district. Some inducement must be offered to secure patronage, and usually it will be necessary to employ advertising to inform prospective customers both of the store's location and of reasons for patronage. The lower rent paid for these locations is compensated for in part by higher necessary advertising expense, as well as by the cost of customer inducements. Although the returns per dollar of advertising expenditure alone may be less for these fringe stores, the combined effect of low rent and moderate advertising may be very profitable. Thus it is the rent-advertising com-

[10] Kelley, Pearce C., *The Fundamentals of Chain Store Location.* M. A. Thesis, 1924, University of California, Berkeley; unpublished.

bination that is the most significant, and the second largest item of expense in all retail stores.

The beginning small retailer may find the number of usable sites available to him to be very limited. This is especially true during periods of good business activity. An understanding of site selection may enable him, however, at least to choose the least undesirable location of those available. The established small retailer will usually have the advantage over the beginner in being able to wait a few years to secure a desirable site.

The following factors are usually of maximum importance in retail site selection: environment, accessibility, nature of the building, rent and terms of the lease, and history of the site. Sometimes unusual restrictive ordinances may be encountered that would make one otherwise ideal site less desirable than another, such as limitations on the hours of the day when trucks are permitted to load or unload. Zoning and similar regulations are usually of minor importance, however, unless an individual attempts to open a store in an area restricted against business.

Environment. A retail store, like an individual, should keep the right company. Under the broad term "environment" come the subjects of "affinities," competition, and unfavorable conditions. It is well known that certain kinds of stores do well when located close to each other. Customers who patronize stores of one type in such a group are the best prospects for others in the same "affinity" class. One study of these natural clusterings of stores of various kinds disclosed the following combinations:

Department stores—women's clothing (appear in 35.2 per cent of all blocks in which there are department stores), shoe, variety, drug, men's furnishing, and millinery stores.

Variety stores—women's clothing (appear in 60.7 per cent of the blocks that have variety stores), shoe, department, jewelry, men's furnishing, and millinery stores.

Shoe stores—weak affinity for women's clothing, department, variety, men's furnishing stores, and restaurants.

Jewelry stores—no strong affinities; most frequent neighbors are restaurants, shoe stores, and men's furnishing stores.

Furniture stores—restaurants (found in 40 per cent of the blocks that contain furniture stores), men's furnishing, shoe, and women's clothing stores.

Florists—restaurants (found in 47.5 per cent of the blocks that contain florist shops), women's clothing, drug, and shoe stores.

Theaters—strong affinity for restaurants (found in 58.5 per cent of the blocks that contain theaters), jewelry, men's furnishing, and shoe stores.

Women's clothing—variety (found in 60.7 per cent of the blocks that contain women's clothing stores), department, and shoe stores.

Millinery shops—women's clothing, variety, shoe, and department stores.

Furs—furniture stores, florists, and shoe stores.

Candy stores—theaters, jewelry, variety stores, and florists.

Men's furnishings—restaurants, furniture stores, theaters, and men's shoe stores.

Haberdashery—jewelry and men's furnishing stores.

Tobacco stores—shoe, jewelry stores, and theaters.

Restaurants—florists, theaters, furniture, and jewelry stores.

Drug stores—may appear near any stores, except furniture. (Twenty-five to 35 per cent of all central shopping district blocks contain drug stores.)

Curtain stores—near furniture stores.

Paint stores—near furniture stores.

Shoe repair shops—may appear near any stores, except department or variety.

Barber shops—near florists, theaters, and jewelry stores.

Grocery stores—seldom appear in the central shopping district.

Proximity to offices of professional men is desirable, especially in outlying shopping centers. People having appointments with doctors, dentists, lawyers, and so on, quite often will become shoppers if stores are conveniently accessible.[11]

Customers are people with habit patterns and buying needs that are often associated with other activities, as the foregoing paragraph illustrates. The same type of analysis may disclose other natural business groupings. For example, in recent years launderettes have been established in thousands of towns. What does the woman who brings in her clothes do during the fifteen or twenty minutes while the Bendix does the work? She shops in nearby stores to fill frequently recurring needs for items such as groceries, variety goods, and possibly magazines or similar articles.

In contrast to complementary or related store groupings, certain kinds of stores do better if not located close together. For the exclusive sale of convenience goods, unless the customer traffic is unusually heavy, stores of the same kind do not locate close to competitors. An apparent exception to this generalization arises where an alert independent in the drug, variety, or similar line finds advantageous a location adjacent to a chain store in the same line. The "spillover" traffic attracted to the chain may provide sufficient business for the independent. By making his merchandise offerings fit in with those of the chain he may secure additional volume. This means that some of the chain's customers who normally buy standardized popular styles or colors will be attracted by similar goods in novel designs, unusual colors, or other variations. Good examples of this will be found in party novelties, popular-price gift items, unusual but low-price toys, and seasonal greeting cards.

[11] Canoyer, Helen G., *Selecting A Store Location,* page 20. Washington: U. S. Department of Commerce, Economic Series No. 56, 1946.

The small independent's natural tendency is to want to avoid competing stores. The foregoing discussion should demonstrate that often locations close to the right kind of competitors are especially desirable. As an aid to appraising competition a plot of the district may be made, such as that illustrated in Figure I.

There are certain neighbors, in addition to the wrong kind of retail store, that usually are undesirable for nearly any kind of retailer. Proximity to places that are normally avoided by shoppers—funeral parlors, cemeteries, hospitals, establishments of ill repute, and industries having disagreeable noises or odors —is unfavorable. Some such environmental conditions may be temporary, such as broken sidewalks, vacant lots or stores, and construction in progress, but during the time they exist shopping traffic will shun the vicinity.

Accessibility. For the small retailer accessibility is mainly a question of the ease with which his customers can reach the store. A site with the heaviest volume of pedestrian traffic including his potential customers would be ideal except that the rent might be beyond his means. Accessibility to pedestrian traffic for other sites will be influenced by distance from the "100 per cent" block, terrain, dangerous street crossings or other hazards, and similar factors. The nature of the entrance may be important if it is even slightly above sidewalk level, or if the store has an off-the-street location, such as an upper floor.

Traffic analysis. From careful analysis of experience in numerous outlets, chain stores know the approximate sales value of each pedestrian passing a given location. Pedestrian traffic can thus be used as a direct guide to the evaluation of any site. The small independent retailer can utilize chain methods in comparing and appraising various possible locations. Two factors are especially important: total pedestrian traffic during business hours, and the percentage of it that is likely to enter the store.

In making traffic counts, the checker should select a few half-hour periods, especially during the normally busy hours

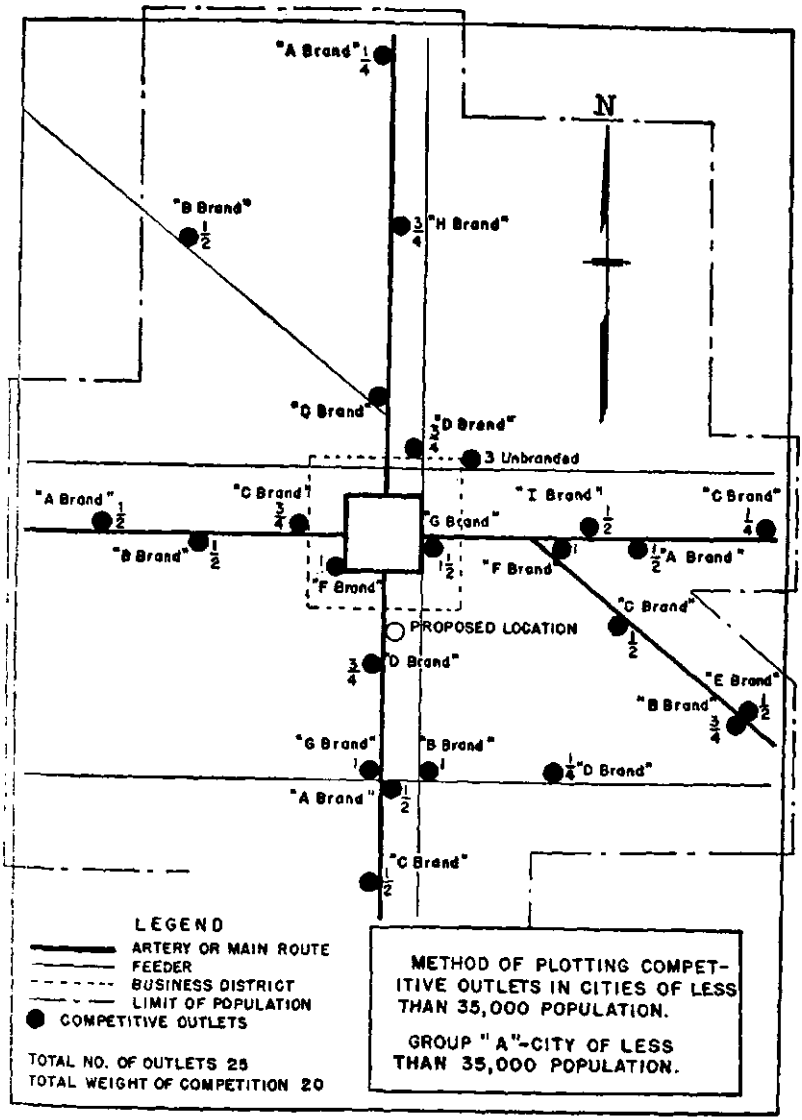


Figure I.[12]

[12] Canoyer, Helen G., *op. cit.*, page 28.

of the day. Only possible customers for the particular kind of business should be counted, with men and women recorded separately. Children may also be put in a separate category if they are likely customers. Even two 15-minute counts daily will enable the analyst to estimate the total eight-hour traffic fairly accurately.[13]

To estimate the probable number of pedestrians who would enter a given kind of store, sample counts may be made of the percentage of them that enters stores of the same kind in each district. The results may be checked against similar surveys made by other agencies.[14]

The mode of transportation used by customers is important. When most customers come to the store in their own cars, a site several blocks from the shopping center that has ample parking space is more accessible than a so-called "100 per cent" site. Corner locations with entrances on each street have similar advantages for pedestrian traffic.

The accessibility of a site is sometimes related to the sequence of shopping. For example, food stores located on the right-hand side of an artery leading away from the downtown shopping district are more accessible because grocery customers usually shop on the way home, whereas a laundry or dry cleaner located on the right-hand side going into town is more accessible because customers prefer to unload the wash or cleaning before continuing to town.

Store building. Most retailers rent rather than construct the store building. Of major importance to the small retailer is that the building be suitable to his type of business, or that it could be made so, preferably at the landlord's expense. The former will be discussed in the next chapter, the latter is part of our next topic.

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[13] Kelley, Pearce C., *A Traffic Survey of Salt Lake City.* Salt Lake City: Bureau of Economic and Business Research, University of Utah, 1931.

[14] Converse, P. D., "Retail Store Location." *Opinion and Comment,* May 17, 1947, Vol. 9, No. 2, pages 22–23.

Rent and terms of the lease. Two types of lease agreements are used in retailing—the flat rate and percentage lease. Under the flat rate plan, an annual rental of a definite amount payable monthly in advance is stipulated in the lease. For each line of retailing this amount should be consistent with the standard operating ratios in the field, modified according to the size of store, size of town, and the combined rent-advertising ratios discussed on page 190. The percentage lease usually guarantees the landlord a minimum monthly rental, with additional payments at some percentage of sales agreed upon by both parties. Except during periods of slack business activity the percentage lease is not likely to be available to the average small retailer. For either type of lease, however, the objective is to stay in line with the standard rent ratio or to compensate for any deviation by more or less advertising, superior managerial ability, or similar considerations. Consequently, the standard ratio for the particular line of business should be known, and the rental demanded for any site under consideration should be appraised in terms of the site's potential volume of sales and the volume necessary to achieve this ratio. Table 10 presents the standard rent ratios for the average retail store in a large number of different lines.[15]

Leases may be secured for from one to ten years or more. Usually it is desirable for the beginning retailer to get a one- or two-year lease with an option on renewal for five to ten years at an agreed rental. This is not always possible, but he should bargain for the best terms at the time the lease is under discussion.

The lease usually provides for many other important points, such as any remodeling to be done, who is to pay for it, liabilities and duties assumed by each party, permission or authority for the tenant to erect certain external signs, engage in additional lines of business, or make alterations to the premises in the future if needed. If the landlord owns adjacent prop-

[15] For a more detailed tabulation of occupancy expense ratios see Canoyer, Helen C., *op. cit.*

TABLE 10[16]

RETAIL STORE RENTALS EXPRESSED IN PERCENTAGES OF NET SALES, BY SIZE OF TOWN

(All Data for Stores with Annual Net Sales of $30,000 to $50,000)

Type of Business and Size of town	Percentage
Filling stations:	
Less than 20,000 population	4.0
20,000 to 100,000	3.3
Over 100,000	4.7
Country general stores:	
Less than 20,000	2.0
Grocery and meat stores:	
Less than 20,000	1.9
20,000 to 100,000	2.2
Over 100,000	1.8
Lumber and building materials:	
Less than 20,000	2.1
20,000 to 100,000	3.3
Motor vehicle dealers:	
20,000 to 100,000	2.5
Drug stores:	
Less than 20,000	3.6
20,000 to 100,000	4.9
Over 100,000	5.1
Drug stores with fountains:	
Less than 20,000	3.3
20,000 to 100,000	4.4
Over 100,000	4.9
Drug stores without fountains:	
Less than 20,000	4.1
Over 20,000	4.7
Grocery stores:	
Less than 20,000	2.3
20,000 to 100,000	2.6
100,000 to 500,000	2.7
Over 500,000	2.6
Grocery stores with filling stations:	
Less than 20,000	2.0
20,000 to 100,000	3.5
Over 100,000	3.7
Auto accessories and parts:	
Less than 20,000	2.5
20,000 to 100,000	2.0
Over 100,000	2.6

[16] Adapted from Canoyer, Helen C., *op. cit.*, pages 7–8.

TABLE 10 *(Continued)*

RETAIL STORE RENTALS EXPRESSED IN PERCENTAGES OF NET SALES, BY SIZE OF TOWN

(All Data for Stores with Annual Net Sales of $30,000 *to* $50,000*)*

Type of Business and Size of town	Percentage
Garages:	
Less than 20,000	3.1
Over 20,000	8.3
Hardware stores:	
Less than 20,000	3.5
20,000 to 100,000	4.0
Over 100,000	4.7
Furniture stores:	
Less than 20,000	4.5
20,000 to 100,000	4.2
Dry goods and general merchandise:	
Less than 20,000	3.3
20,000 to 100,000	5.4
Electric and gas appliances:	
Less than 20,000	3.0
20,000 to 100,000	3.6
Over 100,000	2.4
Farmers' supply stores:	
Less than 20,000	1.3
20,000 to 100,000	3.1
Women's ready-to-wear:	
Less than 20,000	4.7
20,000 to 100,000	4.8
Over 100,000	5.7
Limited-price variety stores:	
Less than 20,000	4.5
20,000 to 100,000	6.0
100,000 to 500,000	5.2
Men's, boys' clothing, furnishings:	
Less than 20,000	3.3
20,000 to 100,000	5.4
Over 100,000	5.2
Family clothing:	
Less than 20,000	2.9
20,000 to 100,000	5.6
Restaurants; other eating places:	
Less than 20,000	5.0
20,000 to 100,000	4.4
Over 100,000	5.5
Hardware and farm implements:	
Less than 20,000	2.6

erty, it is sometimes possible to incorporate in the lease provisions governing the kinds of business for which these sites will be rented. A lease is an important legal document, and the small businessman should always seek competent legal counsel before entering into a formal lease agreement.

Site history. At least the recent history of each site under consideration should be known by the prospective retailer before he makes a final selection. Although most Americans no longer believe in haunted houses, experienced merchants know that hoodoo locations do exist. These are sites that have been occupied by a succession of retail failures. Naturally there are logical reasons having nothing to do with the location why the site has not been a successful one at certain times in the past, but there are also the dangers that prospective customers have formed a habit of avoiding the location, or that the next prospective renter will overestimate his ability to succeed where his predecessors have failed.

Several concrete examples of such hoodoo locations are familiar to the authors. One that was under continuous observation for over 14 years was occupied by eight different businesses in addition to one operated at a loss by the landlord, and was vacant for several years. Directly across the street was a restaurant that was in operation throughout the entire period. Within the same block with the hoodoo location were several prosperous stores. At one time, under the pressure of taking any site that would "keep the rain off the merchandise," an out-of-town merchant opened a branch store in this site. The store now has continued in existence for three years, but it has run more distress sales than all the rest of the stores in the town combined.

As a guide to the selection of the best site for a retail store the check list presented on pages 201 to 203 is recommended.

If this guide is used carefully the chances of making a poor choice will be greatly lessened, and if a number of different sites are available, selection of the best will be assured. It is assumed that the beginner will know his business well enough to assign proper weights to each factor listed.

CHECK LIST FOR GUIDANCE IN SELECTING A SITE [17]

(For each of the points below make a check mark in the rating column showing how it reflects your appraisal of the answer in the first column.)

POINTS UPON WHICH SITE IS CHOSEN	ANSWER (Check, Yes or No, Numerical or Qualitative Answer)	RATING			
		Excellent	Good	Fair	Poor
A. Competition:					
Number of independent stores of same kind					
Same block					
Same side of street					
Across the street					
Number of chain stores					
In same block					
Same side of street					
Across the street					
Kind of stores next door					
Number of vacancies					
Same side of street					
Across the street					
Next door					
Dollar sales of nearest competitors					
B. Traffic flow:					
Sex of pedestrians					
Age of pedestrians					
Destination of pedestrians.....					
Number of passers-by.....					
Automobile traffic count.....					
Peak hours of traffic flow.....					
Percent location of site:					
100 per cent					
90 per cent					
80 per cent					
60 per cent					
Other					
C. Transportation:					
Transfer point					
Highway					
Kind (streetcar, bus, subway, automobile)					

[17] Canoyer, Helen G., *op. cit.*

Points Upon Which Site is Chosen	Answer (Check, Yes or No, Numerical or Qualitative Answer)	Rating			
		Excellent	Good	Fair	Poor
D. Parking facilities:					
Large enough and convenient..					
Large enough but not convenient					
Convenient but too small.....					
Inadequate in all respects.....					
E. Side of street					
F. Plant:					
Frontage (in feet)					
Depth (in feet)					
Shape of building (must permit efficient operation)					
Condition					
Heat (type)					
Light					
Display space					
Back entrance					
Front entrance					
Display windows					
G. Rent and lease					
H. Corner location. If not, what is it?					
I. Unfavorable site characteristics:					
Fire hazards					
Cemetery					
Hospital					
Industry					
Relief office					
Undertaking establishment ...					
Vacant lot—unless it can be used for parking					
Garages					
Playground					
Smoke, dust, disagreeable odors, etc.					
Poor sidewalks and pavement..					
Old and worn-out neighboring structures					

Points Upon Which Site is Chosen	Answer (Check, Yes or No, Numerical or Qualitative Answer)	Rating			
		Excellent	Good	Fair	Poor
J. Number of professional men in block					
Medical doctors					
Dentists					
Lawyers					
Veterinarians					
Others					
K. History of site					

To illustrate recommended procedure for site selection, the following advice prepared by the trade association of independent tire dealers is presented.

Select a site on a main thoroughfare, preferably on one of the main streets leading from the good retail shopping district to the better-class residential area of the city. Keep as close as convenient to the retail shopping district without encountering conditions of traffic congestions. Your location should be on the right-hand side of the street "going home" from work—on the near corner if there is a traffic light—on the far corner if no light. A mid-block position is not as good as a corner location except when the corner location is subject to constant traffic congestion. Be sure that the property permits easy ingress and egress and that the speed of traffic does not interfere with access to your driveways. Avoid locations where traffic speed exceeds 20 to 25 m.p.h. and give consideration to easy entrance for trucks as well as automobiles. Be sure that property will accommodate all the service facilities you propose to operate. Also be sure that the space is available to accommodate trucks. Make certain that local ordinances or zoning laws will not interfere with your projected operations.

Make sure that curb passage for cars entering or leaving your establishment can be secured. It is advisable to check with the City street department. Do not locate too near to a firehouse where

the street may frequently be blocked with fire apparatus. Guard against rear alleys which may frequently be crowded with trucks and vans from nearby warehouses. As a further consideration, keep in mind the factor of identification visibility for your establishment.

Be sure that the property is large enough for your purpose and can easily be modified to meet your expanding needs in the future. Check into the building construction to make certain that it will be strong enough to stand the required load stress. Carefully investigate the condition of the heating plant, electric wiring, plumbing, roof, ceiling, basement, toilet and disposal facilities. An insurance broker should be consulted to be sure that the property is insurable.

If you intend to modernize the property, permission to do so must be incorporated in your lease. The cost of such modernization should be considered as a rent expense to be amortized over the period of the lease. The rental rate should be specific and the rent you pay should range between 2 and 4 per cent of your projected sales volume—depending on the size of the market. If the landlord agrees to bear the whole or part of the modernization costs, see to it that these provisions are adequately incorporated in the lease.

Be sure that your lease does not prohibit your adding any service functions which you may want to add to your operation. Be sure that the local building and fire laws and regulations will make it possible for you to make the desired improvements or changes necessary for the operation of your business.[18]

The Small Wholesaler's Location

Small wholesalers are widely distributed over the country, many being located in very small towns in the 5,000 population class. In the long established lines—groceries, hardware, drugs, dry goods, and general merchandise—these wholesalers are relatively quite small in terms of volume of business as compared with the average in each line. In such fields the country for some time has been pretty well provided with wholesale

[18] *Planning Your Business,* page 10. Washington: The National Association of Independent Tire Dealers, Inc., 1945.

establishments that many years ago passed the "small" stage. These firms continue to operate in towns where they were originally established 20 to 50 years ago. Annual sales volume of many of these houses, even in towns of the 10,000 population class, runs close to the $1,000,000 mark. In some of the newer fields, such as wholesaling of electrical goods, radios, certain appliances, and various specialties, small town markets have not been so profusely supplied from local wholesale houses. In both new and old fields, however, there has been an influx of newcomers operating as small businessmen.

Selecting the town

Usually the small wholesaler depends more on the local market; that is, retailers within his town or within a trading area radius of less than 100 miles. This means that the income in the community is of major importance in selecting a location. In this respect the small wholesaler emphasizes the same location factor as do his retailer customers, except that a wholesaler is also interested in the incomes of adjacent towns.

There are a few situations where a wholesaler's selection of the region or town is influenced by important factors other than the income of the town's immediate trading area. Three in particular deserve mention. If a wholesaler, even though he starts on a small scale, has definite ambitions to expand rapidly and aspires to sectional or national distribution, it would be wise for him to locate in one of the key distributing centers for his line of goods. A second example would be a small wholesaler in a specialized line where the customers are small manufacturers and manufacturing retailers located in a few well-defined market centers. At one time Southern California had many special or custom built automobile body factories served by a few such wholesalers. Our third example is the middleman—a functional wholesaler, the resident buying office, or the purchasing agent. He must of necessity be located in the major markets, such as New York for women's wear or Chicago for furniture.

The small wholesaler is primarily interested in a town with stability of income, diversified industry (including agriculture) in the trading area, prosperous retail stores, and competition. The last named includes competition from other wholesalers in nearby towns. In special cases an individual may also lay some stress on availability of local financing, local taxes, and the attitudes of established businessmen.

Personal factors play a major role in the selection of the region and often the town in which many small wholesalers locate. A large majority of small wholesale houses develop in one of two ways. The first is when an established retailer experiments with quantity buying and starts selling at "wholesale" to other retailers. In the grocery field this has happened numerous times. First the retailer buys a carload of feed, flour, sugar, or other staple. Sometimes the first order is the result of pooling with one or more nearby merchants. When storage space at the retail site is exhausted, this retailer-wholesaler seeks a building for which the rent is smaller and the location is more convenient for wholesaling activities. Such cases include many other lines like hardware, electrical goods, radios and parts, automobile accessories, and seed and feed. Since the town was automatically selected by virtue of the retailer's original location, this shows the influence of the personal factor.

A second way in which many small wholesalers start occurs when a salesman for a wholesale house teams up with an experienced wholesale bookkeeper or office man, with or without additional "family" financing. The salesman spots a promising territory and may have it under observation for several years before selecting the best town in which to locate. Often the salesman has also become interested in a girl in the territory. Marriage, pooling of financial resources, and selecting the new family's home town for the wholesale location seem to go together. An example that recently came to the authors' attention was a traveling accountant who had specialized in auditing freight bills for wholesalers. After many years of this kind of experience he started his own wholesale

grocery in a small town in the Southwest, where he has done remarkably well.

Well-informed persons estimate that as high as 90 per cent of all small wholesale houses are started in either of the two ways just discussed. Those resulting from a retailer's expansion into the wholesale field are said to be less likely to continue successfully than are firms started initially as wholesale houses by men experienced in wholesaling. This theory raises interesting questions concerning the selection of the town for a small wholesale business. Does it indicate that a retailer established in a town is less able to evaluate his own town as a good location for a wholesale plant than is the outsider who may visit the town from time to time as a salesman? Does it reflect the power of "first love"—retail interests, or the difficulty of successfully operating two businesses—wholesale and retail? Or does it prove that running a wholesale business is sufficiently different from retailing to require special experience? Certain established wholesalers subscribe to the last viewpoint and can cite many cases where this factor apparently was the chief reason why retailer-wholesaler businesses reverted exclusively to retailing. Probably there is also some validity to the theory that a salesman calling upon retailers in many different towns has a much better basis than any one of his customers for selecting a particular town in which to locate a small wholesale business.

Small wholesale establishments, like other small businesses, often originate as a result of family enterprise. The case of pooled buying by three brothers is one example. Here the father turned his original wholesale grocery over to the eldest son; then father and the one son helped the other two boys get started in nearby, but non-competing towns. (The details in this case are told more fully in another connection in Chapter XII.) A few of one of the authors' former students have received family backing to expand the parent's retail business into the wholesale field, the son taking over the wholesale enterprise. In one of these cases the wholesale business and

the retail store were located in different towns, although in the same wholesale trading area. The location was selected only after several years of study of the economic factors involved; the main objective was to become centrally located in the trading area desired, with a good local (town) market, and without "live" competition.

Selecting the district within a town

The average age of wholesale establishments is greater than that of other major fields of business. Most cities have wholesale districts. Usually these were in operation long before the automobile and truck appeared. Naturally they were located adjacent to water or rail transportation and frequently to both. Chicago and other cities served by both types of transportation are specific examples. In smaller inland towns the established wholesale district is adjacent to the railroad freight facilities.

In recent years there have been two significant developments leading to new wholesale locations within the town: highway transportation, and the rise of cash-and-carry wholesalers, especially in the grocery field. A third development that is having an increasing effect on intracity locations is air travel. Some cities are pushing plans to build super merchandise marts designed for use by the private planes of buyers. One authority stressed the beneficial effects of increased air travel on the location of wholesalers in smaller towns.[19] When this forecast is considered in connection with the present trend of moving wholesale plants to the edge of town, the conclusion is evident.

In many situations the small wholesaler must still decide between locating in the established wholesale district or elsewhere in the town. Usually the advantages of locating outside of the wholesale district are far more compelling. The principal exception occurs when the need to pick up "shorts" from

[19] Boreman, Arthur I., "Where Does the Wholesaler Go from Here?" An address delivered to the Wholesale Dry Goods Institute, Des Moines, Iowa, June 4–5, 1948.

other wholesalers happens frequently, as it does sometimes in the drug business.

Within the wholesale district space is limited, plants are multi-story because of high ground rents, warehousing costs—which usually constitute a major item of expense—are high, and traffic congestion is prevalent. Largely because of these conditions it is improbable that the small operator will be able to secure the street level, efficient type of plant he needs. Although rent is a relatively minor expense for service wholesalers in most fields, warehouse labor is a big item. Particularly for the small wholesaler who is not in a position to use labor-saving material-handling equipment, a wholesale district location would seem to have most of the disadvantages, and almost none of the advantages of other sites.

Selecting the wholesale site

Since small wholesalers serve principally the local market, their location should be selected with this fact as a primary consideration. However, there are many aspects to be considered. The rise of truck transportation and increased speed of all forms of transportation are important. For example, many small wholesale grocers located in small towns use their own trucks to deliver to customers as well as to bring in warehouse stocks. In nearly every city of 100,000 population or more there are public warehouses where commission men and brokers maintain stocks of goods. A small wholesaler located 200 miles from such a city sends his truck up to 75 or 100 miles to make customer deliveries, and the driver then continues on to the city distributing point where he picks up small lots of assorted goods from the warehouse stocks of commission men and brokers. Obviously this practice frees the small wholesaler (who could not ordinarily buy in carload lots anyway) from any dependence upon locations close to railroad facilities.

The preceding example assumed truck delivery by the wholesaler to his retail customers, location in a relatively small town, and distribution to a trading area that included out-of-town

customers. There are other situations to be considered that bear heavily upon the intratown site. A primary such consideration is the amount of "store" business, meaning the extent to which retail buyers visit the warehouse as compared to sale and delivery at the retailers' stores. "Store" business is of two types. The older form, still used in variety and general merchandise lines, is where the wholesaler maintains a show room with displays from which visiting buyers make their selections. The goods may be taken by the buyer or delivered later by the wholesaler, the former practice being common with out-of-town buyers (that is, retailers located in small towns in the trading area). For this type of business a site near other wholesalers, in order to obtain the "shopping center advantages," with moderate parking facilities for customers' cars is desirable.

The second example of "store" business is the cash-and-carry type of warehouse. There are many more small wholesalers operating this type of "store" business than the other. Often one or two persons can operate a cash-and-carry plant doing several hundred thousand dollars' annual volume of business. Usually most of the patronage comes from retailers within the town, and a site of maximum convenience to these retailers that also has adequate parking and truck loading facilities is needed. This means higher rent expense. As illustrated in the following case, adapted from an earlier study by the U. S. Department of Commerce, the total operating expense, however, is likely to be less. Whereas to the service wholesaler rent was 0.40 per cent of annual sales, with a total operating expense of 6.91 per cent, for the cash-and-carry plant rent was 0.57 per cent of a total of 2.90 per cent. Rent for the service wholesaler was the seventh largest item of expense, but for the cash-and-carry it was the second largest. The foregoing are figures of a small wholesaler in the grocery field relating to the main house (sales $126,000) and its cash-and-carry branch (sales $57,000) for 1939. Although they probably are not exactly accurate for current conditions, they do show the much greater

importance of rent among total expenses for the cash-and-carry type.[20]

Recently small wholesalers, and a few large concerns that have built new plants, have chosen sites near the edge of town. The chief advantages are lower rent and ample space, the latter making possible the construction of the most efficient type of ground floor warehouse with transportation access on all sides. More rapid transportation and good highways, less traffic congestion, and new types of construction that provide better light and ventilation all have contributed to this trend. Probably many of these operators also have had in mind the use of some air travel to markets and air transportation to the warehouse.

Small wholesalers who make truck deliveries or whose salesmen travel have a different problem of site selection from that of those doing "store" business. Here the relative amount of city business compared to out-of-town business is a major factor. The objective is to locate near the center of the desired trading area so as to keep the total distance traveled by salesmen and trucks at a minimum. A difference of one mile between two possible sites would be a large factor in such a case. Traffic congestion and highway facilities are important. Rent is usually a minor item of total expense, the major ones, in order, being salesmen's expenses, warehouse expense, and delivery costs. To illustrate this situation, assume there are two small wholesalers, one having 90 per cent of his business within the town, the other only 50 per cent. The former would locate in town, close to the retailers served, and at the best site available in terms of rent, traffic conditions, space, and type of building required. The other would determine toward which direction the out-of-town half of his business was concentrated, and then would logically pick a site at the appropriate edge of

[20] Economic Series, No. 14, U. S. Department of Commerce, *Effective Grocery Wholesaling*, page 174. Washington: U. S. Government Printing Office, 1941.

town or about midway between his two groups of customers.[21]

In some lines, notably drugs, retailers often want frequent emergency deliveries. One survey showed most druggists (52 per cent) gave quicker deliveries as the reason they bought from their major wholesale supplier.[22] A limited survey conducted by the authors disclosed the same foremost reason for patronizing a particular wholesaler, plus the following: ability to buy on a small order basis, complete stocks carried locally, preference for new one-story plants that operate on a five per cent mark up (groceries). In dry goods and variety lines the retailers expressed a desire to be able to visit the warehouse showrooms conveniently. In the area where the survey was made many grocery wholesalers are operating on a six to seven per cent margin, although some of the more efficient service wholesalers have been able to reduce total expenses so as to operate on a five per cent margin.

The Small Factory Location

The location pattern of American industry has been changing considerably since the late 1930's. Prior to 1939, when the National Resources Committee published its findings on the structure of our economy, the vast majority of manufacturing plants, both large and small, were concentrated in the highly industrialized area of the Northeast. This concentration came about naturally as a result of a combination of factors that influence plant location. It is important to understand this condition before investigating more recent trends and circumstances that currently affect the location of small plants.

Once soundly started, an industrial community tends to generate forces that make for continued growth. Established

[21] Industrial Series, No. 62, U. S. Department of Commerce, *A Study of Tobacco Wholesalers' Operations,* pages 9–11. Washington: U. S. Government Printing Office, 1946.

[22] Small Business Aids, No. 165, U. S. Department of Commerce, "What Retail Druggists Want from Their Wholesalers." Condensed from "The Wholesale Drug Salesman," a report before the 1946 convention of the National Wholesale Druggists' Association.

industries attract subsidiary plants of a servicing or specialized product nature. These may be called "facilitating industries." Material suppliers expand their activities. Some of these are small plants making parts, semi-processed materials, or specialized tools used by the primary industries in the community. Others may be branch supply houses of factories located elsewhere, as well as any of the various types of wholesalers serving the industrial market. A pool of experienced labor grows up. Transportation, financing, local utilities and similar facilities develop to meet growing needs. New industries arise to complement those already established and to make for an integrated industrial center. This in turn tends to attract buyers, and the community becomes a market center for its type of products.

For most product lines, small manufacturers find locations in these industrial areas and large city markets to be more advantageous than those in small town or rural areas. Most of these small factories are in one of two groups: those manufacturing for the adjacent large industries, or those producing for a specialized consumer market. Usually the latter group produces unstandardized goods not suited to large-scale mass production, such as the higher-priced lines of men's and women's wearing apparel. Four industry groups of this type are highly concentrated in the large industrial city market centers: women's clothing, men's clothing, printing and publishing, and confectionery.

In general, the firms located outside industrial areas are fairly large units, principally because small firms so located find it difficult to manufacture specialized or style goods, and in the production of standardized goods large units are more efficient. In other cases branch plants of large corporations could operate in many fields suitable to the small factory.[23]

[23] National Resources Planning Board, *Industrial Location and National Resources,* pages 288–301. Washington: U. S. Government Printing Office, December, 1942.

Concentration of industry, like concentration of population or retail districts, eventually encounters difficulties from traffic congestion, high rentals and costs of multi-story buildings, labor problems, and the law of diminishing returns. The serious effects of business depression on certain highly industrialized communities were evident during the depression following 1929. During prosperous times labor shortage and other difficulties lent further support to the growing realization that industrial concentration can go too far. Even before the stimulus toward decentralization given by national defense needs commenced in the late 1930's, trends away from industrial centers were in operation. The decentralizing effects of the World War II period are too familiar to warrant further comments here. However, experience gained during this period regarding plant location, sub-contracting, integration of the operations of many small plants widely separated as to location, and other developments resulting from wartime conditions, has had and will continue to have considerable bearing on small plant location.

The great disparity of wages and per capita incomes between industrial and non-industrial communities has been recognized for some time, although the reasons for the differences are still confused in much popular thinking. The trek from farm to city, from small towns to industrialized cities, and in general from less industrialized states to those of greater industrialization has been arousing increasing public concern. Usually it is the younger, better trained (at home-state expense) individuals who seek the higher pay offered in industrial centers. Although it is desirable to have permanent productive employment available to absorb the surplus labor of rural areas, it does not follow that this employment must be concentrated in a few already overindustrialized communities. Nor are there any sound reasons why the benefits of industrialization should not be widely distributed throughout the whole country. Rather, the reverse is true.

Agencies assisting in plant location

Nearly all states, and many cities, in both industrial and non-industrial areas, have developed agencies to assist industries seeking new locations as well as communities seeking new industries. These may be government agencies, such as the Department of Commerce of the State of New York; state and local chambers of commerce or other businessmen's associations; or special agencies established for this purpose, such as the various industrial commissions and planning boards. In recent years there has been a pronounced trend for the less industrialized areas of the South and West, both states and communities, to establish agencies and seek aggressively to promote industrialization of their localities. The Area Development Division of the United States Department of Commerce as well as the various field offices have assisted in this work.

There are three typical situations where such agencies aid industry in finding desirable locations: local concerns seeking to expand, out-of-state companies looking for sites for branch plants, and local individuals wishing to start a new factory. The following comments are based on a survey of state and local industrial promotion agencies conducted by the authors during the summer of 1948. These agencies make no distinction as to the size of a concern inquiring about locations with reference to the amount of information and assistance provided. Both general information and specific data are furnished as needed. The trend seems to be to encourage local industries to expand and local individuals to start new industries. For example, the Annual Report for 1947 of the Portland, Oregon, Chamber of Commerce shows that out of 173 new industries started in the Portland area during the year, 162 were locally organized and owned, whereas only 11 were branch plants of companies with headquarters elsewhere.

The manager of the Industrial Department of a middle-western city agency stated in a letter to the authors:

Our Chamber of Commerce is spending 90 per cent of its efforts in providing assistance for our existing industries. We believe that sound, long-run growth should be based upon encouraging local industry to grow and expand rather than spending large amounts of time and money attracting industries from out of state. We provide an ever-increasing amount of services for our local industries. We frequently find it necessary not to encourage business re-locations in [name of city] after our broader investigation has shown that such industries would be under large competitive handicaps, and would probably not be successful if located here.[24]

Several agencies, such as the Mississippi Agricultural and Industrial Board, are anxious to help small local independent businessmen find suitable locations, and are equipped to render technical assistance to them.

Many agencies reporting to the authors stated their desire to assist local individuals but added that few requests of this type have been received. Apparently many prospective small factory owners are neglecting a valuable source of assistance. There are at least three reasons for this. First, individuals seeking to enter manufacturing on a small scale are not well informed about the services available through state and local industrial development agencies. Second, many such factories are started in the home community where the need for location advice is not felt, and third, sometimes the principal need is for financial assistance.

Several communities have established Industrial Foundations with local capital or other means to assist in the financing of new industries. Especially in the little-industrialized towns, there has been some tendency to use these funds only to assist established out-of-state industries in setting up branch plants. In other situations funds are available to buy sites, construct buildings, or do other things needed by a new industry that is suited to the community, especially when it will complement

[24] Excerpt from letters of August 16, 1948, and May 18, 1949, from J. Alden Trovillo, Manager, Industrial Department, Wichita Chamber of Commerce, Wichita, Kansas.

already established industries, regardless of whether the organizers are local individuals or out-of-state concerns. Oakland, California, has been aggressively promoting this type of activity. Gary, Indiana, is reported to have an Industrial Foundation that has helped to start dozens of young businessmen on their careers by furnishing loans totaling $100,000, and assisting in finding national and international markets for the products of these new small industries. The Foundation concentrates on local talent, stressing the Negro element (which constitutes 20 per cent of Gary's population), and is seeking industrial diversification.[25]

The prevailing attitude toward local financial assistance was aptly expressed in a letter to the authors by an official of a state chamber of commerce as follows:

> In matters of financial assistance to a prospective industry we insist that all arrangements be based on sound business policy. We do not encourage any plan which involves "something for nothing." We always insist that the current interest rate be paid by the prospect for private funds invested by local citizens in constructing a plant. Local citizens are advised by us to do all possible to keep costs down and many services are rendered without cost during construction period by civic-minded citizens. Good coöperation and a friendly welcome is far more valuable to all concerned than free land and free rent.[26]

Both state and community agencies seek all pertinent information about a location-seeking industry before recommending or showing particular sites. Included in this study are questions concerning the prospect's need for financial assistance, as well as requirements and preferences relating to transportation, labor, and similar matters. The following is

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[25] "Gary Cuts Loose; Steel Town Takes on New Industries." *Business Week*, February 14, 1948, No. 963, pages 50–52.

[26] Excerpt from letter of August 26, 1948, from Jefferson D. Henry, Director, Industrial Division, Alabama State Chamber of Commerce, Montgomery, Alabama.

fairly representative of an inquiry form used for this purpose where no question of local financial aid is involved:

STATE CHAMBER OF COMMERCE, INC.[27]
Industrial Development Schedule No. 4
STATEMENT OF INDUSTRIAL REQUIREMENTS

Date of inquiry _____
Name of firm _____ Date established _____
Address _____ City _____
State _____ Date inquiry received _____
Manner received _____
Name and title of inquiring party _____
Type of industry _____
Contemplated plant will be: Main plant ☐ Branch ☐ Distributing ☐
Type of area or community desired _____
Must be no farther than _____ miles from _____
Space needed on or before _____
Building requirements: Building to be (in order of preference)
Single story ☐ Multi-storied ☐ Leased ☐
Purchased ☐ Constructed ☐
Minimum sq. ft. _____ Maximum sq. ft. _____
Storage yard sq. ft. _____ Type construction _____
Floor load (lbs. per sq. ft.) _____ Ceiling (height of clearance) _____
Plant situation desired: Minimum _____ Acres
Maximum _____ Acres
Raw materials used in manufacturing _____
Distribution from location: National ☐ Regional ☐ Foreign ☐
Transportation facilities needed: Railway siding _____
Car capacity _____ River terminal _____
Truck loading dock _____
Bulk of raw materials received by: Rail ☐ Water ☐ Truck ☐
Air ☐

(Reverse side of inquiry form)

Bulk of finished products shipped by: Rail ☐ Water ☐
Truck ☐ Air ☐

[27] Inquiry form used by the Kentucky Chamber of Commerce, Inc., Louisville, Kentucky.

Electric power required: Minimum daily load _____KWH.
Potential daily load _____KWH.
Annual fuel requirements: Coal _____Tons Gas _____Feet
Oil _____Gals.
Daily water requirements: Minimum _____Gals. Maximum _____Gals.
For what process is water to be used: _____
If specific chemical requirements, give details _____

List in order of importance major factors which will determine location:

Bank reference or financial statement _____
Labor requirements: _____

	MALE	FEMALE
Skilled		
Semi-skilled		
Unskilled		

Union Affiliation: _____
Individual to whom correspondence should be addressed: Name _____
_____Position _____Address _____
Do you wish your name withheld in these negotiations? Yes ☐ No ☐
Remarks: _____

In the latter case inquiries such as the following, used by one state chamber of commerce, may be added to the usual questions.

Industrial building: (If an existing building is not available)—
A. Wish to construct own building?
B. Wish local investors to construct building?
1. On long-term lease?
2. On rental purchase contract?
3. For out-right purchase on cost-plus basis? [28]

A liaison office such as the agencies under discussion needs information about communities within the state that are seek-

[28] Excerpt from letter of August 26, 1948, from Jefferson D. Henry, Director, Industrial Division, Alabama State Chamber of Commerce, Montgomery, Alabama.

ing new industries as well as data on the requirements and preferences of industries seeking sites. Information of the former type consists of complete lists of all available buildings and industrial sites, and data on basic industrial location factors. Most state and community agencies make surveys to discover available buildings and sites and relevant information about each, such as area, rental, type of building, and equipment. In recent years, according to comments made by the directors of many of these agencies, small firms seeking locations have been unduly influenced by the availability of a usable building that can be rented. This is a short-run viewpoint, and it could easily lead to uneconomic locations.

The most comprehensive analysis of the basic factors influencing industrial location was prepared and published in revised form by the Area Development Division, U. S. Department of Commerce, in June, 1947.[29] This is an excellent guide for evaluating an area's resources for industrial development.

For 75 industry groups the report evaluates each of the 13 basic factors as "most important" or "usually important." An examination of the report supports the statements made by community agency directors that each industrial location problem is a case by itself. A careful study of the report is necessary to understand the complexity of industrial location, and the following comments based on the report are generalizations. Six of the basic factors were rated "most important" for the 75 industry groups as follows: distribution facilities, 66; tax structure, 63; transportation structure, 56; labor, 39; market, 32; and location of production material, 27. This means that out of all industry groups included, 66 rated distribution facilities among the "most important" factors, and for 9 groups they were "usually important" factors, whereas location of production material was a "most important" factor for only 27 industry groups and a "usually important" factor for 48. Nat-

[29] Industrial Series, No. 74, U. S. Department of Commerce, *Basic Industrial Location Factors*. Washington: U. S. Government Printing Office, 1947.

urally the relative importance assigned to each of these basic factors by a particular industry will depend not only on its normal requirements (as intended in the report) but also upon the particular objective in seeking a new location at a certain time, and prevailing conditions if they are unusual. For example, a company for which labor is not normally a "most important" factor, may under certain conditions place major weight on this aspect in seeking a new location.

For the purpose of encouraging local communities to conduct surveys and to do some self-appraisal, as well as to furnish information necessary to help industries make an intelligent location selection, most state agencies provide guidance to local communities. Many have issued booklets for this purpose. Others use a prepared form. The most comprehensive of these questionnaire outlines to come to the authors' attention was that used by the Minneapolis Field Office of the U. S. Department of Commerce. It is a 12-page work sheet prepared for use in connection with the U. S. Department of Commerce publication, *Basic Industrial Location Factors,* and was originated by the Michigan Department of Economic Development. The work sheet is presented as Appendix D.

In response to inquiries, a number of state and community agencies reported their opinions as to the factors of greatest importance to small- and medium-sized firms in seeking a plant location. The following are representative of their comments:

1. New industry, according to our observation, selects a community for location because of the following reasons:

Desire for expansion forces consideration of the South; nearness to growing market.

Available existing industrial buildings.

Financial assistance in construction of new plants.

Availability of raw and basic materials.

Availability of large labor pool.

Lower operating costs:

Cheaper rents.
Cheaper utilities.
Cheaper costs of construction and maintenance.
Taxes (state and local).

Human element—more production per labor-wage dollar; desire to be important in a small community: "Big frog in a little pond vs. little frog in a big pond!"

2. There are specific needs for natural resources which affect the location of many industries. Heads of several hundred important companies were asked to indicate those factors most important in choosing a site for a plant. This survey revealed the following requisites in the order of their importance:

	Factor	*Per Cent of Total Points Scored*
1.	Proximity to markets	17.5
2.	Settled labor conditions	16.9
3.	Favorable tax rates	12.7
4.	Railroad facilities	11.4
5.	Proximity to sources of supply	11.4
6.	Plentiful labor	10.5
7.	Power facilities	7.0
8.	Water supply	5.0
9.	Residential characteristics	3.1
10.	Water transportation	2.7
11.	Miscellaneous	1.8

Of course there are times when this ratio can be materially shifted. Many factors on a specific need or requirement of a company take higher orders of importance.

3. Under ordinary conditions industries in selecting a location are influenced by (a) reputation of labor for working and coöperating (b) location of markets and raw material (c) reputation of state and community for working with and not against the industry.

4. The factors of greatest importance causing small- and medium-sized manufacturers to select a particular location vary from case to case. However proximity to a large, discriminating and relatively prosperous market stands high on the list. Labor

supply and available plants are frequently emphasized, although the larger concern is less likely to need an available plant than is the small manufacturer.

5. With respect to the factors affecting plant location, . . . the type of plant governs these factors to a great extent. Generally speaking, however, the relationship of raw materials to markets, with the attendant problem of transportation, is generally considered of primary importance.

It has been our experience that the second most important factor is the attitude of state and local government officials towards new industry. This may include the over-all tax picture or merely a willingness to coöperate with an infant industry, but certainly one of the most unfavorable factors in keeping a plant away from a given locality is a hostile attitude of those in authority.

The third factor in our opinion deals directly with labor—both its availability in the necessary skills and its attitude in general. Of course, and dependent on the type of plant, other factors are considered as basic. These may be ground water or utilities, waste disposal, proximity to related industries, etc.

6. The factor which seems to be of greatest importance in causing small- and medium-sized manufacturers to select locations in small towns is the lack of competition for a particular type of labor. We have had some few industries which were interested in getting away from radical C.I.O. leadership, but in general most of the concerns which have contacted us are not opposed to union labor.

7. It is our opinion that the following factors in the order listed are of the greatest importance to small- or medium-size manufacturers in their selection of a location:

(1) Cost or rental of building.
(2) Labor supplies.
(3) Taxes.
(4) Source of raw material.
(5) Location of markets.
(6) Transportation facilities.

8. The relative importance of the major economic factors influencing plant location, large or small, varies with the classification

of industry, depending on whether and to what degree it is resource oriented, market oriented, or somewhere in the intermediate or "footloose" zone.

My experience with "small business" opportunity seekers in the industrial field gives me the impression that few of them know how to gather and analyze factual data and apply their own judgment to such a problem. Far too many of them think or hope there is some shortcut, by which a central research agency such as ours can give them offhand opinions as to what field of industry or what community offers the best opportunities.

As a guide to individual planning for starting small manufacturing businesses, the U. S. Department of Commerce prepared a list of 100 questions, 11 of which deal with plant location. These are:

1. Which will provide you with the most economical operation, locating nearer your source of material supply, your labor, or your market, measured by relative freight, labor, distribution, power and other costs?
2. Which is more desirable, a city or country location?
3. Where will you find an adequate supply of labor of the types you require?
4. What transportation, power, water supply, fuel, do you need, and where will you find them adequate?
5. Are climatic conditions important to your product or process?
6. What zoning ordinances are there to consider? (You should check with your local authorities. Unless the site you select is zoned for the type of business you intend going into, there is little point in considering it further.)
7. What fire protection will you receive in various localities and sites? (You must provide it if the community does not.)
8. What waste disposal and sanitation features do you find in various localities and sites? (This is highly important in certain industries.)
9. How do tax rates compare, allowing for differences in municipal services?
10. If the cost of the proposed site appears excessive, what neces-

sary services or advantages does it possess which would require additional expenditures at a cheaper site?

11. If your market will be local, what are the market prospects that justify your choice of community? [30]

When the small manufacturer has become familiar with the basic location factors and available sources of information and assistance, his next step should be to analyze his particular business as to location requirements. His choice of region or community will be limited to those suitable to the nature of his concern. Otherwise he will weigh the relative importance of each basic factor and select the community most advantageous from the standpoint of personal preferences and future prospects. The personal aspect is the one outstanding difference between plant location for the average small factory as contrasted with the large concern. For industries in the "footloose" category, it may be the only consideration for the small businessman as far as region or community are concerned.

In most cases of small plant location where personal factors are not of great importance there will be some choice as to size of the city and character of the area, such as industrial or agricultural, densely populated or average, mature or expanding regions, central city or suburban locations. Since we have eliminated personal factors, preference should be given to the newer, expanding areas, and suburban rather than central locations. If other factors are the same, the small manufacturer should weigh carefully certain advantages of the agricultural region in preference to the industrial. Since most of the reasons for choosing the newer and the suburban areas are similar to those for preferring the agricultural region, our explanation will be limited to this comparison.

An agricultural community is more appreciative of a new industry, even a small factory, than is an industrial area. Even

[30] Manufacturing Management Section, Management Service Division, U. S. Department of Commerce Office of Small Business, *One Hundred Questions to Be Considered in Establishing a Small Manufacturing Business,* pages 2–3. Washington: 1946.

when the factory does not use local crops or natural resources it provides regular or seasonal employment for surplus local

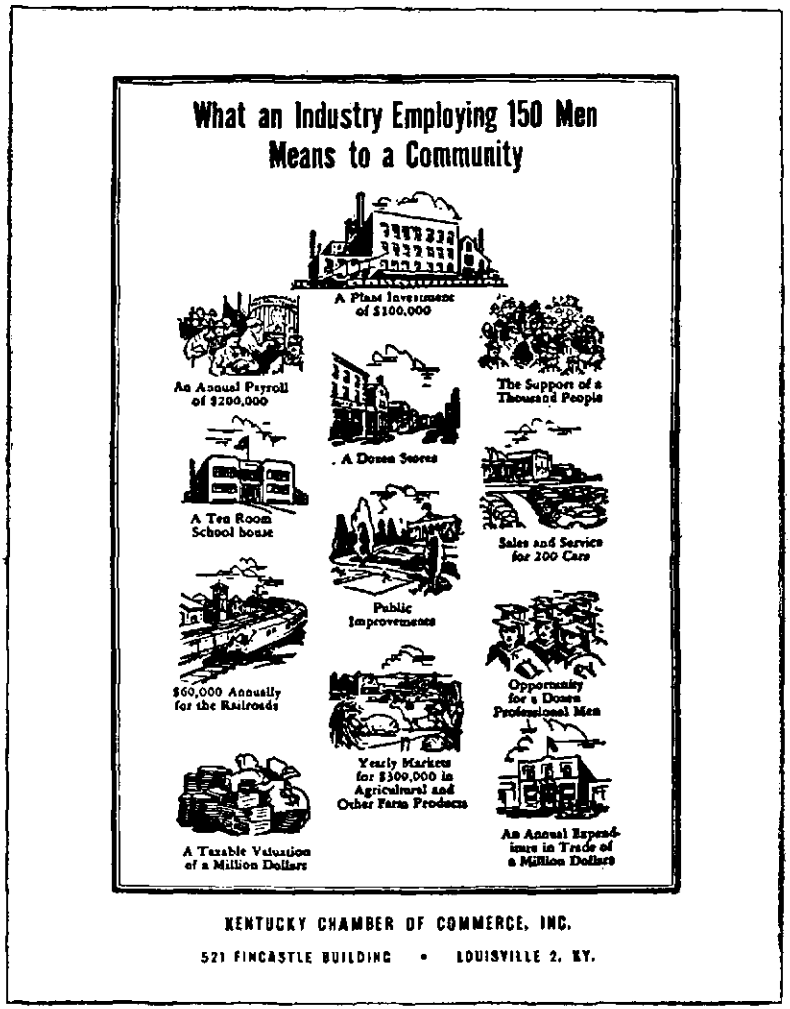


Figure II.

labor.[31] Wage levels tend to be lower in agricultural than in industrialized areas, but under appropriate conditions the

[31] What a small industry can mean to a town is pictured in Figure II.

quality of workers can be as good or better. Usually it is more stable and less independent. Industrial machinery is just as productive when operated by a competent former farm boy as when run by a native of an industrial center. Within reasonable limits the same is true of modern methods of labor subdivision and other aspects of the technology of production. It is the machine and the highly developed technology of modern production rather than the birthplace of the worker that makes American manufacturing so much more productive per man-hour of work than activities such as merchandising, or services that are performed "by hand," and those of agriculture that are largely dependent upon both hand labor and the relatively fixed productivity of "nature."

In capsule fashion the preceding paragraph explains the economic superiority of manufacturing over all other types of business activity. Higher wages for the same hours of work and effort are paid in manufacturing than in other fields of business—i.e., comparable labor receives higher wages. Most of this payroll circulates in the community to the benefit of merchants, service establishment operators, professional men, real estate owners, and others. Manufacturing enables the local community to "export" its most immobile resource, labor. The much greater productivity of industry makes possible more rapid capital accumulation, which in turn increases the rate of expansion in all local economic values. Is there any wonder why a factory is appreciated in an agricultural community?

The small businessman considering an agricultural versus an industrial location is interested in two important aspects favoring the former. The first relates to cost. Not only is labor more loyal, dependable, and of lower unit cost (in spite of the manufacturer paying well above prevailing local wages), but other costs, with the possible exception of transportation, are also lower. Since his product is in price competition with other products, whether of the same type or not, lower total unit costs are especially important. This is particularly true during the "small" stage, when volume of output is not large and a

greater margin per unit is required for satisfactory total profits.

The second aspect relates to the effects of future industrial development of the community. If the product manufactured can be sold more profitably in a local market, the more rapid expansion of demand to be expected in the agricultural community is an advantage. If the market is widely but thinly distributed over the country, however, a rapid industrial expansion of the community in which the factory is located may become an economic disadvantage by increasing total production costs per unit.

Selection of a site for the small factory within a city will be governed by the same factors that apply to larger industries: comparative cost of rent or construction, accessibility of inter- and intracity transportation, parking facilities and accessibility for workers, zoning regulations, and similar considerations. Principally to the extent that the small concern may require less land, a small work force, and other factors on a smaller scale, will the import of these be significantly different.

One other aspect of location that should be considered is visibility for mass traffic. Recent surveys by the authors have disclosed what common observation should confirm, that newly established branch plants of large corporations have been located to capitalize on this "outdoor advertising." Although the beginning small manufacturer lacks the nationwide reputation that is associated with the identification of branch plants as just mentioned, he needs this free advertising even more than the large concern does. It is good judgment for the small operator to select a site that will permit full use of outdoor advertising. Identifying signs, modern appearance of the building, well-kept premises, and visible evidence of a modern though small factory all will serve this end.

Location of the Service Business

The general policy governing the kind of service business to be established will probably have more bearing on the requirements for a good location than in other major fields. A per-

sonal service, professional or semi-professional, where clients call at the place of business should be as accessible as possible. This may mean an office location in the financial district or a shop location in one of the better retail districts. If the customer does not visit the business, then location as far as site within the town is concerned is relatively unimportant. An interesting characteristic of most service businesses is that a reputation for extra high quality of workmanship will attract customers in spite of a poor location to a far greater extent than is true of other kinds of business. However, since this is an exception and since it comes about only after the reputation is earned, the beginner especially should seek the best location in which to build such a reputation.

Some kinds of service businesses require a factory type of location where the actual work is performed, and a retail site for customer contact. This may be illustrated by a laundry or dry cleaning firm doing a large amount of cash-and-carry business.

Policies relating to the market or type of clientele desired will influence the choice of town and area within a town whenever: (1) a special type of customer constitutes the market, such as office workers, or automobile factories; (2) the service is one for which there is widespread demand; or (3) existing competition deviates appreciably from normal.

Both in selecting the town and the district within a large city, care should be exercised to learn the facts. Assumptions that appear to be logical are not always borne out by reality. For example, although a heavy concentration of car ownership means a good market for automobile service establishments, clean cities are better markets for dry cleaning establishments than dirty ones.

Drive-ins are important in many service fields where the customer brings the article to the shop. These include many types of repair shops, and laundry and cleaning establishments. A location close to the central business area on an automobile artery and on the side nearer the better residential districts is

considered best. Delivery services are becoming increasingly costly, the present trend is toward service at the shop rather than in the home, and customers are willing to do the transporting in most cases. For these reasons service businesses not yet launched on the drive-in principle should consider this possibility whenever it is appropriate. Even some personal services like beauty parlors and barber shops are finding advantages in this type of location.[32]

To illustrate the application of location factors, several different kinds of service businesses have been selected. The following bits of advice adapted from various government publications [33] touch upon some of the important points in each line but are not intended to be a complete treatment of each case.

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[32] For further study see: Small Business Aids, No. 193, U. S. Department of Commerce, "Your Shop Location." Condensed from "Your Shop Location," by Samuel C. Milbourne. *Radio News,* January, 1947, Chicago, Ziff-Davis Publishing Co.; Trimble, P. C., *Establishing and Operating a Dry Cleaning Business.* Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 33, 1946.

[33] Gordon, Edith E. (under the direction of H. G. McCoy), *Establishing and Operating a Beauty Shop,* page 15. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 25, 1946. Bryan, Mary de Garmo, Macfarlane, Alberta M., and Hawkins, E. R. (under the direction of Walter F. Crowder), *Establishing and Operating a Restaurant,* page 28. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 39, 1946. Small Business Aids, No. 133, U. S. Department of Commerce, "Establishing a Drive-In Cash-and-Carry Laundry." Condensed from Chapter 16, "Drive-In Cash-and-Carry." *Establishing and Operating a Laundry,* Industrial (Small Business) Series No. 37, U. S. Department of Commerce, 1946. Small Business Aids, No. 147, U. S. Department of Commerce, "Operating a Photographic Supply Store." Condensed from *Photographic Supply Store Operation,* March, 1946, Albany, State of New York Department of Commerce. Small Business Aids, No. 160, U. S. Department of Commerce, "Establishing a Diaper Service." Condensed from *Establishing and Operating a Laundry,* Industrial (Small Business) Series No. 37, U. S. Department of Commerce, 1946. Small Business Aids, No. 193, U. S. Department of Commerce, "Your Shop Location." Condensed from "Your Shop Location," by Samuel C. Milbourne. *Radio News,* January, 1947, Chicago, Ziff-Davis Publishing Co.

Beauty shop

A well-established beauty shop is much less dependent on customer accessibility than are most other business enterprises. With very few exceptions, the clientele of the beauty shop is composed of women, and when shopping for personal service, women are rarely concerned about convenience of location.

Most women dread the thought of changing from one beauty shop, or one operator, to another. They are reluctant to give up the services or special treatments they have been accustomed to in one shop and brave the ordeal of finding a new operator who will understand their needs. Accordingly, they will follow a well-known or popular operator when she leaves a shop even though her new location is not so convenient as her former place of employment.

Such customer behavior does not rule out the importance of location, however. While a good location in itself may not assure you a large business, an undesirable location will lessen your chances. There are certain objectionable features of buildings and sites which you must avoid. Women are repelled by dark, dingy, uninviting stairways, and by musty, ill-smelling, run-down buildings. They are quick to notice unsanitary conditions, noisy surroundings, or proximity to certain kinds of businesses they consider public nuisances.

Privacy from public view is important in a beauty shop. Many women object to sitting under driers in a street-front shop unless some provision is made to exclude the public gaze. On the other hand, they are not attracted by little-used sidestreets, unattractive entrances, and doorways that are difficult to locate.

You cannot build and maintain a high-class beauty trade unless your location is attractive. Select a location that will be an advantage to your business, but do not depend on this one factor for your success.[34]

Restaurant

In selecting the actual site—the street address—for the eating place, one of the first things that must be considered is its access to

[34] Gordon, Edith E., *op. cit.*, page 15.

transportation facilities. If customers will come by automobile, parking space will be essential. In fact, if the majority of them come by automobile, you may need your own parking area. A fire hydrant in front of the restaurant will prevent parking there, and will slow up food delivery. Lack of an alley means that trucks must take up parking space in front.

The preferred side of the street can only be decided by actual observation in the proposed location. A southern exposure gets the sun all day, it is the warmer side in cold weather, and the ice melts more quickly. On the other hand, the sun may be considered undesirable because of the effect it has in producing window glare. As a general rule, the southern exposure might be preferable in a cold climate, and the northern exposure in a warm climate.

A good spot for some types of restaurants is near . . . a streetcar or bus stop, [on the stop side,] not across the street beyond it. Transfer points are particularly good, as are bus and railroad depots.

In some cases, the going-home side of the street is better for dinner business, and the going-to-work side is better for breakfast business.

It is desirable also to choose the side that is easier for automobile traffic to reach, and where it is easier to obtain parking space.

More important, however, is the amount of customer traffic, especially for the convenience type of eating place. And for the more elaborate restaurants, the quality of the traffic is of some consequence, for one side of a street may be regarded as higher class even though the other side has a greater amount of traffic.[35]

Drive-in cash-and-carry laundry

As far as geography is concerned, almost any section of the United States is suitable. All that is needed is a trading area large enough to support the drive-in. However, the chief development in this type of laundry has come in the South, where pleasant weather permits people to enjoy being out of doors and in their cars.

Since the drive-in operator is dependent on his market coming to him, he must find out where the best potential market is. The best market is where there is the largest concentration of home

[35] Bryan, Mary de Garmo, *et al.*, *op. cit.*, page 28.

owners, or high rent payers, and car owners. In most cities, the chamber of commerce or the real estate firms will have maps showing residential areas by rent-paying groups. Study of such a map will indicate a good section in which to locate your plant.

If figures are available, it would also be well to check the population-shift trend and choose a location in which the population is growing. Then observe closely to see on which streets people drive most. The best spot for a drive-in laundry is on a main artery of traffic, fairly close to the outskirts of the business area. It should be on a corner, if possible.[36]

Photographic supply store

The retail photographic supplier generally should locate in or near the main shopping districts. The proprietor may intend, however, to concentrate upon commercial photographic supplies and equipment, selling to photographic laboratories of manufacturing and commercial establishments. For this kind of trade the store may be more nearly of the nature of a warehouse, with most of the selling done by calling upon customers. Whatever the type of operation, it is advisable for the prospective store owner to consider location carefully as an important factor affecting the success of his business. Rentals should be closely checked against expected sales volume in each prospective location.[37]

Diaper service

The matter of geographic location for a diaper service requires careful thought from the standpoint of potential business. The following factors are significant:

Birth Rate. An average of 2,500,000 babies were born each year in the prewar period. That number increased to 3,260,000 in 1946. Hence it would seem that the present is a good time to start a diaper service. Of course the birth rate varies in different cities, but if the rate in a particular city is climbing, that city will be a more favorable market for a diaper service than one in which the birth rate is stationary or declining.

Income Level. The best prospects for diaper laundry service are

[36] Small Business Aids, No. 133, *op. cit.*, page 2.
[37] Small Business Aids, No. 147, *op. cit.*, page 2.

in the upper-middle or middle-income groups, among native-born, white-collar families that do not have many children.

Competition. You may be faced with competition from other diaper service laundries, from large family laundries and linen supply companies that have added diaper service, and from further possible development of the disposable diaper. The number of possible customers is strictly limited by the number of infants in the community. To support a business that is exclusively a diaper laundry service, a city should have a population of at least 100,000. For two competing laundries, 150,000 population is considered necessary. Include the population of the metropolitan trading area (suburbs) in estimating your potential market.

Estimating Sales Per Customer. Service for the average baby starts with 70 to 90 diapers per week, tapering off after six months to 50 or 60 per week. The price schedule will vary with the community, but assume an average price of $1.40 for 70 diapers. If you had 300 customers at $1.40 weekly, your weekly sales would be $420, your yearly sales about $22,000. An alert operator could make a satisfactory living out of a business as small as this.[38]

Radio service business

If you do not have sufficient radio [and television] service work to support a small store on a side street, your logical step is to work up a clientele in the basement or in a spare room of your home before you risk too much money in the rental of a store. Many [radio and television] service men make a satisfactory living operating from their homes with a minimum of expense.

If you are to engage in a "wholesale" repair business, doing work exclusively for other radio dealers and service men, there would be no need for a fancy store front on or near a main street. A loft, or other cheap but commodious floor space, centrally located with respect to your dealers, would be your answer.

If you intend to service only a portion of the town or city, locate your shop near the center of this area. If you are operating in a large city and plan to confine yourself to one neighborhood, consider the location of your new shop as it relates to the district

[38] Small Business Aids, No. 160, *op. cit.*, pages 1–2.

you wish to serve. Try to locate near the center of your customer area.[39]

Conclusions

To the inexperienced businessman it may seem that this chapter has been unduly long in view of the infrequency with which new locations are selected by the independent small business owner. If so, he has missed the main point. Location is so intimately, and *continuously* related to all other aspects of a small business that over-emphasis would be difficult. As the reader will notice in later chapters, *nearly every phase of operating the business depends to some degree upon its location.* This fact probably ranks in importance only after one's religion, wife, and choice of occupation.

Review and Discussion Questions

1. For what kind of business is the percentage lease most suitable? Why? For what kind of business is it most widely used? Why?

2. List the various conditions and circumstances under which you would prefer:

(1) a percentage lease.

(2) a long-term lease of ten years or more.

Be prepared to justify your answers.

3. Although chain organizations give the greatest attention to selecting localities, why is this task of even greater importance to the small businessman?

4. Explain how, and why, the relative importance of location varies in the different major fields of small business.

5. How does the importance of location for the small businessman depend upon the extent to which he is known in the community?

6. List all the kinds of businesses that could effectively use a drive-in type of location. Explain any unusual cases.

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[39] Small Business Aids, No. 193, *op. cit.*, page 1.

7. List the zoning ordinances and other legal regulations to consider for several types of businesses of possible interest to you.

8. Outline a plan for taking traffic counts for two different kinds of small businesses.

9. Select what appears to be one of the best and also one of the poorest locations for one kind of business in your vicinity and discuss the location with each business manager.

10. What important developments regarding location do you predict for the next ten years? Discuss each.

11. Does the rent-advertising relationship discussed in this chapter, with regard to retailing, apply to small-scale manufacturing? To small-scale service businesses? Explain.

12. How would you expect location to be related to factors like the following for each field of small business: layout, credit and delivery policies, financing, relations with resources, customer relations and sales promotion, government regulations and taxation, personnel? Discuss.

13. Assume your choice of location for a retail store in each of the following instances is limited to two sites as described. Explain which you would choose and why.

(1) For an independent variety store in a town of 15,000: (a) two doors from a chain variety store at a rent of $125 per month; or (b) one block from the central shopping district, on a parallel street with service shops and offices, at a rent of $50 per month.

(2) For a small dress shop in a town of 50,000: (a) in the center block occupied by the two leading department stores, at a rent of $150 per month; or (b) on the same street on the corner opposite one of the department stores, at a rent of $125 per month.

(3) For a factory making an item half the sale of which is to local stores and half to "drop in" customers, processed from local raw materials of ample supply, in a town of 100,000 population: (a) one mile from the central retail district, on a main automobile artery one-half mile from the railroad station, at a rent of $65 per month; or (b) three blocks from the central retail district, on the main U. S. highway one-half mile from the railroad station, at a rent of $110 per month.

14. List any factors not mentioned in the chapter that should be considered in selecting a location. Discuss.

15. Why is the right location so necessary to a retail store? Explain.

16. For a retail grocery store doing exclusively telephone order and delivery business (no customers admitted to the store) describe the ideal location.

17. Assume a "robot" type of grocery store using mechanical equipment that cost $50,000 and having a useful life of ten years. The store is operated by one man with a helper, giving a total payroll of $300 per month. A complete line of packaged groceries and meats is sold at 15 per cent less than the prices in regular service grocery stores. Describe the ideal location for such a store. Discuss.

18. Discuss the factors to be considered in selecting a location within a town by: wholesaler, manufacturer, and service establishment.

19. Explain how the beginning businessman can profit by fitting his offerings into wants not already supplied by large competitors.

20. Discuss the advantages and disadvantages for a small manufacturer selling to a local market. How would these vary by type of product? By size of town?

21. Why is location so important in all aspects of business? Discuss.

Chapter VIII

PHYSICAL PLANT AND LAYOUT

In Chapter VII we noted that for the small businessman who does not want to construct his own building an important consideration in selecting a desirable location is the nature of the building. For a particular type of business some buildings will be ready for use with little or no alteration; others will require varying amounts. It is our purpose in this chapter to discuss basic considerations regarding the most desirable building and the way in which it will be put into use through proper layout. Very often these two problems are so closely related that a satisfactory solution of one necessarily involves solving the other. Since a building cannot be utilized most effectively unless machines, equipment, fixtures, and similar elements used by the business are provided for, we must consider all these topics as integral parts of the major problem of determining the physical plant and layout.

Most beginning small businessmen will start with a building more or less well adapted to their needs, especially in the retail field and in most service businesses. An available building will customarily be used in beginning manufacturing operations on a small scale also. In either case the problem is to adapt the structure to approximate as nearly as possible an ideal building for the purpose. The same result is desired as if the building were designed and constructed for the particular business.

Adapting the Building

The building itself does much more than merely house the concern. It should aid greatly in performing the type of activities that are of greatest importance in each kind of enter-

prise. Some of these considerations may be grouped under three major headings: (1) function, (2) construction, and (3) modernization, or improvement in appearance, comfort, and effectiveness.

Function

At least seven aspects of this problem must be considered: (1) suitability, (2) cost, (3) accessibility, (4) internal transportation or traffic, (5) human aspect, (6) layout, and (7) current trends in management.

A building is good or bad in direct proportion to its suitability to the activities that must be performed for its intended use. Excellent housing for one business may be next to impossible for use by some other. Utility is the keynote here. Simple protection from the elements and burglary may be sufficient for many lines of retailing, whereas heavy construction and solid concrete floors might be required for certain manufacturing or service industries. The shape of the building may affect its suitability. An unusually long, narrow structure might be of little value for a retail store but ideal for some factories or service industries.

Low cost of operation and maintenance is always desirable, provided it is not obtained at the expense of such more important considerations as efficiency in use. Efficient maintenance and use depend upon two factors, the condition of the building and its business application. The former is obvious and does not vary according to most of the different uses to which a building may be put. The latter must be considered in relation to all the other functional aspects.

Accessibility is an important factor. By kinds of business it varies as follows: in retailing customer accessibility is of greatest importance, but adequate facilities for receiving merchandise and making deliveries should be provided; in manufacturing easy receipt of raw materials and discharge of finished product are dominant; service industries usually re-

quire accessibility for customers or clients and often also require easy access for delivery equipment. Accessibility to a retail store building is hampered by steps, a narrow entrance, or any type of obstruction, such as a post. Steps represent an accident hazard as well as an obstacle to customer traffic. A non-skid ramp may be the best solution if no way can be found to eliminate differences in elevation.

Receipt of goods may be difficult if there is no door to an alley or if goods must be unloaded from a heavy traffic lane without an offset for trucks. Delivery through the main customer entrance is extremely undesirable. Where merchandise traffic is heavy, unloading platforms at truck level are useful; gravity chutes may be used if the receiving room is below ground level. Recently portable roller chutes that save human energy and time have come into use. Employee accessibility also is often important for manufacturing and service industries.

A small drycleaning plant increased daily output 50 per cent by making some changes involving improved accessibility for trucks and internal rearrangement of departments. The rug cleaning department, which handled only 25 or 30 rugs a year, was discontinued. Marking and sorting operations were moved from the finishing room to the former rug cleaning room, and a new rear exit was made where trucks could load and unload. Formerly, the routemen had brought everything in through the front door. After marking, it had been pushed up to the dry cleaning room in baskets. By this change, undesirable traffic through the front door was eliminated. Adding the rear exit also made it possible to leave the solvent tanks and purification equipment where they were. The washers, extractors, and tumblers are now part of a straight line flow of work from marker and sorter through dry cleaning and finally to the finishing lines. The spotting board was taken out of the dry cleaning room and put at the head of the finishing line. The work now flows in two unbroken lines—

wool and silk—and no operator needs to leave her station to get garments or to carry them to someone else.[1]

Closely related to external accessibility is the question of internal transportation and traffic facilities provided by the building. Movement of materials has become of great importance in manufacturing. Except in extreme cases where the construction of the building actually obstructs movement, however, operations beginning on a small scale may subordinate this factor. Retail stores naturally wish customer traffic to be unhindered by columns, different floor levels, irregularly shaped buildings, and similar conditions. Movement of merchandise within the store may be important for items like furniture, heavy appliances, or especially bulky containers. In service establishments the nature of the process largely determines the importance as well as the type of internal transportation facilities. A beauty parlor and a job type of machine shop obviously have very different requirements.

Good layout often depends upon the nature of the building. At one extreme is the industry that almost requires a specially constructed building; at the other is the type of business for which any average building is suitable. An example of the former might be a power laundry; of the latter, the typical small retail store. This topic will be developed in greater detail later in the chapter.

Comfort and convenience are motives that account for a surprising amount of human conduct. The department store as well as the modern automobile are based on these consumer objectives. Workers shift to jobs of lower pay if comfort and convenience are more attractive. No businessman can safely neglect this pair of essential factors in the building and layout. Modern methods have been developed whereby most large businesses can meet these demands in spite of unfavorable elements in the construction of the building. In general, if the building will permit a desirable layout and economical mod-

[1] "Small Plant Gets Modern Work-Flow." *American Drycleaner*, December, 1945, Vol. 13, No. 9, page 29.

ernizing, these objectives will be achieved.

Management methods change from time to time in keeping with changes in relative costs of land, labor, and construction and in response to new technological developments and changes in accounting, control, or supervisory procedures. A prospective building should be examined in relation to such management trends. Does it permit utilizing modern management methods, and can it be easily adapted to those that appear imminent?

Construction

Our concern here is less with architectural engineering factors than with existing conditions. Safety for customers, personnel, merchandise, and equipment comes first. Condition of the roof, foundation, supporting columns, and floors should be investigated, especially in the case of older buildings. Most cities prescribe acceptable types of construction to protect occupants. However, a building constructed according to these requirements may not be safe at a later date, especially for a totally different type of business. Insurance rates will be one useful indicator.

Modern design as well as the use of improved construction materials should receive attention when a building is appraised. The former is more functional and less ornate than traditional architecture. It permits remodeling to secure a greater amount of glass for light and ventilation, or removal of supporting columns that obstruct internal movement or visibility. Load-bearing walls used in older buildings make certain types of remodeling difficult and constitute a hazard in case of fire. Modern design also stamps the business occupant as being modern. However, wonders have been accomplished in modernizing many old buildings. It is not so much the age of a building as the feasibility of modernizing that is important. Naturally the tenant will want the landlord to bear the cost of modernization or other structural changes required to make the building suitable, and very often this can be arranged.

A peculiar situation sometimes arises when an old building was formerly used for a special purpose. One example was encountered by the authors recently. A narrow structure that was used as a small town bank for many years had a large reinforced concrete vault located in the center of the floor area, constructed as an integral part of the building. To remove the vault meant demolishing the structure at a heavy cost and involving the occupants of the second floor. A workable solution was reached by converting the vault into a stock room for the shoe department of the men's store with the shoe selling area adjacent to the vault entrance. Since the building was owned by the new merchant's father, it was a case of making the best of a bad situation and the solution may not prove satisfactory over a period of years. However, considerable ingenuity has resulted in a remarkably attractive store in which the former vault is as inconspicuous as possible.

Improvements are constantly under way in the field of floor coverings. Terrazzo, asphaltic tile, inlaid linoleum, hardwood or composition blocks, and special waterproof, rubber base, and anti-skid paints are examples of fairly recent developments. Floor coverings and materials for special purposes are also available, such as those resistant to acid, impervious to gasoline, and unharmed by certain fumes or other chemicals likely to be present in particular types of business.

Floors should be selected with their intended use in mind. Reinforced concrete reduces vibration and is ideal for heavy warehouses; resilient materials increase employee and customer comfort; non-slippery surfaces reduce accident hazards; some materials are resistant to special chemicals or unusual wear; and others are attractive and particularly suitable for lighting requirements. Areas visited by customers may have sales promoting features, guide lines, trade-marks, or "atmosphere" inlaid in the floor.

Will the building permit expansion or alterations that may be needed later? Is it flexible and adaptable to other possible uses? Potential growth and changes in the proposed business

during the term of the lease and possibly for the next five to ten years should be considered. Will the occupant want to add new departments? Where can they be housed? If one is starting a service business and may contemplate adding retail sales later, is the building, as well as its location, suitable? Is the area or space such that he can use it economically? What about subleasing part of the building now in order to have it available later for expansion? Is extra space that can be used effectively during dull seasons available for recurring peaks of selling, storage, or processing? These are some of the many questions that should be investigated before a final decision is made, and many of them should be provided for in the lease.

Modernization

The external appearance of the building is important in many ways. In one sense it serves as an advertising medium. It should represent the character of the business, identifying it and at the same time distinguishing it from others. Some attempts to make the building represent the character of the business take extreme forms. The massive columns and thick marble walls, floors, and fixtures of many bank buildings illustrate the point. Modern architecture can achieve the desired impression of safety, stability, permanence, and dignity by less expensive means. Such a building may become a "white elephant" if the bank fails and the building cannot be converted to other uses. A better example of representative character is the modern fronts of retail and service businesses operating on up-to-date principles and methods, the luxurious front of the exclusive shop being contrasted to the practical, economical appearance of the popular-price store.

Certain characteristic store fronts have become so well associated in the minds of most people as to identify the type of store. These so-called "family characteristics" may be noticed in the red front, gold trimmed variety store or the blue and white bakery. The size and height of the windows in these

stores, like the windows of jewelry and apparel stores, betray other family characteristics. Chain stores and voluntary chains have store fronts that identify the line of business as well as the particular company. Corporate chains that have entered the field of agency or franchise stores, as well as the voluntary chains sponsored by wholesalers, usually require a standard, identifying type of store front.

The building, including the front, may distinguish a particular business merely by being different, yet fashionable, or by attempting to visualize the nature of the business or its name. The Brown Derby in Hollywood illustrates the latter case. Orange juice stands are often constructed to resemble a huge orange, hot dog stands are shaped like a sausage, and many other specialized lines of business advertise their wares through the shape of their buildings. For the small businessman entering a line of business in which such novel treatment of the appearance of the building is neither too costly nor too permanent, it may be a quick way to get started. If successful, the design may be patented and serve as the basis for granting franchises, as was the case with Clarence Saunder's unusual Piggly Wiggly store fronts, or it may be used to open additional stores of a similar nature. Often this idea of the theme of the business is carried out for the interior. A luggage shop in Little Rock, Arkansas, for example, was constructed in the form of a Pullman car. Unless watched carefully, these attempts to visualize the nature of the business may result in a single purpose structure with all the disadvantages of special purpose machinery.

Three aspects of modernization are especially important: modern lighting, color, and air conditioning. Recent writings in each of these fields should be consulted as only a few comments can be included here. Modern lighting is both functional and decorative. At present three types of lighting units are used, each having its advantages and limitations: filament, fluorescent, and spotlight. Retailers often combine

incandescent light for its pleasing customer effects with fluorescent lighting to show merchandise to advantage. Spot- or floodlights are used either to focus attention at a certain point or to furnish unusually intense illumination. Often colored lights provide certain desired effects. Local public utilities can give the businessman good advice on proper lighting.[2]

Color conditioning implies that the effects upon people produced by the colors of walls, ceilings, floors, fixtures, and even merchandise may be controlled to secure desired effects. In general the trend is toward lighter colors, because they usually are more pleasing as well as more economical in light reflecting ability. Consumer surveys show the following colors to be desirable: ivory, blue, green, peach, rose, and other cool colors. Warmth can be simulated, if desired, by the use of warm colors of the red and yellow varieties. Apparent size can be increased through the use of receding colors like white or decreased by use of advancing colors. Although blue ranks highest in abstract color preference, each color should be used to accomplish the particular result desired. These are only a few of the ways in which color conditioning may be useful.[3]

Air conditioning, which is familiar to most readers and has proved its value in many types of small businesses, is now expanding to include odor conditioning. Not only are tem-

[2] For further study see: Potter, W. M., "Store Lighting to Sell Stationery." *The National Stationer,* September, 1946, Vol. 18, No. 6, pages 98–99; Small Business Aids, No. 207, U. S. Department of Commerce, "Modern Lighting for Hardware Retailers." Condensed from "Modern Lighting for Hardware Merchandisers," *Hardware Retailer,* July, 1946, Indianapolis, Indiana, and the National Retail Hardware Association; and Small Business Aids, No. 12, U. S. Department of Commerce, "Fluorescent Lighting for Apparel Plants." Condensed from "Fluorescent Lighting for Apparel Plants," *Apparel Manufacturer,* June, 1946, New York, Frederick Kogos Publishing Company.

[3] For further study see Small Business Aids, No. 43, U. S. Department of Commerce, "Color is a Supersalesman." Condensed from "Color is a Supersalesman," by William A. Rossi. *Department Store Economist,* July, 1946, New York, Chilton Company, Inc.

perature and humidity being controlled but often pleasant or even sales-stimulating odors are provided.[4]

The Store Building—Special Requirements

Most of what has been said about the appearance and interior of the building probably applies to retailing to an even greater extent than to the other main fields of small business. In addition, the retail store has a few special requirements. Everything possible should be done to make the store attractive and inviting to customers. Colors of walls, background, and fixtures should be selected to set particular kinds of merchandise off to greatest advantage. For example, light blue is not so good for vegetable displays as for other goods. Lighting should be used as a silent salesman.

The store front, especially the windows and entrance, should be designed with care to be in keeping with the type of merchandise sold and the style of retail architecture prevalent in the community. Although the general trend is toward the all-glass front, almost eliminating separate windows as such for many kinds of business, this is not suitable in all cases. Paint, furniture, food, and wearing-apparel stores may use this open front to advantage, but jewelry stores and others dealing in small items may find the traditional window desirable. In addition to the references included in this section, valuable help may be secured from the trade association in each field and from equipment manufacturers and store front engineering firms as well as from the Merchants Service Bureaus.[5]

[4] For further study see Small Business Aids, No. 121, U. S. Department of Commerce, "The Value of Air Conditioning in a Restaurant" (Case Study). February, 1947.

[5] For further study see: Small Business Aids, No. 65, U. S. Department of Commerce, "Receiving and Displaying Goods." Condensed from "Receiving and Displaying Goods," by Roy F. Soule. *Your Business,* August, 1946, Philadelphia, Liberty Distributors; Small Business Aids, No. 253, U. S. Department of Commerce, "Modernizing the Jewelry Store Front." Condensed from "Modernizing the Jewelry Store." *The Jewelers' Circular-Keystone,* April, 1947, New York, Chilton Company, Inc.

The Factory Building—Special Requirements

In the case of buildings for small factories and for the processing type of service establishments, requirements center around the nature of work processes and types of machinery and equipment to be used. Adequate provisions for the economical installation of necessary piping, ventilating equipment, foundations for heavy machines, and similar requirements will vary according to the nature of the business. The trend is toward the rectangular rather than the U- or L-shaped building and toward single-story structures if ground values permit. Good lighting is important, with the elimination of glare and variations of light intensities according to the needs of each operation being performed as major objectives. Most of the remaining requirements are related to layout and will be discussed later under that heading.[6]

Although very little has been written about the small factory, a great many companies have constructed decentralized branch plants throughout the country. Most of these would be small businesses if they were independently owned and operated. A personal inspection of these buildings in any area should provide a wealth of ideas on modern small factory building design.

The Service Building—Special Requirements

Service businesses are so diverse in nature that building requirements vary greatly. Certain consulting and other personal services may require nothing more than facilities for a telephone, desk, chair, and filing equipment. Personal services like beauty shops may require an attractive, comfortable interior arrangement and provisions for adequate electric power, plumbing, and processes connected with the preparation of solutions used, as well as rest rooms for patrons and display

[6] For further study see Small Business Aids, No. 195, U. S. Department of Commerce, "The Best Type of Building for an Apparel Factory." Condensed from "The Progressive Sewing Room," by Bertrand Frank. *Apparel Manufacturer,* February, 1947, New York, Frederick Kogos Publishing Company.

space for the promotion of merchandise and services for sale.

Three considerations are important in the determination of service building requirements: (1) whether the service is of the merchandising or the processing type, (2) necessary facilities, and (3) legal aspects. Many service establishments sell enough merchandise to make provisions for adequate display, stockkeeping, and selling space important considerations. These merchandising activities can be performed most effectively with a physical plant of the retail store variety. Examples of such services include shops that repair electrical appliances, radios, refrigerators, watches, and similar articles. Some beauty shops also sell large quantities of merchandise. Often shops such as these will need a building wired for heavy-duty electrical equipment.

Another group of service businesses with special plant requirements is composed of those working with heavy, bulky materials or products. Examples include automobile, truck, and tractor repair shops and storage places, and sheet metal and heavy machine shops. In general a street-level single-story building without basement is preferable for such establishments. Large open spaces free of supporting columns and heavy, level, non-sagging concrete floors are also important. The latter may be essential for accurate welding and other operations commonly performed in sheet metal shops. The industrial, rather than commercial, type of building has many advantages for such shops. Exposed steel ceiling beams may be used for the suspension of hoisting and monorail overhead crane equipment. Steel columns may serve similarly for jib cranes and strong walls for supporting storage racks. Wide aisles and entrances are needed to accommodate delivery trucks as well as vehicles to be repaired. Frequently special facilities for ventilation may be necessary. Safety codes governing ventilation, exits, fire walls, floor loads, and similar conditions may introduce unusual building requirements.

Service stations will have some of the special requirements already discussed and in addition will need facilities for petro-

leum storage tanks, a hydraulic car lift or grease pit, and an appropriate exterior appearance for attracting motorists. Floors and service areas should be easily cleaned and resistant to grease, oil, gasoline, and other chemicals. Other types of service businesses that require work areas resistant to certain chemicals and fumes are battery repair shops, photo engraving plants, and electroplating firms.

In certain types of service establishments special hazards from fire or explosion may be present. Petroleum solvent dry cleaning plants constitute one example. Ordinances in many cities specify the type of construction and safety provisions required for such concerns. Windows of shatterproof glass may be needed.

Arranging the Layout

Layout deals with the arrangement of machines, fixtures, equipment, and designated spaces *according to a plan*. It is a subject that has received much study by industrial engineers and retail executives. Merchants Service Bureaus help retail customers with layout problems. Some of the better known Merchants Service Bureaus are those of the National Cash Register Company, Dayton, Ohio; Rice-Stix Manufacturing Wholesalers, St. Louis, Missouri; and Butler Brothers, Chicago, Illinois.

In most of the retail and in many of the service fields trade associations have developed layouts best suited to the particular needs of the business concerned. Some trade associations, like the National Retail Hardware Association, Indianapolis, Indiana, will make layouts for individual members.

Layout implies the most effective use of space for the particular business. A notable difference concerning space exists between manufacturing and retailing. Whereas in the former space is measured by area or volume, in the latter a fourth dimension is added—location. The same area or volume in one part of a store may be worth many times more than an equal area or volume in another part of the same store.

Layout starts with an analysis of activities involved in operating the business, objectives sought, and facilities for achieving them. In manufacturing and in many service businesses the primary objective is to facilitate productive operations. In the retail store it is to direct the flow of customer traffic for maximum profitable sales. The retail store is a machine for selling, and layout is properly regarded as a sales promotion device.

Certain factors must always be considered in arrangement and layout. They are, in summary:

1. *Logical and psychological arrangement of equipment and merchandise with reference to production flow for manufacturing and to customer buying habits for merchandising.* Having machinery in proper sequence and conveniently located saves factory workers much lost motion. Also, having merchandise in the right place at the right time increases sales per customer and reduces steps for salespeople.

2. *Maximum use of light and ventilation, or of heat, to take full advantage of natural conditions resulting from the building construction.* Effective use of windows, doors, vents, and skylights will save eyes, improve work and health, and reduce bills. Customers will also appreciate the fact that arrangements made with these factors in mind facilitate their personal comfort and their selection of proper merchandise.

3. *Maximum efficiency in the use of equipment.* Improper location of equipment may cause workers to do entirely by hand work that the equipment was purchased to facilitate. If the machine for putting "the finishing touch" on the final processing or packaging of goods requires extra steps, for example, employees may tend to do this work manually or to avoid it entirely. The laborsaving or appearance benefits of the machine's use are lost.

4. *Location of materials or merchandise in such a way as to be readily available to workers or customers.* By thus reducing steps for workers or reminding customers of their needs, an orderly arrangement saves time in location for

workers and permits customer study and handling, in both cases protecting goods from deterioration or pilferage.

5. *Maximum facilities for a clear view of the establishment by management, worker, or customer.* Management can readily observe all activities of customers and employees, workers can observe customers' presence and movements, and customers can readily see all the store's offerings and the location of particular groups of merchandise.

The same principles of arrangement apply to various types of businesses, since certain categories of factors are always present, namely:

1. People—workers, customers, management.
2. Equipment—machinery or fixtures.
3. Goods—materials, merchandise, or supplies.
4. The building and its features—windows, doors, stairs, and so forth.

To summarize, layout for any kind of business—merchandising, manufacturing, or service—involves arrangement of equipment, machines, and other elements to secure maximum efficiency in use. The relative importance of meeting the needs of customers, workers, and management varies according to the type of business but must be considered in making the layout.

Store Layout

The retailer has three objectives for his layout: customer satisfaction, maximum sales, and economy. Customer satisfaction includes convenience, service, and attractive appearance. The objective of maximum sales involves proper selection of fixtures and placing of merchandise. Economy of operation covers both expenses and protection.

Stores vary in the relative amount of their business secured from telephone and delivery orders and from customers who visit the store. The former kind of sales demand a manufac-

turer's efficiency type of layout, usually of the process variety; the latter require a "selling machine" type. Finally, the amount of self-service compared to clerk service desired influences layout. The result is a compromise between these conflicting objectives for all stores except the few that concentrate exclusively on one type of selling, such as cash-and-carry self-service only.

Like store sites, space locations within a store can be used more effectively in some ways than in others. It is usually poor business to try to increase the volume of a slow-selling department by giving it one of the best locations when that results in shifting another department better able to take full advantage of the good location.

The diagram on page 254 shows an approximate distribution of the total rent or value of space in a small store according to location on the main floor.

When a one-floor store has entrances on two or more sides, such as the front and rear or front and one side, the relative amount of traffic through each door is the important consideration. In such cases the diagram can be used to indicate the relative value of space inward from each entrance if they have equal traffic volume; otherwise, it can be adapted in approximate proportion to the importance of each.

Whether one plans to make his own final layout or to call on the assistance of some member of the outside staff, such as a Merchants Service Bureau, he should make a tentative layout of his own as carefully as possible.

First, make a plan of the floor space to scale and divide it into areas as indicated in the diagram, noting the percentage value of each area. These values are in terms of relative sales potentials. Now list the space needs, and evaluate each in terms of several factors, such as need for particular locations, ability to capitalize fully on heavy customer traffic through impulse sales, ability to draw customers to remote sections of the store, need for privacy, and miscellaneous factors like employee conveniences and nearness to other activities.

A preliminary step is to separate selling from non-selling or facilitating activities. Non-selling work is in turn divided into essential store activities like office work, receiving and storing

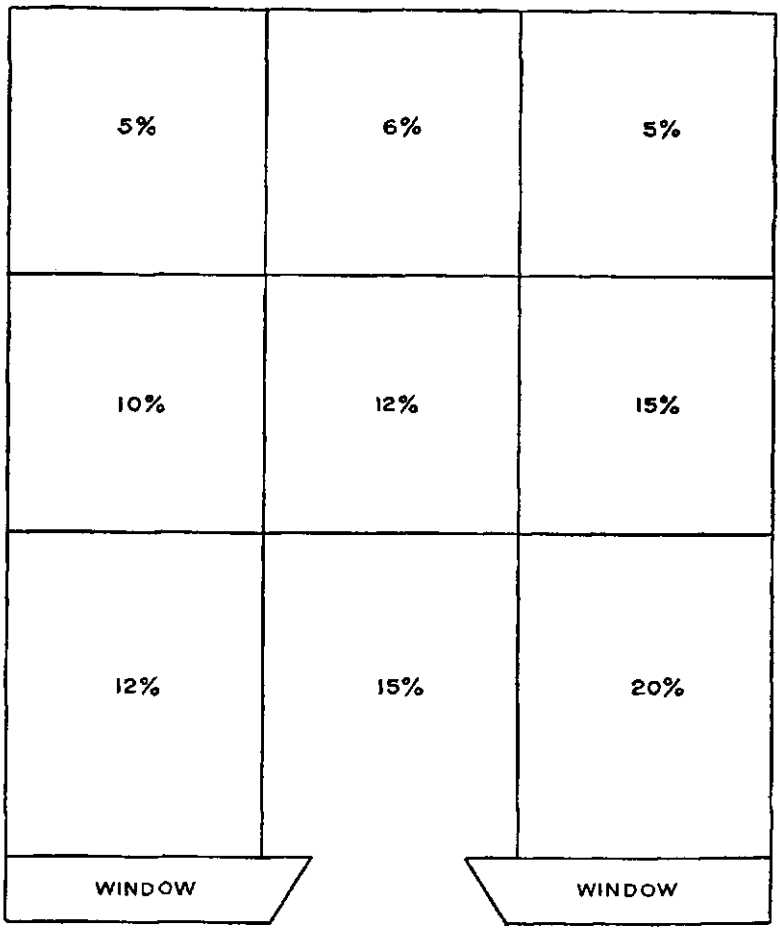


Figure III

goods, sign writing, and display constructon and "customer bait" like telephones, package checking, and postal substations. Facilitating activities may be assigned the least desirable locations that still meet the need for the receiving room to be

accessible to outside transportation lanes and for the office to provide the manager with a view of the selling floor. Customer service departments will be strategically located to lure customers past tempting selling displays of impulse goods.

Selection and arrangement of fixtures and merchandise within any store building will be determined in some part by the kind of merchandise sold, the kind of customers it seeks to serve, and the kind of service it offers. As to fixtures, an exclusive shop selling but one kind of merchandise—apparel, furniture, or leather goods, for example—should possess an atmosphere of dignity, comfort, modernness, and perhaps even luxury and ease. Stores selling primarily to men will need to present a rugged, masculine, "he-man," and business-like atmosphere; those serving women will have "the feminine touch" characterized by carefully harmonized colors, decorative figures, and diffused lighting.

This same principle of selecting fixtures to harmonize with the merchandise to be sold will extend into almost any field of merchandising. The sportsman's shop will frequently have sturdy oak tables and chairs or a boat-like interior with walls and decorations in character. The jewelry store will seek in its fixtures to present each piece of merchandise as the true gem, work of art, or mechanical triumph that it is. The butcher shop reflects cleanliness and wholesomeness.

The first great division of merchandise from the viewpoint of arrangement is into "impulse" goods and "demand" goods; that is, goods which are bought on sight without previous deliberation and those which customers have in mind when they go to a particular store. This fact is frequently capitalized on. The druggist keeps patent medicines, hospital supplies, and his prescription department in the rear of the store. To get to these, the customer must pass many displays of other possible but unpremeditated needs, such as candy, tobacco, cosmetics, magazines, and greeting cards. The wise shoe store operator has his staple shoes in the rear; as the customer goes to them, he passes attractive hosiery, house slippers, and sundries such

as polish and strings. Shoes will be bought in that store or in that kind of store without being prominently displayed, for competition on them is limited.

Competition on impulse items, which are often volume items available in many kinds of stores, is necessarily very keen. The hardware man has his nails, wire, bolts, locks, and tools—the things you expect him alone to have—at the rear; at the front he has colorful kitchenware, and garden supplies, sporting goods, clever gadgets, and shining new appliances. The demand items, which the store is expected to have, will draw trade because those things are expected there. A few items, however, may be found in any one of several kinds of stores. Competition in demand goods is among a smaller number of stores of the same kind.

Careful placing of impulse goods, demand goods, and store fixtures and facilities will cause the customer to traverse almost the entire store area. Some stores have found that having the wrapping desk in the rear draws people back, as they tend to follow the merchandise and the salesman as he moves in that direction. The value of this location, however, may be offset by the loss of the salesman's time in making the trip back that far for each sale.

Guiding traffic is helpful, and many devices are useful in managing this. Some stores, not fully relying on the "keep to the right" habit or perhaps wishing to counteract it, place obstacles in the way of customers in some paths and make wider entrances to others. A pile of boxes on display or a sizable show case is an effective barrier, and an open, well-lighted passage is inviting. The point to be remembered is that traffic can be controlled. People's tendency to act by habit and to follow the line of least resistance can be capitalized on by the alert merchant.

Open and unobstructed view

The success of the variety store, beginning with Woolworth, has been attributed to the use of open display. The modern

department store, having discovered the value of spaciousness, put it to use in wide aisles and low display cases. Open displays are good salesmanship because so many items may be classified as impulse goods and because customers like to see and handle the merchandise. Most store owners agree with the findings of one experiment which showed that open display in a drug store doubled face powder sales, tripled soap sales, and increased candy sales over five times. Vegetables, fruits, meats, candies, and other perishable and edible items should be seen but not handled by the customer.

In the apparel field some dealers believe that items are sold only after a salesperson, who is regarded in such cases as the expert advisor, has analyzed the customer's needs and reviewed the customer's size, coloring, and features.

By line, by item, by size, by color?

The old story of the grandfather who, after being asked whether he slept with his beard under or over the covers, could not sleep at all later for worrying about it may have a counterpart in the merchant who starts experimenting after having considered the many possibilities of arrangement. When impulse and demand items are assigned to locations that secure maximum impulse sales consistent with efficient use of the wage dollar, other very practical considerations arise. They include the logical arrangement of stock, the protection of expensive items from pilferage, and efficient arrangements for the handling of cash and charge transactions and for wrapping and packaging.

Should a selection of men's suits be arranged by price, by size, by line, or on some other basis? Arrangement by size seems to be the best plan, because the customer is not so likely to be attracted to a suit not available in his size and the mixture of price lines more readily permits trading up by showing and selling better lines. Placing the same colors together might make a more expensive suit look drab in comparison with a cheaper suit of a brighter shade. Also, if a merchant has a

large stock of one style in different colors and sizes, he should not put them all on display, for this makes the garment look cheap and the customer feel that he would meet himself everywhere he went. This avoidance of large one-style displays is a rule that will apply generally to apparel. The problem may also arise in furnishings, appliances, paints, or shoes. Since shoes remain in boxes, ease in location for the salesperson is of major importance. In this connection it may be noted that, contrary to the common practice of keeping shoe stocks by lot number for convenience in re-ordering, one store found that keeping them by size saved salesmen many of the steps they had previously wasted in going from one lot number group to another looking for the size wanted. Similar reductions in effort and time may be made as the merchant opposes practical to traditional procedures.

Expensive merchandise or small items tempting to children should be out of reach or protected by glass, as is the custom in candy stores, jewelry stores, and variety stores. Where open display and handling are desirable but where pilferage is a hazard, the merchant must study the situation carefully to determine what action should be taken.

Wrapping and cashiering facilities are frequently mislocated. They are usually together for employee convenience. They may be at the rear of the store to draw trade past other goods. Frequently, however, they comprise a rather bulky unit consisting of a large table and a large cash register, each of them used for both large and small items and sales. Sometimes in credit businesses these facilities are combined with the credit records.

Many stores have found that small items may not have to be wrapped if "charged" facilities for the handling of such small cash sales may be arranged at other strategic points in the store. Under this arrangement only larger items or those sold on credit and requiring credit approval will require wrapping and the use of the larger facilities, which may be placed in space at the rear that is less expensive from the traffic viewpoint.

Movable fixture units

The manufacturers of store fixtures, recognizing the changing nature of merchandise and the desire of merchants to experiment, have for several years produced fixture units of such uniformity, mobility, and ready interchangeability that they permit various combinations. Although they are separate units, when properly placed they join together so readily as to appear to be one unit, perhaps specially built for the store. These fixtures are on casters and have movable shelves, changeable partitions, and many other desirable features.[7]

Layout in Wholesaling

Layout of the wholesale establishment is based on the primary function of the business, order filling. Optimum use should be made of the force of gravity, mechanical conveyors, and materials-handling equipment, since about 60 per cent of the cost of operation is likely to be payroll. Often forward stocks (say six to ten days' supply) of a frequently purchased item can be arranged along a conveyor or order assembly line. All articles requiring special care or operations other than mere assembly should be separated from this area. Major functions like receiving, "dead" storage, order assembly, breaking packages, packing and shipping, and office work should be physically separated. An exception might be combining receiving, packing, and shipping in the smaller plant. In general, the

[7] For further study see: Small Business Aids, No. 79, U. S. Department of Commerce, "Make Your Floor Space Produce Sales." Condensed from "Look at the Footage Problem This Way—," by James I. McMahan. *National Furniture Review,* July, 1946, Chicago, National Retail Furniture Association; Small Business Aids, No. 31, U. S. Department of Commerce, "Layout and Operation of a Location System." Condensed from "Layout and Operation of a Location System," by Albert K. Kaye. *National Furniture Review,* August, 1946, Chicago, National Retail Furniture Association; and "The Problems at the Checkout Counter." *Retail Food Merchandiser,* April, 1947, Vol. 15, No. 143, page 4.

wholesale layout will resemble more closely that of a factory, and many good ideas can be adapted from factory layouts.[8]

The following discussion, which is adapted from publications of the U. S. Department of Commerce, contains many suggestions applicable to the small wholesale house.

Most wholesale-warehouse activities, whether in the drug trade or other trades, are subject to a production-line type of operation. Unlike a manufacturer, who turns out goods that are identical, however, the wholesaler turns out orders—assortments of goods—that are seldom alike.

The wholesaler's problem is to arrange an order-picking route and routine that will enable him to handle these unpredictable assortments without special adjustment for any of them. Therefore, both route and routine should be flexible enough to meet any reasonable contingency.

In a good many instances where the physical characteristics of the building have prevented the establishment of a basically sound layout special mechanization has been substituted. For example, one wholesaler has five levels of roller-conveyor lines across a single wall, two of them running in one direction and three in the other. Such mechanization is usually confined to the lower floors, where the shelf stock is assembled and orders are checked, packed, and shipped. Above these lower levels the mechanical equipment, aside from that used in manufacturing, consists of elevators and chutes only.

There seem to be many operational advantages in intermingling the full- and broken-case stocks for order-filling purposes. Some of these are:

1. Fewer work stations are needed and therefore fewer persons have to take the time to scan orders.
2. A smoother flow of orders is effected, since the fewer the work stations, the smoother the flow of work.
3. The amount of paper work is reduced, because an extra copy of the order or floor ticket from which to fill the full- and broken-

[8] For further study see Meserole, W. H., *A Suggested Design for a Wholesale Grocery Warehouse*. Washington: Bureau of Foreign and Domestic Commerce, U. S. Department of Commerce, 1943.

case portions of the order is not needed and thus one operation is eliminated.

It is noteworthy that after a discussion of the matter several wholesalers said that when and if they were to acquire one-story warehouses they would probably intermingle their full- and broken-case stocks for order-picking purposes.

Although the selection of the basic order-pick-line pattern is determined largely by the character of the building, the wholesaler has some freedom of choice in applying it. He may arrange (1) a system featuring a short conveyor line with a long distance between the line and much of the merchandise, (2) a system featuring a long conveyor line with a relatively short distance between the line and all the goods, or (3) a system featuring pushbuggies which carry the baskets to the merchandise at all times. If the wholesaler uses conveyors, he should have the shortest possible conveyor line which will carry the baskets close enough to the merchandise.

Individual applications vary, of course, with the floor plans of different buildings. However, nearly all strive to adhere to the underlying principle of moving the order baskets to the goods.

It is also the usual custom to place the order-pick line around the perimeter of the shelf stock. This is a fault, no matter what the reason for the practice—whether it be to gain daylight for the order-picking process or to gain enough length of line either to reach all the goods or to accommodate all the baskets that might have to be placed on the line at any one time.

Drug wholesalers realize the importance of laying out the shortest average walk for order pickers. They know that these employees walk miles every day in the routine of order filling and that carrying goods from shelf to basket accounts for half of this distance.[9]

In the grocery field, progressive wholesalers have recently taken a new view of the warehouse building. Instead of seeing the building as a storage warehouse only, they now see it also as a machine for the low-cost movement of merchandise.

This new concept has brought about a separation of storage from order assembly. Separation of these functions is a principle of the

[9] Bromell, John R., *Effective Use of Wholesale Drug Warehouses*, pages 19–20, 24–25. Washington: U. S. Department of Commerce, Industrial Series No. 68, July, 1947.

assembly line, as used by wholesale grocers. In the assembly-line type of operation the goods to be used in assembly are set up in a

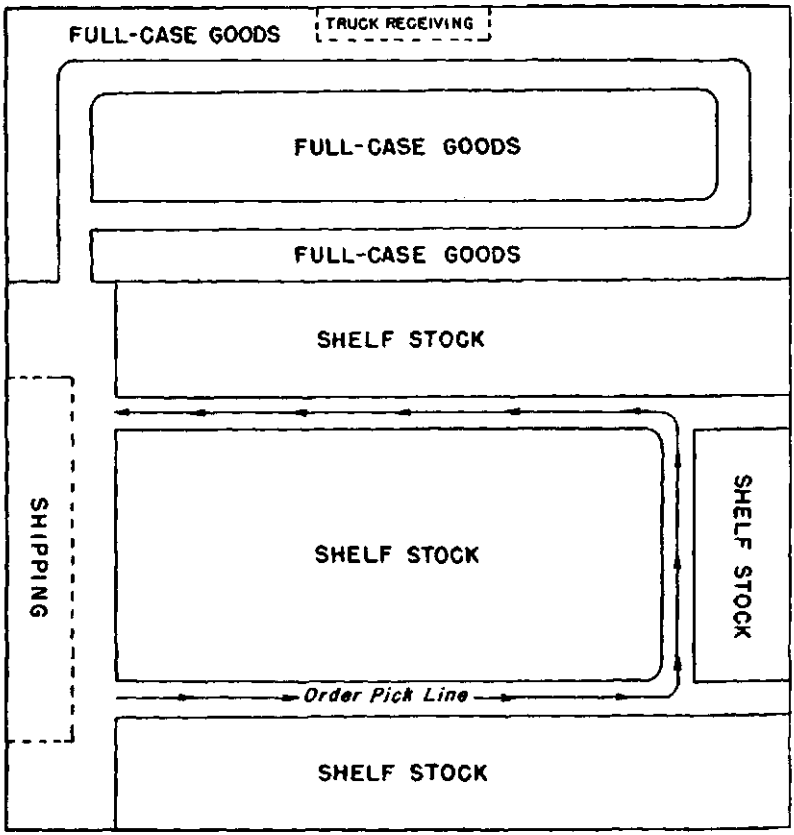


Figure IV.[10] Suggested location of shipping and receiving platforms where full-case goods and shelf stock are kept in entirely different places. This diagram refers to a one-floor operation in a building that is almost square and in which broken- and full-case goods are picked into orders from different areas in the warehouse. (The floor plan is not drawn to scale.)

nearby space, preferably on one level. The "storage" stocks are in other parts of the building. Sufficient space must be specifically

[10] Bromell, John R., *op. cit.*, page 12.

devoted to receiving and shipping docks for an efficient movement of goods in the receiving and shipping operations. In short, the warehouse building is "functionalized." Different parts of the building are specially designed for the functions to be performed in them. The results of this new concept of functional design are seen in the new streamlined one-story warehouse building.[11]

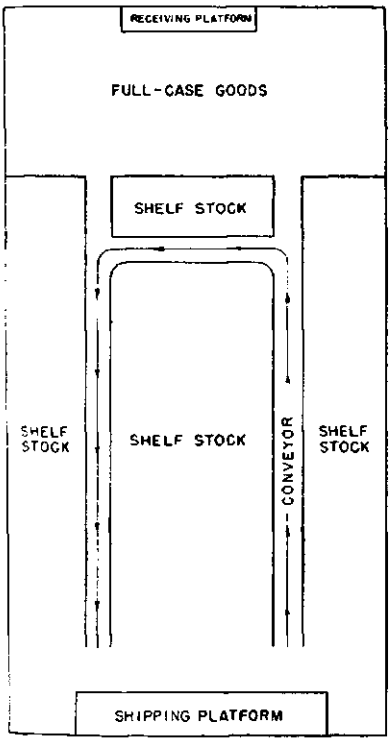


Figure V.[12] Suggested location of the shipping and receiving platforms in a long, narrow building. In this case the full- and broken-case goods are picked into orders from different places in the warehouse. (The diagram is not drawn to scale.)

The small wholesaler is likely to have the advantage of being able to select a modern one-story building and plan his layout accordingly. Naturally there will be variations from any plan that could be presented. Figures IV and V show two layouts, one for a square building and the other for a long, narrow structure.

In the electrical goods and appliance field a committee recently studied the problem of warehouse building and layout. The following discussion is based upon some of the suggestions made by the committee, with particular reference to layout:

[11] Meserole, William H., and Sevin, Charles H., *Effective Grocery Wholesaling*, page 116. Washington: U. S. Department of Commerce, Economic Series No. 14, October, 1941.

[12] Bromell, John R., *op. cit.*, page 13.

1. Office or other suitable facilities for shipping and receiving clerks should be close to shipping and receiving doors.

2. The ceiling height in warehouses should be 16 feet where sprinklers are used and 14 feet where they are not. This will provide mezzanine space where required.

3. The building should provide adequate toilet and rest room facilities for all personnel.

4. In order to facilitate protection from theft, building entrances and exits should be few in number.

5. When the business includes distribution of major appliances and radios, the building should provide suitable display rooms and meeting space for salesmen and dealers.

6. Broken-package stock should be placed in bins directly behind the store counter in order to serve the sales counter as well as to fill broken-package orders out of stock. This stock should be enclosed. Aisles between bins should be 30 to 36 inches wide, with a main aisle 48 inches wide, and bins should be not more than 8 feet 4 inches high. Bins with dimensions in accordance with the type of stocks handled should be provided. The aisle space between bins and the store sales counter should be 4 to 6 feet, and the ends of the bins should face the counter.

Where wall space is utilized for the broken-package stock department, one bin should be backed against the wall, with the other bins arranged back to back with aisle space as suggested in the preceding paragraph. Bins should be no longer than 24 and no deeper than 2 feet each.

7. When preparing warehouse layouts wholesalers should investigate the latest mechanical devices and products available for materials-handling in order to take advantage of laborsaving ideas. Pallets were mentioned by the committee as one means of simplifying material-handling under certain conditions.

8. In arranging the building layout, some consideration should be given to the use of gravity chutes.[13]

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[13] National Electrical Wholesalers Association, Johannesen, J. G., Chairman, *Warehousing, Deliveries, Installations, Freight Rates and Claims Committee Suggests Building Lay-outs; Offers Sample Plans.* Report to meeting held on May 14 and 15, 1945, by this committee in New York.

Factory Layout

Most industries are of two primary types according to whether their products are diversified or uniform. Each type in turn has subdivisions. Some diversified industries, such as candy manufacturing or toymaking, turn out a variety of products; others perform a wide range of operations, such as those accomplished in a machine or other kind of metal-working shop or in a printing establishment. This division results in two major types of layout: process or job layout and product or straight line layout.

In process or job layout all work of a certain kind is performed at one place and machines for doing each kind of work are placed together. Whenever successive jobs require different types of work in varying amounts and in different sequences, when the quantity involved in each job is small, and when many different jobs are being worked on at the same time, process or job layout is likely to be employed. It is the older of the two basic types of layout and still has many advantages. Among these are more specialized supervision, less duplication of machines, greater flexibility, lower initial cost, and adaptability to a wider variety of work. However, it requires higher unit costs, greater movement of materials, more delays, difficulty of estimating costs and completion times on many jobs, and better daily planning and scheduling of work to avoid costly congestion at certain work centers. Since even a job shop will excel in certain types of work, the usual tendency is to find a few products or kinds of service increasing in frequency of demand. Sooner or later the advantages of product or straight line layout are realized for these cases. It is partly for this reason that most layout specialists recommend the product or straight line layout whenever possible, even sacrificing certain advantages of flexibility and lower initial cost in many cases.

Although two examples from big business—automobile assembly and meat packing—both illustrate almost the ulti-

mate in straight line layout, the former is an example of the assembly type of process, the latter of the analytical type. In spite of the little they seem to have in common, Henry Ford, the originator of continuous assembly straight line production, got his ideas from the meat packers. Small businessmen can find some of the best examples of layout and other "how to do it" ideas in big business concerns that have developed certain methods to a high degree of perfection.

Considering the foregoing variations in greater detail, we can first summarize some of the objectives as follows:

1. Materials and semi-finished products should follow the shortest and quickest possible route from entrance to exit.
2. A minimum of physical handling, with as many operations being performed at each "stop" as possible, is essential.
3. Through layout, management must seek to free production flow from "bottlenecks" caused by the slowing down of any one process at a strategic location. Although this may depend largely on the adequacy and care of machinery, the location of the machinery is a vital factor.
4. The misuse and waste of space must be recognized as being of equal importance to wasted use of machinery and manpower.
5. Complete elimination of "backtracking," overlapping of work, and unnecessary rechecking and inspection should be achieved through constant alertness to possibilities for new sequences and combinations of steps in processing or fabrication.

Efficiency in manufacturing layout will depend greatly on the nature of the work done. It is impossible to develop a standard layout pattern that will apply to all processes. The continuous process, such as that used in the sheet metal products field, where raw materials may flow in at one end of the plant and the finished products out of the other end, can be arranged in such a way as to achieve constant maximum efficiency day after day; for once a product is designed, materials to make spe-

cific items are determined, and standards are set, the manufacturing sequence can usually be arranged once and for all until the materials, design, specifications, or methods are changed. In some plants production assignments are constantly changing in sequence and between machines and men. Smaller plants of this type will require that one man do the job through all operations; as plants grow larger, different phases of the work can be assigned to different machines. A third type of factory is the one where various kinds of work involving different materials are going on in different sections of the plant, sometimes interdependently. A pump factory may have one department casting iron, another turning out brass parts, and another cutting leathers. The keynote here is coördination of a group of continuous processes.

In the case of a shop with constantly changing assignments and a variety of tools and equipment, like an auto repair shop or a candy factory, the major problem seems to be the avoidance of delays arising when workmen desire to use the same equipment or to have access to the same materials at the same time. Men get in each other's way, find themselves hampered in getting work out, and develop a sort of frustration that lowers morale and both quality and quantity of production.

Plant owners experienced in this type of production have two problems, among others:

1. Which machine is most used and what location of it will reduce workers' steps and material-handling most?
2. Can and should the machinery and men be moved to the work or the work be moved to the machinery and men?

The answers to the first question are simple in the case of tire retreading, in which the work revolves around one or more basic items of equipment; it is not so simple in a metal-working shop. The determination of the answer may require a serious study of a number of typical jobs.

The answer to the second question is largely a matter of the relative bulkiness and mobility of the work or the equipment

and the walking distance and time involved. Frequently it is better to hire material-handlers at lower wages than to have specialized workers do the moving. Analysis and balancing of one method against the other have been known to reduce costs as much as eight per cent.

To demonstrate concrete applications of layout considerations, the following suggestions (slightly adapted) for a metal-working plant have been selected, because this type of shop involves a diversity of operations on both light and heavy materials.

The shop as a whole is a production machine and must be suitable for the work it is to turn out. To make certain that a shop is right for your work, a simple production analysis is necessary.

Consider what will be the flow of work through the shop; the processes through which the material must pass and in what order; the number and sizes of machines or equipment required; and the volume of business that must be handled.

For a simple beginning, consider the storage of supplies and materials. Should all be stored in racks, shelves, and cupboards in one spot? Or should small, expensive, easily stolen items be kept in the office and the heavier, bulkier stock—such as pipe, bars, straps, sheets, and structural shapes—be piled in racks as close as possible to the part of the shop where they will be used in order to cut down extra handling?

Suppose a factory in the neighborhood offers a subcontract. Is the plant layout such that the material can flow naturally from machine to machine or from process to process? If some extra equipment is required, will space be available in which to install it? Hindsight is of little use when such emergencies come up, but with foresight these emergencies become opportunities for unexpected profits.

A good method for checking layout is to draw to fairly exact scale on a large sheet of paper the floor plan of the shop you intend to lease. Show the size and location of doors, windows, and partitions. Make it like the house plans which home magazines picture. It is not difficult.

Then to the same scale cut out of heavy paper the plan of each

piece of machinery or equipment, workbench, storage space, or other space-occupying item. Arrange them on the floor plan for efficient flow of work, taking best advantage of natural light and keeping in mind the various other factors mentioned in this chapter. Shift again and again until you make certain that ample space will be available. For checking proposed floor plans, there is no substitute for this method, which is used by the largest industries.

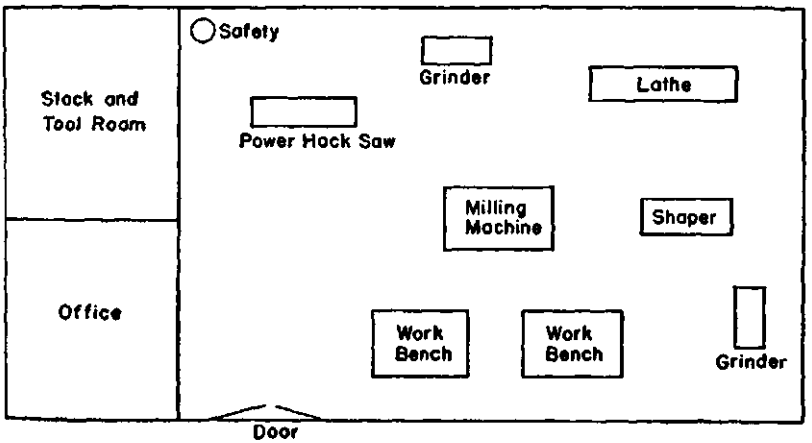


Figure VI. Typical metal shop layout.[14]

Measure to see if there are plenty of aisle spaces. Indicate on your plan where the aisles must be to insure the easy flow of work from one bench, machine, or station to another throughout the shop. Is there enough space left for expansion as more equipment and working space are needed?

This simple planning removes all guesswork. You know definitely whether or not the building will be satisfactory. Some minor compromises will have to be made to fit the flow sheet to the available building.[15]

The proper arrangement of the shop is essential. Figure VI

[14] Myer, William H., Beck, William L., Way, Howard E., and Schreiner, O., Jr., *Establishing and Operating a Metal Working Shop*, page 145. Washington: U. S. Department of Commerce, Industrial Series No. 16, April, 1945.

[15] *Ibid.*, pages 48–49.

shows a typical layout, but it should be remembered that such layouts are typical only for an assumed floor and building.

Truck delivery under the shop roof will save labor and time. If the truck can be driven onto the floor of the shop, large pieces can be unloaded safely with a minimum of labor by using hoists and tracks.

Plan the location of machines in such a way as to have adequate room for operating them. The lathe must have plenty of space at each end. Furthermore, machines should not be placed in such a manner that the operators are compelled to look out of a window or into bright sunlight. If there is too great a contrast between the light on a nearby surface and the work in the machine, the mechanic's eyes are fatigued and he becomes an accident risk.

There should be an aisle or aisles of sufficient width for the passage of work. These aisles should be marked with painted lines as reminders.

Before placing machines permanently, examine the foundation or floor. On a concrete floor where the concrete has been poured on the ground, any spot should be suitable after you have checked for sewers and conduits. In other instances it is best to determine the weights and sizes of beams. You should also consult the local building inspector. In any arrangement, observe the following principles, if possible:

1. Arrange machines, benches, and work stations to approximate the layout found in large industrial shops. This arrangement makes expansion easier.

2. Arrange machines to take advantage of natural lighting as far as possible. Machines used most often should be nearest the source of natural light, if such placement does not interfere with the efficiency of the general arrangement.

3. Arrange heavy-duty machines so that (a) they are as near as possible to the entrance through which castings or other material will be brought in and (b) they are easily serviced by any available swing crane or lifting apparatus.

4. Arrange all machines so that (a) a small truck or dolly may be moved into position beside any one of them for the purpose of unloading jigs, fixtures, attachments, or pans of material (for such an arrangement adequate aisle space is necessary); (b) there is

sufficient floor space for servicing, oiling, and repairing all belts, motors, and other parts; (c) there is sufficient floor space for the operator; and (d) there is adequate safe clearance for machine tables, shaper rams, radial drill arms, and so on.

5. Arrange your utility grinder so that a minimum of travel is required in order to reach it from lathes, shapers, and planers. If a second such grinder is used, it should be readily accessible from bench and drill-press work stations.

6. Arrange all grinding machines so that as little abrasive dust as possible will come in contact with other machines.

7. A service table, with arrangements for holding machine attachments, accessories, and tools, should be adjacent to every machine.

8. Power saws should be located near the stock room and should have sufficient space to permit the handling of 24-foot bars.

9. Tool and cutter grinders should be located near the tool crib.

10. Shapers and benches should be placed so that long bars may be held in vises.

11. All machines should be leveled and fastened to the floor.

12. Machine control switches should be located in positions where there is minimum danger of disturbance.

13. The master control panel which disconnects all power should be easily accessible and plainly marked. Its operation should be understood by all workers.

14. Conduit or other service cord, even in temporary installations, should extend vertically from the machine at least seven feet before being suspended horizontally to service outlet. This would not apply to under-floor conduit installations, of course.

15. Stringing benches along a wall should be avoided.

16. Space under benches should be clear and free from cupboards or obstructions.[16]

Layout for the Service Establishment

Service businesses may be divided into two broad groups as far as layout and physical plants are concerned, the merchandising type and the processing type. The former would in-

[16] *Ibid.*, pages 144–147.

clude tourist courts and most personal service establishments. Customer convenience, pleasing appearance, and similar considerations would be of relatively great importance. Accordingly, although it might be a more economical use of employees' time to have all cottages in a court located in a circle around the laundry and supply room, this arrangement would be rejected as inconvenient for the patrons and unpleasing in appearance.

The second, or processing, type of service business has much in common with a factory. Here various operations, such as cleaning, repairing, or altering, are performed on articles owned by the customers. In many cases the customer never sees the work being done and may not even come to the plant at all. Factors governing productive efficiency are of relatively great importance in such cases with regard to both building and layout. Like manufacturing *operations,* most service businesses of the processing type can be classed as either job or continuous. For example, a typical repair shop has a variety of activities comparable to those of a diversified-type factory using a job type of layout, whereas a modern automobile laundry is a continuous process type.

Principles and standards governing layout in manufacturing, as previously discussed, will be found to apply to processing service establishments if allowance is made for the greater diversity of activities carried on in the service fields.

In the well-established service fields trade associations and trade periodicals can be very helpful in solving problems relating to layout, equipment selection, and building construction.[17] Many equipment manufacturers have an engineering or service division to assist in this work. There are also several independent firms and free lance specialists whose services may be obtained for a fee on a basis comparable to that used by the industrial engineers often consulted by manufacturers.

[17] For further study see, "How to Install a Plant Layout." *American Drycleaner,* April, 1946, Vol. 13, No. 1, page 72.

Although management consultants may be needed to solve more complicated problems of layout, there is much the average service establishment operator can do by himself if he will follow certain suggestions. First he should make a floor plan of the building and work areas to scale. After deciding which are the most important types of work done, he should go into the plant and observe the sequence of operations performed on each of these and draw a line representing the flow of work, using a different color for each. The result is a process or flow chart of the operations as they are actually being performed. It is important to limit the first chart to the few most important types of work, for otherwise the diagram is likely to become hopelessly confusing. If the major operations are provided for first, most of the minor ones will usually be cared for. Any that do not fit the main pattern with only slight adjustments should probably be eliminated.

The flow chart should be examined against certain standards of desirable layout, the most important of which are maximum straight line flow, minimum backtrack flow, and minimum cross flow. The new layout can best be developed by experimenting with different flow charts on paper once the information needed is at hand. It is not always possible, even for one type of work, to achieve completely straight line flow because of the size and shape of the building or because of certain equipment that requires particular and relatively fixed locations. One solution is the U-shaped layout, according to which processes on one type of work begin and end at the same side of the building. When two or more types of work are of approximately equal importance but require different sequences of operations at the same kind of workplaces, two solutions are possible. If the volume of work justifies duplication of equipment or work centers, several straight line flows may be used. In very small plants a compromise process and job layout may be necessary, planned for the maximum straight line flow and minimum backtrack and cross flows.

Even where straight line flow is used, in certain cases, back-

tracking may also be present. This is true especially when the work is trucked between operations to particular equipment, such as to washers and then back along the same path to extractors in a dry cleaning plant. The flow chart will show such conditions, many of which may be corrected once they are discovered.

Cross flow resembles a street intersection. The voluntary or compulsory "stop and go" restrictions made necessary result in loss of time that could be avoided with proper layout. Careful study of the flow chart will disclose conditions that might continue unobserved indefinitely in the absence of planning of the type suggested. As mentioned earlier, layout is arrangement according to a plan.[18]

Conclusions

The building, whether designed and constructed or adapted, must serve many purposes to be entirely satisfactory. Layout is the most important of these, but layout is almost a science in its own right and requires a building that will permit securing certain ideals. *Since business is not static and both building and layout requirements change, an alert businessman will give continuous attention to these important profit-making tools.*

For the small businessman valuable information is available in the trade press, from his trade association, and from other agencies mentioned in the chapter. However, he can often make worth-while improvements by analyzing his needs and studying operations as they are being performed to locate waste motion, uneconomical use of labor, and other weaknesses. By making a process or flow chart further improvements may be made. Often suggestions made by employees or customers will lead to valuable changes in layout, equipment, or construction. Planning layout is a fascinating undertaking that usually more than repays the effort and study given to it.

[18] For further study see "If You're Making Your Own Plant Layout." *American Drycleaner*, November, 1946, Vol. 13, No. 8, pages 74–75.

Review and Discussion Questions

1. Why is layout a continuous problem for most small businessmen?

2. Select some particular kind of business and tell how the best layout affects requirements of the ideal building.

3. List separately the standards or principles governing layout for retailing, wholesaling, manufacturing, and service operations. Comment on similarities and differences in your four lists.

4. How, if at all, is retail store layout related to each of the following: display, advertising, personnel, location, customer services, buying?

5. Examine the layouts of several chain stores and independent stores in the same kind of business and discuss your findings.

6. List several kinds of service businesses where the layout is based on factory layout principles, and do the same for those based on retail store layout principles. What types of service establishments have special layout problems of their own? Explain.

7. Visit several recently built small branch plants of large manufacturing or processing companies and study both building and layout. Discuss how your findings could be utilized by the small businessman in several different lines of business.

8. Is it better for the retail store layout to accept the customers' habit of going to the right or to divert them to the left? Discuss.

9. Suggest methods for different kinds of stores to draw almost every customer to the rear of the store.

10. What developments in layout do you predict for the near future? Explain.

11. Make a list of the different things that could be done in a retail store to eliminate "blind spots." Discuss the practicality of each.

12. Visit a number of modern retail stores in different lines of business to study the colors used for backgrounds, walls, floors, and fixtures. What conclusions do you draw?

13. Is novel use of interior lighting more appropriate in certain lines of business than in others? Explain and illustrate from your own observations or material found in trade journals.

14. Select a small business in the field of your major interest where the management will permit you to make a study. Make a diagram or plan showing the nature and location of every department or work center. Analyze the operations performed. Prepare a process or flow chart and study it for improvements both in work processes and layout. Prepare a concise report of your findings and recommended changes.

15. Look up several references on color conditioning and prepare a summary of the effects produced by each color, such as: emotional effect—pleasing, depressive, stimulating; temperature simulation—warm, cold; nerve response—restful, exciting, jittery; and appropriateness for several specific kinds of merchandise and types of service business operations. Look for basic general color characteristics.

16. Make a list of all the ways odors could be added to particular business areas to produce desirable effects on customers and workers. What factors would tend to limit the use of each? Discuss.

17. Select a retail store for study and secure permission of the management. Over an extended period of time make a record of the sequence in which each customer visits different departments. Make special note of stops for impulse purchases or inspection of impulse displays. Plot your results as a flow chart. Try for an improved layout based on your observations and report your conclusions.

18. Visit a number of stores of all kinds and take note of every case where former "blind spots" have been eliminated, describing how this was accomplished in each case. What conclusions do you draw?

19. Talk to any businessman who has recently changed his layout and find out the expected and actual results.

20. Take some simple kind of manufacturing business or process type of service business for analysis. Analyze the work to be done and prepare an ideal layout chart for maximum productive efficiency. Would any practical considerations of cost, building construction, or other factors limit the realization of such a layout? Comment.

Chapter IX

ESTABLISHING BUSINESS POLICIES

Modern business operates in a complex and continuously changing environment. Change is the only constant factor. Daily the businessman is faced with new conditions and questions requiring decision and action. Some stabilizing force must be present to guide all the activities of the business in one direction or it will flutter around aimlessly like a leaf in an autumn breeze. This stabilizing force is policy, without which a business is like a mariner without a compass or an automobile tourist without a road map.

Modern business success depends upon the firm's reputation. This may be for any one of a variety of desirable features: low prices, exclusive merchandise, customer service, rapid delivery, reliable quality, freshness of stock, always having something different, and numerous others. Whether it plans one or not, every business acquires a certain reputation. Policy enables it to build the particular reputation desired. All other activities of the business are related to its policies and dependent upon them. The very idea that later results in the establishment of a new business is the kernel from which develop major and minor (that is, departmental) policies, an integrated set of guides expressing the purpose, objectives, and principles of the concern. The owner and all his employees use these policies to guide their actions.

Webster Robinson defines policy as "an accurately determined directive control which is based on definite and adequate knowledge and which designates the aims of the business

and the approximate methods to be used in their accomplishment." [1] A policy directs the business and controls its activities to keep them in line with objectives set. To be worthy of the name it should be based on definite and adequate information. A wild business venture is a gamble based on guess or hope rather than sufficient knowledge. If it "hits the jackpot," success may bring the necessary knowledge, but the business is more likely to fail. Policies should be definite and stable, yet flexible enough to be adjusted to meet fundamental changes.

Policies enable the small businessman to conserve his energies and resources by directing them consistently toward an established goal. This concentration in itself increases his effectiveness and chances for success by lessening dissipation or dilution of effort. Experience can be utilized to the greatest extent, because policies show what not to do as well as what should be done to accomplish a particular purpose.

The elimination of inconsistencies by a well-regulated set of policies results in less lost effort and less working at cross-purposes. Each policy should be selected in relation to the general policy and to all other policies. For example, the temptation to invest in a very efficient machine that would treble a firm's output immediately would require careful consideration if production policy stressed volume, whereas financial and expansion policies stressed growth from profits only.

Policies should capitalize all advantages a business may have, including special skills and knowledge the owner or firm members possess. Limiting factors may at times require the rejection of an otherwise attractive-appearing policy. Financial resources are usually a major limitation for small businesses Also, character and abilities of personnel available and various forms of social control must be considered.

Written policies are more definite and can be followed more

[1] By permission from pages 1–2, *Fundamentals of Business Organization*, by Webster Robinson, Copyrighted, 1925. New York: McGraw-Hill Book Company, Inc.

easily, but unwritten policies in the small business may be equally effective. The most important requirement is that the policies be understood and followed by all members of the firm. Customers, competitors, and other groups that look to a firm's policies to know what they can expect from it should be informed of all policies that affect their dealings with the company.

Policies are of three types—general, major, and minor. General policies relate to the business as a whole and include the over-all purpose and aims of the business. They define what the business is to accomplish and what success is desired for it. These policies must be the result of much forethought and planning, and they may still have to be changed somewhat with time.

One example of the general policy is that of the Heart of the Ozarks Products Company in northwest Arkansas, makers of various nut butters. This is a small family concern with national distribution in a highly specialized field. As a result of personal experience with certain health values derived from eating nut butters, the founders of the business concentrate on one fundamental idea—producing and distributing nut butters that retain their natural health values.[2]

Further illustrations of general policy that also show changes in even the basic idea behind the birth of new small businesses that have subsequently become leaders in their fields are the following familiar examples: Henry Ford's original "economical transportation," Frank W. Woolworth's "all merchandise that could be sold profitably for ten cents," and Robert H. Ingersoll's "production of a serviceable dollar watch."

Major policies include the formulation of guiding principles for each important long-range activity, including department coördination. Examples of such activities are finance, expan-

[2] Hughes, Helen, "Many Kinds Of Nut Butters Are Made by Couple Living Near Fayetteville; Orders Come In From All Over Nation." *Northwest Arkansas Times* [Fayetteville, Arkansas], June 23, 1948.

sion, personnel, and public relations. Major policies also cover such things as: what type of merchandise is to be sold; what customer services are to be rendered; what customer relationships will be; what the relationship between management and employees will be; and how the firm should participate in community activities. Minor, or departmental, policies are those affecting the actions of various departments directly. They include decisions regarding the use of newspaper, radio, or enclosure advertising, if not all three; the extension of open-account credit, installment credit, or perhaps both; and similar procedures. All three kinds of policies are vital to a business and must be formulated carefully according to its needs.

In the launching of an entirely new business, there is always an experimental or pioneering period during which initial policies will be on trial. Two dangers are to be guarded against. First, after every reasonable effort has been made to justify the need for the new business as recommended in Chapter V and after the real opportunity has been defined, great care should be taken to formulate policies most likely to enable the business to satisfy this need at a profit. All too often a small business is started not only with little serious attempt to justify its need, but also with only vague ideas as to how the assumed need can best be satisfied. It is better to formulate the policies one considers desirable, even though later experience proves the advisability of changing them, than to have no policies at all. Thus, one will at least profit by directed experience. Changes can be made as required and the firm will be basing on proved experience a coördinated set of policies that will continue to develop as the business progresses.

Second, well-conceived policies should not be abandoned before they have had a fair chance to prove their worth. A beginner often fails to realize how long it may take people to become familiar with something new and to approve of it. As the sponsor of the idea, the proprietor is understandably enthusiastic about it. When potential customers fail to show their

interest and appreciation, it is natural for him to become discouraged. Again, unduly slow progress may make the enterprise seem hardly worth the effort. At this stage it is easy to be tempted by some other, more attractive venture. A change in general policy, the basic idea upon which the new business was founded, will probably cause it to lose whatever progress it has made, and the new line may very likely be even harder to pioneer than the first.

It is admittedly difficult to tell at just what point a general policy proves unsound and should be abandoned. However, the danger of early discouragement is so great that every reasonable effort should be made to give a carefully selected policy sufficient time to prove itself. About the only guides that can be offered as to when policy abandonment is desirable are: (1) if experience shows actual errors of fact or judgment in formulating the original policy; (2) if unforeseen changes destroy the soundness of the policy; and (3) if the time required to establish the business on a paying basis is greater than the owner is able to stand financially.

This discussion relates primarily to the general policy of a new business. During the experimental period it is to be expected that some major and departmental policy changes will be made as the business finds its place and tests the desirability of minor variations in policy. For example, although a policy of accepting no special orders may have been decided upon at the start, an adjustment would be called for if it developed that only a few requests for special orders were received, that these came from some of the most profitable customers, and that the trouble and expense of handling special orders was less than had been expected.

As we have said, most successful businessmen have the faculty of making prompt decisions. Since well-formulated policies guide these decisions, in one sense the decisions were all made well in advance, at the time of policy formation. In most cases the businessman tests each problem as it arises in the light

of his policies and decides accordingly. This is one of the big advantages of having a good set of policies.

Two types of situations may arise when a decision is of the utmost importance. Occasionally the proprietor is required to make a hasty decision of far-reaching importance without having time to investigate all the ramifications of the question or to deliberate upon the possible effects of his decision. In such cases his established policies are the safest. No matter how attractive a proposition that violates his policies may seem, he should reject it without hesitation if he does not have time for an investigation at least as thorough as that involved in establishing the policies.

The second kind of situation may be illustrated by a true story that could be matched by hundreds of examples from different fields. Two partners had built up a very exclusive and profitable women's shoe store in a western city. Their location, building, fixtures, personnel, credit, and customer services were all in keeping with this class of trade. They accepted the offer at a very attractive price of a large quantity of a manufacturer's overstock of the same style and quality of shoes they regularly handled. To dispose of this purchase the partners made a dignified announcement of the shoes at reduced prices. Too bad! Shoppers literally mobbed the store. The sale itself was a financial success, but it killed the business. Former customers refused to continue their patronage after such vulgar and disgraceful conduct; and everything about the organization rendered it unsuitable to any other class of trade. Lack of definite policy guides was clearly the cause of failure in this and similar cases that could be cited. All policies are closely related. It was just as inconsistent and just as certainly commercial suicide for the shoe store to stage a sale as it would be inconsistent and humorous for a bargain basement to attempt to promote the first showings of a high fashion merchandise.

Policies Applicable to All Fields

In addition to a general policy, which every business must have if it is to be a business venture rather than just an accident, certain major policies deal with such fundamental matters that they are likely to be very similar, at least in basic content, for all lines of business. These major policies involve basic business principles and experience which cannot safely be slighted by the small businessman regardless of his choice of field. Deviations must be justified by unique circumstances and should be recognized as exceptions. They should be labeled "handle at your own risk." Differences in policies necessary to individualize each business undertaking and to suit each different set of circumstances can usually be made in the departmental policies.

The following major policies are basic to every business: product, finance and expansion, and personnel or organization.

Product policy

Decisions governing products to be made, merchandise to be handled, or services to be offered should be guided by what is variously referred to as the product, merchandise, or merchandising policy. Merchandising in a policy sense deals with designing, adapting, or selecting the goods or services to be offered by the business. Naturally the producer designs or adapts the goods, whereas the merchant selects goods to suit customer demands. Although closely related to general policy, which defines the field in which the business will engage, product policy goes beyond this by designating a particular area of operation as well as the methods to be followed. For example, a small factory that plans to make furniture must ask itself: What kind? For what customers? What principles will be followed as guides in designing and restyling? Will it cater to custom designs or work toward standard articles? Will it attempt to introduce or pioneer new concepts of style, such as improvements in functional design? When will designs for-

merly made be abandoned? What standards will be used in making these and other decisions affecting the goods to be offered?

Similar questions must be decided in the merchandising and service fields. In retailing and wholesaling, merchandise selection rather than product design is involved, although this difference is less significant than is commonly assumed. Actually some retailers have secured manufacturers who would make products according to specifications or designs dictated by their customers' needs. Also, some small "manufacturers" merely submit their product designs to private label firms or subcontractors for actual production.

In the service fields competition, new developments, and market strategy are continually raising questions of adapting present services to customer needs, of adding new services, and of dropping old ones.

Two other policy guides may be suggested. Especially in the initial selection of products to make, merchandise to carry, or particular services to offer, a decision must be made as to whether to enter an already established though possibly crowded field, offering goods or services the same as those of competitors, or to differentiate the new firm's offerings in some way. The latter policy is usually better, if practical, as it gives the company a new market within the already established field, a strong claim for patronage, and a good talking point for its advertising. Too many beginners merely copy the policies of firms already established, often without investigating how successful these have been.

There is one situation in which adopting policies similar to those of established firms may be justified. If careful investigation shows these policies to be the best for the conditions and if the newcomer has a good chance of competing successfully, these would be the logical policies to adopt. When existing firms are lax or careless in following stated policies or have other obvious weaknesses, the new entrant would have a good chance for success. Policies are often publicized in general

terms with principles phrased for public approval rather than as guides that the business sincerely intends to follow. Many real business opportunities are found through investigations that readily disclose this to be the situation.

The following list, which comprises elements of a successful merchandising policy formulated to apply to a particular product, illustrates the basic nature of such a policy and shows that policies and methods developed for one kind of business may be used to equal advantage in other lines.

1. You must believe in, use, and know your product if you would retail it successfully.
2. It must be a principal product, not a side line.
3. Your stock must be broad in its offering of brands, types, and sizes.
4. Don't sell anything that is not in perfect condition.
5. Uncrowded display space is your best product business insurance.
6. You cannot sell them in the dark. Spend money for light.
7. Departmentalize your department, window, and counter displays.
8. Don't use ugly types of price tickets. They detract from the product itself.
9. Plan your sales method and work your sales plan.
10. Remember your profit is in your selling, not in your buying.
11. Put in a special article which consumers of this product use, and it will increase your business.
12. Worry about what you are doing and how you are doing it, not about your competitor.
13. You cannot sell them in quantity by simply saying, "How about a box today?"
14. When you close your store at night, ask yourself these two questions: "Did I make a new customer, and did I make a new user, today?"
15. Remember, every non-user is potentially a new prospect.
16. As you sell the product, compliment the buyer on his choice.
17. Dead items will invariably accumulate, so make these rules:
    (a) Don't displace a live item to liquidate a dead one.

(b) Don't palm off the dead ones to unknown customers.
(c) Don't "let them lay" in the hope that they will move themselves.
(d) Develop a few customers who are glad to accept the economy offered in a reduced price on such items.
(e) Sell them at any reasonable salvage value to outlets making a specialty of bargains.
(f) Arrange an attractive monthly clearance sale of such items, and be honest in whatever form of announcement you use in connection with it.

18. Not every customer likes the item in a large size. Carry at least one low-price and one high-price small size of your item.

19. Every better-class retailer in this field should carry some imported item.

20. Be open to good merchandising suggestions. Learn from the other man's experience.

21. You can't bluff or fool the man who is spending his money, but you can guide him.

22. If you know your business, you will find your customers eager listeners.

23. Learn to merchandise up, not down. Sell quality, and price will be no problem.

24. Windows are one of your most undeveloped assets in the sale of your product. Don't use them for catch-all displays or easy extra revenue.

25. Believe in and be an exponent of fair trade. It's good for your business.[3]

Finance and expansion policies

Policies regarding finance and expansion are so closely related for the small business they may well be considered together. Two diverse viewpoints of considerable merit appear, namely: the conservative and the adventurous. In most other

[3] Adapted from Small Business Aids, No. 197, U. S. Department of Commerce, "26 Pointers to Help You in Merchandising Cigars." Reprinted from "26 Pointers to Help You in Merchandising Cigars," by Ralph Williams. *Modern Merchandising*, August, 1946, New York, National Association of Tobacco Distributors.

fields of policy it is possible to state well-established principles that have very few exceptions. Maybe underneath the surface even these apparently different expansion policies will display common principles.

The adventurous, or heavy-risk-taking, attitude is based on premises like the following: any business ownership is a risk; if the risk is worth taking at all, it should be exploited to the limit. That some limit exists is implied, but it is accepted only when necessary. Waiting for a conservative opportunity or condition is likely to defeat the very purpose of independent business ownership. By the time a person has accumulated adequate capital and experience and a good business opportunity occurs, he is too old and too much saddled with family responsibilities to take advantage of it. A small business waiting to expand conservatively may sit by and see competitors become entrenched before conditions arise to permit its expansion by conservative standards.

Since numerous examples can be cited of success on a shoestring, of fortunes made from expansion against conservative advice, and of hundreds of thousands of individuals who waited too long to satisfy their business ownership ambitions, as well as of conservative small businesses that are still small, this adventurous policy must be recognized as having merit. However, it is to some extent a matter of individual attitude and ability, and it varies so greatly with circumstances that probably the best approach is to use the more conservative principles as a starting point. After that, each individual may proceed at his own risk.

The financial policy should state the amount of the concern's total capital the small businessman plans to own or what his equity will be at all times. Advice varies from half to over three-fourths as the minimum safe owner equity. Of course in a corporation fifty-one per cent of the voting stock will give the holder control of the business, but a powerful minority can be annoying. From what sources and under what terms will the businessman secure funds needed for initial capital, fluctuating

amounts of working capital, and future expansion? Initial capital secured from the outside should be on terms that allow more than ample time for repayment out of reasonable expected earnings from the business. A serious danger to most small businesses is the need to finance fixed capital from short term loans. Even if renewal is promised orally, it may not come as expected when needed. One form of fixed capital is that invested in fixtures and equipment. Since both of these may usually be purchased on instalment, the temptation to overspend is great. A better policy might well be to follow recommendations of authorities in the field as to the approximate amount of capital to invest in fixtures and equipment. Adequate depreciation should be taken each year in order that a reserve for replacement when each item wears out may be accumulated. The policy should provide for comparing vendors' instalment prices with their cash prices and the terms upon which a bank loan could be used to buy for cash.

Working capital is usually the easiest to secure for a sound, going business. The principal problem for small business seems to be securing favorable terms or a low interest charge when funds are borrowed from lending institutions. When a business is once established, vendor credit is an important source of working capital. Comparison should again be made of prices quoted on credit and cash prices with payments made from funds borrowed from your local bank. Often the latter policy will save money.

Although the soundest policy is to expand from earnings only, this is not always the most profitable. It "takes money to make money," but carefully borrowed money works just as well as owned capital. There is always the possibility that many excellent opportunities will be lost if expansion is based solely on accumulated surplus. Expansion from borrowed capital, however, should be as much guided by adequate information and good judgment as initial entry into business. Two policies especially important during the early years of a business career are paying off all indebtedness in the shortest pos-

sible time and leaving as much of the total profit in the business as possible. This means that the owner's drawing account, or "salary," should be as small as possible. It should definitely be much less than what he could earn working for someone else.

The monetary factor is the common denominator or thread connecting various activities of the business through the same measurable unit. Sales volume is related to production or merchandise needs by furnishing the dollar revenue with which to pay all expenses and costs of materials or merchandise sold. The financial budget is the device used by business to bring all its activities into close coördination over a period of time. Policies should be formulated covering the scope of budgetary control, major steps in developing and administrating the budget, and the extent to which a long range budget, a five- or ten-year plan, will serve as a guide for future expansion.

One final point to be covered in the financial policy will be the reputation desired regarding payment of bills and the taking of discounts. At one extreme is a policy of paying cash for every purchase and seeking the largest allowable discounts. The average small business will usually take advantage of regular credit terms, however, as this is an important source of working capital. Too many are careless about taking advantage of cash discounts, and some tend to be slow in making payment even when bills are due at the net amount. A reputation for paying all bills promptly is a valuable business asset. Always taking advantage of cash discounts gives the business an even better reputation. In addition, cash discounts alone amount to important savings in most fields. The typical terms "2 per cent, 10 days, net 30" are equivalent to an annual interest rate of 36 per cent when cash discounts are taken. For example, an invoice dated January 1, amounting to $100 with terms of 2 per cent, 10 days, net 30, would carry a 2 per cent discount of $2 if paid on the 10th. If it were paid twenty days later, on the 30th, the gross amount, $100, would be due. Assume it is necessary to borrow from the bank at 6 per cent to discount the bill. Interest on $100 (actually only $98 would be needed) at 6

per cent would be due for only $^{20}/_{365}$, or approximately one-eighteenth, of a year to secure $2 or 2 per cent of the principal. The annual rate would be 18 times 2 per cent or 36 per cent. Thus by borrowing at 6 per cent to discount the invoice the businessman actually makes 30 per cent interest. A bill with terms of 5 per cent, 10 days, net 30 would net him an 84 per per cent return on a bank loan at 6 per cent; one with terms of 6 per cent, 10 days, net 40 would give him a gain of approximately 72 per cent on a 6 per cent loan.[4]

The policy should be emphatic about paying all bills promptly when due. If cash discounts are used by vendors, the policy should provide for taking full advantage of every cash discount. In both cases standards or procedures to follow in case funds on hand are inadequate to discount bills should be formulated. These may include short term bank loans, special sales, use of a revolving reserve fund set up by the business for such emergencies, special efforts to collect accounts due to the business, and sometimes others. The important thing is *always to take advantage of all cash discounts* even though at times extreme measures may be necessary to do so.

Personnel or organization policy

Personnel and organization policies in the small business could hardly be considered separately except possibly for the one-man business in which there is no personnel and organization is confined to a systematic distribution of the owner's time. An organization policy should cover the way in which responsibility and authority are distributed to different members of the firm. Decision must be made as to the extent to which authority of various sorts is to be delegated to others by the proprietor and as to the particular types of authority that he will retain for himself.

An axiom of good organization is that responsibility and

[4] The examples assume continuous discounting of invoices throughout the year. Other similar qualifications have been omitted to keep the illustrations simple.

authority must always be equal. No person should ever be held responsible for a job unless he has the authority to do it, nor should an individual, even a relative, be given authority in a business unless he is held fully responsible for the results. Unless a policy is absolutely clear and definite in this point, it will lead to confusion and low morale.

A common weakness in many small businesses is failure to delegate sufficient responsibility and authority to leave the owner free to devote his time to the more important management functions. It is this same condition that discourages good men from staying with a small business. A correct balance between delegating enough authority of the right type to relieve the owner and furnish incentives to employees, on the one hand, and actually losing control over the business by unwise delegation, on the other hand, is the ideal of good organization in the small business. In most cases the owner will want to reserve final authority over all major expenditures, the employment of persons for important positions, and final settlement of especially difficult customer or vendor complaints. Naturally, at least final approval of all policies above the minor or departmental level will be the prerogative of the owner. The burden of final decision in all important matters relating to labor and public relations will also be the proprietor's.

Because the human element is a factor common to all businesses regardless of type, basic principles of human relations are equally good in any business or other organization. Two standards of paramount importance in any personnel policy are: fair treatment and the recognition of each employee as an individual human being, not as merely a cog in the machine or just another worker on the payroll. Fair treatment is not easy to define, but its absence is quickly detected by employees. Giving promotions and pay raises to a few favorites when they are denied to others equally deserving is one of the rankest forms of unfair treatment, disgusting alike to both groups. Employees tend to "politic the boss" instead of devoting their efforts to worth-while production. Policies that permit dis-

criminations among employees for reasons other than merit tempered with a moderate amount of seniority soon become known and increase the difficulty of securing and retaining valuable employees.

Personnel policies can at least assist executives and top management in meeting the second standard. By encouraging bosses to discuss workers' problems with them, by basing advancement in part on ratings of each individual, by provisions for giving each worker individual personal credit or acknowledgement for contributions, and by many similar devices that can be stated in the personnel policies as the desired company attitude, executives may be continuously reminded of their responsibility to recognize and treat each employee as a self-respecting human being.

A policy regarding promotions and standards to be followed in making promotions should be a part of every firm's personnel policies. Practices usually accepted as desirable are: to promote from within the organization whenever possible; to base promotions on certain factors of which employees have been informed and which are in general accepted as fair; and to promote a good man out of the organization or department when he has reached the limit of the company's ability to give him further promotions within the organization. Certain small companies have acquired an enviable reputation in this last respect. Once a man has developed to a point where he is capable of handling greater responsibilities than the firm can provide, a position is virtually secured for him in some larger concern. This policy attracts a constant stream of high-class personnel to the small company and accumulates a larger and larger number of their "alumni" in big competitors. Reciprocity in many respects is the natural result.

Another aspect of the personnel policy deals with the type of person to employ, as defined by such factors as: age, sex, schooling, previous experience, appearance, health, handicaps, marital status, financial status (sometimes), and others considered im-

portant in certain cases. Until recent years surprisingly few companies had formulated any clear-cut policies in this respect, especially for executives, although each department head had his own unwritten guides, usually prejudices, that he observed.[5] Observation will show that all the salesgirls in one store are, say, redheaded, whereas a competitor will employ only dark-eyed brunettes. Why? The answer is personal liking or preference of the employer. Likewise we often find only very young employees in one firm and only older workers in another concern that operates under similar conditions.

The modern approach to this problem is one of job analysis and description. What type of employee is best suited to each job? What non-basic factors, if any, like color of hair, political belief, or possibly looks, are important in terms of their effect on other members of the organization? A somewhat neglected field for the small business is to employ persons who do not meet certain arbitrary standards of most large companies, such as men over forty, those lacking formal schooling, or those physically handicapped in certain respects that would not interfere with the work or be a hazard to themselves or others. Experience shows that often such individuals are more reliable and steadier because they are not constantly seeking better jobs elsewhere and are so appreciative of an opportunity to earn a self-respecting living that they are actually more efficient in their jobs than the more physically perfect and well-equipped person.

In one other respect the small business has an advantage in securing high-class employees, namely: by being able to select those with potential ability who lack actual experience. Often the small firm is attractive to these people, or could be made so with the right publicity, because it offers a wider range of opportunities to develop well-rounded abilities. A policy seeking to attract persons of this caliber should be accompanied by a

[5] For further study see Kelley, Pearce C., "Selecting Executives." *Personnel*, August, 1933, Vol. 10, No. 1, pages 8–26.

policy of promoting out of the organization after the employee has developed beyond the capacity of the small firm to utilize his abilities fully.

Although the close contact between employer and employee in small firms should be an advantage in training, actually the training done in small companies is often weak because of two prevalent conditions: (1) lack of time by the owner to do the training and (2) lack of knowledge and of ability to train. To meet this need the federal vocational laws have been passed. Starting with the Smith-Hughes Act of 1917 and the George-Deen Act of 1936, federal aid has been provided in the training of both small business managers and their employees. Certainly a small firm should utilize this aid and provide for it in its personnel policies.

There are many other respects in which the small business should formulate its personnel policies to capitalize on its size, as well as to compensate for both the few inherent advantages of employment by big business and the over-publicized advantages claimed for such employment.

Since the middle thirties many personnel policies have come increasingly under government regulation. State and federal minimum wage and maximum hour regulations, management's recognition of unions and collective bargaining, safety provisions, and such socio-economic provisions as minimum employable age, required schooling, and unemployment and old age insurance have become law and must be observed by personnel policies. These vary from time to time, but absolutely must be considered in the formulation of the major personnel policy.

Although personnel policies have been considered as sufficiently basic to the three major business fields for general consideration, important aspects of the human element in each of these fields will be touched upon further as we now examine policies which are of particular importance in each of these fields.

Policies in Retailing

The following advice published before World War II points out how a good public relations policy could have saved many merchants from grief during later rationing and scarcities:

> In the prosperous days ahead many dealers are going to be so busy they will probably forget their manners and ignore their old customers. Then when the lull comes, they will find someone else has cultivated and won them away. No matter how busy you become don't jeopardize the good-will you have been building up for years. The only medium for preserving your market is advertising and whether you need business or not, you need good-will and public recognition for the long pull ahead. The prophets had something like that in mind when they warned: "In the days of thy prosperity prepare for adversity." [6]

Successful retailers do not leave the treatment customers receive to the whims of employees. Rather, they are careful to establish and enforce a policy specifying the attitude the store desires to maintain toward its customers. Usually this covers the type of greeting customers are to receive as to friendliness, intimacy, or formality; limitations to be placed upon the policy that "the customer is always right"; procedures for handling troublesome customers and embarrassing or ticklish situations; employee conduct while in the presence of customers; meeting unusual customer requests; and types of selling to be used and not to be used, sometimes including particular expressions considered objectionable by the management. Among the last might be certain references to competitors.

An important policy for any store is that dealing with the class of trade desired. It is usually difficult for a store to cater successfully to more than one major income group—high, middle, or low. Sometimes catering to particular age or occupational groups is desirable. This policy should be consistent with the store's location, the class of merchandise carried, and related policies such as sales promotion and customer services.

[6] Excerpt from editorial. *Furniture Age,* April, 1941, Vol. 41, No. 4, page 33.

In general, three types of stores are recognized on the basis of the aggressiveness of their sales promotion: promotional, semi-promotional, and non-promotional. Promotional stores rely heavily on advertising and special sales; semi-promotional are represented by the average store; and non-promotional stores rely upon their regular customers, using a limited amount of more dignified advertising and very few, if any, special sales.

Successful stores usually cultivate some outstanding point of superiority over competitors as a result of consistently following a policy emphasizing this particular point. It may be complete assortments, new things first, fashion leadership, fashionable merchandise at popular prices, always lower-than-average prices, more helpful personnel, certain guarantees, or unusual customer services. There is almost no limit to the range of such points from which an imaginative retailer can select his particular one. Of course it should have customer appeal and be practical in application.

In selecting policies regarding customer service, at least the following should be provided for: credit, delivery, guarantees, returns, adjustments, allowances, telephone and mail orders, clerk service, C.O.D. sales, lay-aways, cashing customers' checks, discounts, special orders, alterations when required by the kind of merchandise, and possibly others. This does not mean that all the services mentioned should be granted, but rather that a definite policy about each should be stated and adhered to in practice. If there are to be exceptions, such as monthly open-account credit to fellow businessmen or free deliveries on all orders over ten dollars, these should also be stated and observed—with no exceptions. The great danger of customer service policies for the small retailer is in making exceptions. Because of close personal contact with his customers, it is often difficult for the small retailer to be strict in his policy enforcement. However, this is probably one management aid that should be adhered to more rigidly than any other. If the

policy is too strict, change it, but *never* make an exception so long as the policy is in force.

Certain factors will influence the selection of the best customer service policies in each case. One group relates to what services will be demanded or expected of the retailer. Factors like customs, customers' shopping habits, occupation, competition, location, nature of the merchandise (necessitating delivery of furniture and heavy appliances, for instance), and similar ones operate on the demand side. Offsetting these are what the retailer is willing and able to furnish. Credit may be customary in the area and expected by customers, but the merchant's financial resources might prevent him from offering this service.

Many beginning retailers make the error of merely copying the services of their competitors. A certain service is not necessary just because it is customary and expected. In some cases it may even be undesirable. A former student of one of the authors recently purchased a general store in a town of 2,000 where liberal credit had been the custom for the past thirty years. Most of the trade, which is rural, expected the kind of credit his only direct competitor and all other stores in the town continued to grant. The new owner started immediately with a strictly cash policy and no exceptions, expecting to lose about one-third of the customers and one-fourth of the sales volume of his predecessor. Results during the first year were interesting: for the first month about half of the customers objected to the new policy, but less than 5 per cent (almost all of it low-income trade) shifted to the competitor's store. Instead of declining 25 per cent as expected, business increased slightly. A later remodeling job increased total (cash) sales an additional 10 per cent. The competitor acknowledged receiving the new credit customers—with regrets. Of course, one case does not prove a principle, but it does show that long-established customer service policies *can* be changed. The question of the need for credit extension, as well as certain advantages and dis-

advantages of granting credit, are discussed in Chapter XIX and in the reference given below.[7]

Another policy of special importance to the retailer is his price policy. Two price policies often confused are the one-price and the single-price. The latter, which is of limited application, relates to stores that handle merchandise at only one retail price, such as $5.00 shoes or $6.00 hats. The one-price policy means that goods are plainly marked and are sold only at the one price marked, regardless of who the customer is. It implies no bargaining over the price, but does not preclude policies giving special discounts to institutions or other large buyers. A one-price policy is representative of most retail stores in this country. However, a small retailer selling higher-priced merchandise having a short selling season, like fashion goods, is often tempted to deviate from this policy. Since markdowns must be taken on some of his merchandise, price shading can be easily rationalized as reducing necessary markdowns. Such a procedure will soon be discovered and the retailer will then find it difficult to follow the one-price policy at all. The better practice is to refuse all attempts to get the price cut. A policy is not like a rule to which exceptions can be made. Under no circumstances should even a single exception be made to a policy.

Other aspects of the price policy relate to the markup taken, the number of different prices for each line of goods, and the general level of prices or price zone. Low markup and large volume or rapid turnover at low prices go together. Nature of merchandise and clientele desired are the principal factors governing the markup policy to follow. Averaging markups within a department instead of trying to set a fixed markup on all items is usually necessary. For "shopping goods" and some other lines in which numerous grades exist, price lining (that

[7] Small Business Aids, No. 118, U. S. Department of Commerce, "Should Your Store Sell for Credit?" Condensed from "Will Credit Sales Help My Business?" by Rees D. Stith. *Domestic Commerce*, November, 1946, Washington, U. S. Department of Commerce.

is, maintaining only a few best-selling prices in each line) is usually desirable. A policy of concentration on about three prices within a zone or range of prices suited to the store's class of trade is recommended. Selection of the zone is determined by the income of the class of trade desired. Obviously men's shoes at prices of from three to six dollars would not appeal to the top income group in most cities.

Since the merchant's relations with resources, or buying policies, are important in securing good merchandise on favorable terms and getting good services, considerable attention should be given to these policies. An important decision for many retailers is whether to affiliate with some buying and merchandising group like the voluntary chain or to buy independently. The advantages and limitations of each plan are discussed in greater detail in Chapter XII. If a retailer decides to affiliate with one of these groups, his policies should be formulated to capitalize on all the advantages it offers. Concentration of buying and full coöperation with the group is usually desirable, if the affiliation is one worth forming.

If buying is to be done independently, policies should be formulated to cultivate vendor good will. Fair play, prompt payment of bills, and courteous treatment of salesmen are important. The buying policy should also cover extent of quantity buying, attitude toward "free deals," selection of resources, brands to be carried, and similar important factors. Whether to use a resident buying office may be a consideration for medium-sized department stores. Most small stores need some guides to make their buying more efficient. If possible these should be covered in this policy. Buying guides are of two general types —those relating to quantity, such as the merchandise budget, and those relating to quality, or what to buy. Policy provisions covering the latter might consider the relative weight to be given advice from vendors, advice from a resident buying office, and suggestions found in the trade press or from local surveys; and when, if at all, to use professional forecasting agencies like Amos Parish's.

Policies for the Small Factory

A manufacturer's production policy should define the extent to which he will make or purchase various parts and fabricated materials. At one extreme is the use of private label firms to do all the actual manufacturing. This policy has many advantages for the beginner with limited resources, even though he may plan at some future date to do the manufacturing himself. Private label firms have machinery and "know how" not available to the beginner. They can furnish advice on design and production methods that would be almost impossible for the small manufacturer to obtain independently. The real disadvantage in using these firms is that the beginner is not actually a manufacturer, but merely a sales and distributing organization posing as a factory.

Sources from which raw materials and parts will be secured and under what conditions must be covered in the purchasing policy. The basic principle of concentration should be considered here, even to the extent of buying all parts at first and concentrating on their assembly into the company's finished product.

For the beginner especially, the type of production to use is often a matter of policy. Once a firm is well established production methods are likely to be determined by considerations of relative costs. How rapidly should processes be standardized and machines substituted for hand labor? What quality of labor should be used? This will depend to some extent upon the degree of standardization, upon volume of production, and especially upon the nature of the product, whether highly standardized or custom-built. The previously determined expansion policy will probably have a bearing on such questions. Usually a business planned for rapid expansion will lean toward standardization of processes and introduction of machine methods as quickly as feasible.

Two cases of small manufacturers following widely diverse policies of production standardization may be used to illustrate

the factors involved in this policy decision. They have in common the facts that they produce novelty or fashion goods, tried the wrong pricing policy during the 1930's and have profited by this experience, and are single-owner concerns. In other respects they differ widely.

The Lee Skirt Company of New York City, with an eighth-floor loft "factory," manufactures women's and misses' all-wool and rayon skirts to retail at $1.99 and $2.95. The firm has experienced a phenomenal demand for its low-priced quality products. In 1939 the concern had difficulty in selling higher-priced goods and turned to low-priced products. A flood of orders started the owner on his present policy of low-cost "fashion" merchandise. The policy is to dodge most of the costly style changes by concentrating on "what most women want most of the time." Inflationary conditions have forced the company to adopt policies of production simplification and standardization. Increased volume has made possible, and necessary, the adoption of policies for quantity buying and advance ordering.[8]

In contrast to this example of simplifying and standardizing production methods is the case of a small artificial flower shop. This business, located in the Southwest, produces an artistic product unique in its field. During the 1930's a policy of selling at low prices was unsuccessful. Department store buyers "snooted" the product. During 1948, with a product of slightly better quality, still using raw materials purchased during the 1930's but with new policies, the company was far behind on production. Orders have come in without the use of paid advertising. The new policy is to price the product at about ten times its 1930–1940 price, stress individual artistic production, and sell direct to users or individual gift-givers. Proposals to standardize the product and use mass production and mass marketing have been rejected.

[8] "What Most Women Want." *Time*, August 16, 1948, Vol. LII, No. 7, page 86. Courtesy of TIME, Copyright Time, Inc., 1948.

These examples of small manufacturers' sales, price, production, and related policies demonstrate the necessity of integration. No one factor, such as luxury nature of the product, economic conditions, or location of the plant, should dominate policy decisions. The examples are concrete cases that could be duplicated many times over. The important point is to study each individual situation from every possible angle before adopting what seem to be the best policies to follow. Spurious reasoning in the matter of policy formation is a serious error for the small manufacturer.

Production standards regarding quality of materials, workmanship, inspection, and packaging or packing will be related to the policies governing the class of customers desired and level or zone of the company's products. Policies must be consistent, and the basic one here is the class of trade desired. Production and management standards will be set to serve this market.

Distribution, selling, and advertising policies must be consistent in turn. Present and future costs of marketing the company's product, as well as market strategy, will be influential in this regard. Unless production is under contract for one or a few large distributors, marketing will probably be local at first, expanding gradually as the firm increases in size. Soon the question of what channels of distribution to use must be decided. It is better to study such problems before they arise and formulate tentative policies to be followed than to develop haphazardly even during the beginning years.

Two small business case histories may be used to illustrate desirable coördination and adjustment of distribution, selling, and advertising policies.

Harco Toys, Inc., started in 1937 with a distribution policy based on personal solicitation of orders from local merchants. Although the first year's sales totaled only $500, sufficient interest was aroused to encourage continuance. Sales slowly expanded until the business became a full-time project. Customer

acceptance encouraged the owner to increase output and to widen the market.

Because of limited finances, he chose to introduce the toys to outside markets by mail. From trade journals and trade lists he made up a mailing list of jobbers and stores. Because local department stores gave the toys a good reception, he let such stores predominate. Letters were also mailed to schools, as educational toys are used in some.

Results were satisfactory and the distribution policy was again modified to include sales through manufacturer's agents. The owner secured a list of reputable firms from which he selected agents in several leading cities.

The company exhibits at the annual Toy Fair in New York. New toys as well as old are displayed. Although some orders are obtained at that time, most are placed later in the year, and commissions go to the agents in the territory where the customer is located. Permanent displays have also been set up at merchandising centers in New York and Chicago and in the offices of the agents.[9]

An old, well-established firm located in New England manufactures paints, enamels, and varnishes in keen competition with other small producers and with the manufacturers of nationally advertised brands. The company employs 25 persons, five of whom are salesmen. The majority of sales are made to large industrial users and to contractors. In addition to maintaining the high quality of its own products, the company provides special services to customers, such as distributing a complete line of painters' supplies.

During the long period of its existence the company has experimented with many distribution policies. Recently it was using a combination of methods, each suited to the particular needs involved. Sales are made direct from a factory store to contractors, large industrial users, and retailer customers;

[9] For further study see "Case Studies of Small Business." *Domestic Commerce*, June, 1947, Vol. 35, No. 6, page 65.

prices are maintained slightly under the retail level to reflect the lower selling expense. Elsewhere sales are made direct to retailers and to the large volume consumers. Wholesalers are used only in locations where the maintenance of a warehouse stock is essential to the efficient service of the area involved. In some communities exclusive franchises are granted; in others the company's products are carried by more than one retailer.

Substitution of one method of representation for another is made whenever changes in local conditions occur, such as change of management requiring a review of the dealer's position, or when an established outlet proves inadequate in effectively representing the company in the community.[10]

Product identification should be considered early in the life history of the business. At first the company name may suffice, but a suitable brand name should be sought and adopted early enough to be exploited in the firm's advertising, packaging, and other sales promotion. Hints for the brand name may be secured from the particular selling points of the product, the way customers identify it, and themes of successful advertising or personal selling of the product.

Manufacturers of consumers' goods sold through retail stores find that all practical steps taken to help the dealer resell the product are well worth the effort. At first the small producer will be limited in what he can do. Attractive packaging and appearance of the product, even though it adds nothing to its utility, will be the first step. Later, advertising and dealer aids like signs and display racks may be used. The main point is to keep the dealers' problem of reselling the product in mind at all times. Provision should be made in the policies to see that this is done. Detailed methods to use from time to time are a problem for management.

In certain cases particular activities or objectives will be important enough to be covered by policies not discussed in this

[10] "Case Studies of Small Business." *Domestic Commerce,* April, 1947, Vol. 35, No. 4, pages 70–71.

brief treatment. Naturally they should receive careful administrative attention.

Policies in the Service Business

Policies in this field should stress the basic nature of the business—service—and emphasize those particular aspects of the service that (1) are most desired by customers and (2) the company is best equipped to furnish. The common human resistance to paying for such intangibles as service should be overcome by giving something extra or unexpected, if possible.

A typical example of this problem is that of the independently operated local credit bureau, a small service business. What the bureau sells is the service of providing credit information needed by merchants and other firms selling to local customers. The problem is complicated by the fact that much of this information is obtained from these local merchants. A retailer is expected to supply information to the credit bureau free of charge (members of the bureau actually pay for their membership and are required to furnish the bureau with credit information on their customers). When the same retailer requests a credit report from the bureau he pays a fee for the service. Out-of-town firms sometimes write to local retailers for the credit record of residents, which they try to get free of charge.

The credit bureau's policy, which serves as a guide in "selling" its services and as a standard to follow in deciding borderline cases, must endeavor to solve these related problems. The policy stresses the quality of a credit reporting service that can be furnished only by a reliable, impartial agency that is a depository for credit information obtained from all available sources to provide a complete credit picture of each resident. Credit reports based on this information include unfavorable as well as favorable items when the former are on an individual's record.

Since customers are less qualified to judge most services than

they are to evaluate physical goods, the policies of the service business should stress reputation. To achieve this reputation, product and inspection standards to maintain the desired level of quality should be provided for in the policies and rigidly adhered to in practice; in addition, the quality of the service should be publicized continuously. Accordingly, this need should be mentioned in the publicity policy. Trade journals in each service field are a mine of ideas or themes to use as a basis for developing a desirable reputation. However, the quality of the basic service must be right, even if some unusual theme is selected for publicity purposes.

When the nature and variety of services to be offered are clearly stated in the service operator's policy, the shop is enabled to plan all activities in such a way as to accomplish the stated purpose. For instance, a beauty parlor can offer general service or some type of specialized service for which it would seek a reputation of leadership. General service includes all branches of the beauty business, such as hair work, scalp and facial treatments, hand and arm massaging, and manicuring. Any one of these services can, of course, become a specialized one, constituting in itself a main source of income. Whichever service policy is adopted, the shop facilities and personnel must be planned accordingly.

A somewhat different policy is that of giving each patron complete individual service. When the business is large enough, one person can act as receptionist and beauty consultant. This person's duty is to receive the patron, examine her hair, scalp, and skin, find out her needs, and advise her with reference to the appropriate beauty service. Then skilled operators who are trained for specialty work give her, in the shortest possible time, the treatment indicated. Not only are the patrons willing to pay a higher fee for this type of service, but they are delighted to find a shop where they can obtain particular and specialized attention.

Before the product or service policy is adopted, at least three groups of factors should be investigated—the market or poten-

tial demand for the type of service contemplated, the availability of adequately trained personnel competent to render this kind of service, and the owner's financial resources. Naturally the nature of existing competition would always be studied. In a community where all shops offer general services it might be better to concentrate on hair and scalp treatments or on skin care and make-up, including the sale of proper cosmetics for individual needs.[11]

Repair shops also differ in range of services offered and reputation desired for specialization. Automobile repair shops are classified by types of service. A general shop, for example, does all kinds of repair and maintenance work. Other shops specialize in one or two forms of such repair as brake work, wheel aligning, body repairs and fender straightening, and radiator repair. In addition, there is the superservice station, which most authorities define as a well-managed shop offering complete maintenance and repair service and equipped also as a drive-in type of filling station.[12]

In many types of service business, policies to guide the relative emphasis on the sale of service as compared to the sale of related merchandise are desirable, at least until the shop is well established. At first there is the danger that a division of resources and effort between these two activities may result in doing a poor job of both. Also, it is much easier for the small operator to gain a reputation for one specialty than as being outstanding in all lines. For example, a skilled watch repairman who started in business during the war when this type of service was in great demand quickly established a reputation

[11] For further study see "Types of Service." Industrial (Small Business) Series No. 25, U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, *Establishing and Operating a Beauty Shop,* pages 54–57. Washington: U. S. Government Printing Office, 1946.

[12] "Nature of the Automobile Repair Business." Industrial (Small Business) Series No. 24, U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, *Establishing and Operating an Automobile Repair Shop,* page 2. Washington: U. S. Government Printing Office, 1946.

for quality of workmanship throughout the community of about 15,000. To handle his growing business he moved the shop from the basement of his house to a secondary retail location in town. Starting first with the sale of "reconditioned" watches, he was soon handling a general line of related jewelry items in competition with several other jewelry stores. Thus he has "just another jewelry store" with no distinctive reputation either as a merchant or as a repair shop.

Conclusions

Policies are basic to every business, whether put in writing or formulated only in the mind of the owner. The general policy and usually certain provisions of the major policies should be formulated before a new business is actually started, although many modifications may be required later to keep the policies flexible enough to meet changing conditions. Policies constitute one management control that should be followed without any exception. Change the policy, if necessary, but never make an exception or the policy is automatically destroyed. *All basic, long-run phases of the business's activity should be guided and controlled by policies.*

Review and Discussion Questions

1. Make a list of the basic concepts underlying all policies. Discuss.

2. List the important factors limiting or governing policy formation. Explain each.

3. If you were establishing a beauty shop that catered to a high-class clientele, what advertising policies would you establish?

4. Why is a corporation an unlikely form of organization for a beginning small business? Explain.

5. Compare and contrast buying policies for a retail, a service, and a manufacturing business.

6. Compare personnel training policies of a service and a manufacturing business.

7. Compare and contrast distribution policies and channels for a service business and a manufacturing business.

8. If you owned in a small town of about 12,000 a shoe store selling men's, women's, and children's shoes, what service policies would you establish? Explain.

9. Why must both major and minor policies in a business be formulated? How do minor policies differ for each of the three main fields of small business? Discuss.

10. Why must policies be based on factual information? In what sense is this information "factual"?

11. Why is quality of performance so important to a service business?

12. Select some kind of business, assuming a particular location, and formulate an appropriate general policy and the basic major policies you would recommend.

Cases for Discussion

1. When retailing cooked frozen foods was a new type of business, the problem to be solved was to determine an effective merchandising technique for such a specialty line.

Solution: The problem was partially solved through emphasis on time saved in cooking, economy through no leftovers or waste, and standardized cooking. This solution was made possible by a trained sales force, attractive displays, and newspaper advertising.

Discuss how well you think the problem was solved. Give your own ideas as to how each phase was carried out.[13]

2. This company was engaged primarily in the manufacture of tents and awnings, which are subject to seasonal fluctuations in production. Its problem was to find a means of eliminating seasonal shutdowns and recurring losses in machine-time, reducing labor turnover, and increasing the potential annual dollar volume of business.

Solution: The solution was to find other commodities that had

[13] For further study see Small Business Aids, No. 211, U. S. Department of Commerce, "Merchandising Cooked Frozen Foods" (Case Study). Washington: U. S. Government Printing Office, 1947.

a year-round market not affected by seasonal peaks and that could be manufactured with the same facilities.

Discuss this solution, suggesting suitable complementary products, and describe a program whereby both groups of items could be merchandised effectively.[14]

3. Company *A* changed from contract production of parts to the manufacture of end products without recognizing that new problems were involved. Failure to anticipate these problems was accentuated by overexpanding plant and organization to handle the hoped-for volume.

Solution: a number of costly experiences demonstrated the penalty of inadequate investigation into the problems of a new undertaking. Economies were introduced and, except for one product, the company confined itself to subcontracting for firms that furnished materials.

(1) Assume that the shop was a small sheet metal jobbing shop on the outskirts of a good-sized city. It produced sheet metal ducts, grill work, and other household and industrial metal items on special order. There was no production of standard parts or products at that time. Discuss possible reasons why the owner might have decided to change the type of parts he was manufacturing and the reasons for his failure to manufacture new parts successfully.

(2) Discuss the solution of the problem, telling why it was successful.

(3) Suggest other uses for the solution in different businesses, naming specifically the other types of business to which this might apply.[15]

4. Company *B* planned to expand its operations by adding facilities to produce metal stampings in addition to its well-known and

[14] For further study see Small Business Aids, No. 140, U. S. Department of Commerce, "Introducing New Products to Combat Seasonal Operations" (Case Study). Washington: U. S. Government Printing Office, 1947.

[15] For further study see Small Business Aids, No. 236, U. S. Department of Commerce, "Results of Inadequate Management Planning" (Case Study). Washington: U. S. Government Printing Office, 1947.

reputable line of tools. Customers would be the same as those for whom it produced dies. Before investing in the necessary equipment and starting production, it desired to consider the likelihood of success.

Solution: It proceeded to sound out its customers on their willingness to order stampings and gave careful thought to the factors that might permit it to break into the field successfully.

(1) Although this company was considered "big business," show how the same solution might be applicable to a small business undertaking a new line in addition to its old line of manufacturing.

(2) State the significance of market measurement before beginning the production of something new.

(3) What other factors should be considered before putting in facilities to begin to manufacture a new product?

(4) How might this problem apply to a retail store? to a service business? [16]

[16] For further study see Small Business Aids, No. 214, U. S. Department of Commerce, "Use of Market Measurement in Planning Introduction of a New Product" (Case Study). Washington: U. S. Government Printing Office, 1947.

CHAPTER X

MANAGEMENT AND LEADERSHIP

GOOD MANAGEMENT is more important than any other factor in determining the success of a business. With competent management, each of the special factors prominent in determining success *will* be right. For example, good management will select the best policies and enforce them, maintain favorable relations with resources, install adequate records and controls, and use personnel and other resources effectively. Good management sense is also one of the more difficult qualities for the small businessman to acquire because of the range of knowledge and abilities involved; but fortunately, good managers, even more so than salesmen, are made, not born.

Management

Many prospective small businessmen fail to realize the range of duties and responsibilities a small business manager is expected to master. One reason for introducing the subject of management at this point in the text is to preview some of these duties and responsibilities. The following case will show how inadequate management planning may cause trouble.

Planning problems

In 1934 Mr. C. C. Hopkins started a small sheet metal jobbing shop in a rented building on the outskirts of a good-sized city. He employed four to six men to produce sheet metal ducts, grill work, and other household and industrial metal items on special order. There was no manufacture of standard parts or products at that time. Overhead was low and the business proved successful, but

no particular effort was made to expand. Gross averaged $17,000 to $20,000 a year through 1941.

During World War II the company engaged in subcontracting on military orders and expanded its plant and facilities. By the end of the war the company had 54 employees, of whom 50 were production workers, and gross billings approached the mark of one-half million a year. With the end of the war, these contracts were cancelled.

Mr. Hopkins decided that in view of his success with sheet metal parts and assemblies, he would continue on production work rather than to make sheet metal ducts and similar articles on special order. To provide space for this work, he purchased a large plant in another city some distance away. The old plant was to make the tools, dies, jigs, and fixtures required for production, and the new plant was set up with the production equipment, and with assembly and warehouse space.

Mr. Hopkins solicited work as prime contractor for consumers' products made primarily of sheet metal. The first contract accepted was for a home necessity. The contract called for production of a specific number, at a stated unit price, under a stipulated delivery schedule. A token delivery was to be made at a given date, with the balance due at regular intervals. The company was to have no responsibility for distribution, because the patent owner merely hired the company to manufacture the product for him. A down payment of approximately 20 per cent of the total value of the contract was received from the patentee when the contract was signed.

The company had no established suppliers. From 1934 until the war it was a warehouse buyer of steel. When working on war contracts, metal was furnished. Thus, it had no mill connections. Prior to accepting the contract, Mr. Hopkins had checked the prices and availability of raw materials and component parts. From the information obtained, he concluded that materials and parts would be available to meet the delivery schedule for the end product.

He also used the prices quoted at that time in working out the contract price. Since the company would own the dies, allowance was made for the expense of producing them in determining the unit price for the product in the quantity ordered.

There was a sixty-day lapse between the time prices and the availability of materials were checked and the contract was signed. After closing the contract, difficulty was encountered in placing orders and in obtaining delivery promises. Along with this, prices had increased in the sixty-day interval. Through costly expediting, paying warehouse prices for steel, and similar means, sufficient material was obtained to build the 100 samples called for by the contract.

To deliver these samples on the required date entailed further unexpected costs. The time required to manufacture the dies had been underestimated and the tool room was forced to run two shifts a day for three months, with both shifts working overtime. Many of the subassemblies were made by hand rather than on a production basis, which increased unit costs far above those which might have been expected.

As these initial difficulties were hurdled, the company continued to turn out units as rapidly as acquisition of materials permitted. Meanwhile, Mr. Hopkins was curious to learn what the market reception was. He discovered that the products were not going well. The price was 25 per cent higher than competitive products, and the item was not properly designed for customer satisfaction. He anticipated, therefore, that the patentee would like to find an excuse to cancel the contract.

The failure to meet delivery deadlines provided the opportunity. Despite Mr. Hopkins' realization that the other party to the contract would be happy to cancel, the company suffered most in the settlement. The company received the contract unit price for each unit it had delivered—approximately 12 per cent of the total—which meant that it had to return 40 per cent of the initial deposit. Since the company was just getting into its production stride, unit production costs still exceeded the price received. Economies of quantity production had not yet been attained. The cost of the dies had to be absorbed by the company.

This was the first unit price contract that the company had ever taken, and the results demonstrated the management's inexperience. Shortly after accepting that contract, however, the company also accepted the same type of contract for several other items, thinking to provide capacity operations. With the tool room tied up on

work for the first product, and because of the lack of materials, it failed in all instances to meet delivery dates.

In an effort to secure materials needed, the company made deposits with suppliers. When contracts for orders were cancelled because of inability to deliver finished products on time, Mr. Hopkins accepted deliveries on materials and parts rather than to lose his deposits. In this way, the company acquired a $150,000 inventory of raw materials, components, and finished parts, some of which were not immediately movable.

By July 1, 1946, the company, which had started the year with very substantial finances, was hard pressed and a retrenchment was undertaken. The old plant was subleased and all operations were moved to the new plant. Not only was rental expense saved, but the cost of moving tools and dies between the two cities was eliminated. Seven of the ten administrative positions were abolished and functions were reassigned. The salaries of the men in the three remaining positions were cut 25 per cent. By these means, 75 per cent of the overhead was eliminated.

Mr. Hopkins decided to concentrate on the manufacture of just one product, a 40-gallon household hot water storage tank. He found the tanks could be produced at a profit even at the 50 per cent rate of productive capacity permitted by the limited materials.

Mr. Hopkins realized that a number of factors had contributed to his difficulties:

1. He had accepted contracts without sufficient flexibility to meet increased prices and slow deliveries of materials.
2. He had failed to investigate the mechanical performance and consumer acceptance of products before contracting to make them.
3. He had taken on too many products, and thus compounded the problems inherent in a production program with which he was not familiar.
4. He had committed himself to heavy and rigid overhead expense before developing the necessary volume to support it.
5. He had failed to consider that return on invested capital might not continue at the same rate as it had during the war years or when operating as a small, low overhead sheet metal shop.[1]

[1] Adapted from Small Business Aids, No. 236, U. S. Department of

An experienced manager could have avoided the errors made by Mr. Hopkins. However, to make the right business decisions, especially when undertaking a new venture, sometimes involves more investigation than the novice realizes. The following case of the small Stone Engineering Company, started in the Middlewest in 1941 and operated by an experienced manager, illustrates this point.

The company operations are diverse. The shop is not departmentalized, but is flexible enough to adapt itself so it can do any of the following:

1. Design and produce dies for manufacturers and fabricators.
2. Produce parts or subassemblies for manufacturers.
3. Manufacture and assemble finished products for established concerns.
4. Manufacture and assemble patented products for inventors, under contract. Before accepting a contract, product analysis and market analysis are conducted to determine acceptability.
5. Manufacture its own patented products, such as metal baskets, sporting goods items, etc., for distribution through jobbers.

Operations 1, 2, 3, and 4 are carried on whenever orders for the type of work involved are accepted. Operation 5 is continuous, although the production of individual items will vary from time to time.

For operations 1 and 2, no market studies are made, since Stone Engineering Company does not work on the final product. For operation 3, no market studies are made, since it assumes that the contracting concern knows the marketability of the product. The procedure followed in determining market possibilities in operations 4 and 5 will vary with the product to be manufactured, depending on the type of customer, the usual channels of distribution, et cetera. The technique followed with its most recent product, a plastic item of marine equipment, is illustrative of the detail into which Mr. Stone goes.

Product Analysis. The company secured sales literature, prices,

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Commerce, "Results of Inadequate Management Planning" (Case Study). Washington: U. S. Government Printing Office, May, 1947.

and delivery schedules from all competitive manufacturers. These were studied, with particular attention to prices and potential markets. It analyzed the competitive products, itemizing their advantages and disadvantages. It then listed in parallel columns the advantages and disadvantages of its own product and proceeded to weigh the selling points thus revealed.

A survey was also made of all state laws to learn the permitted uses and types, and the standards of safety and construction that must be met. To permit complete market coverage, specifications must meet the most rigid standards.

Market Analysis. Next, it proceeded to make an estimate of the size of the total market. Lists of dealers were obtained from trade publications and directories. Personal contacts at trade conventions with dealers, representatives of other manufacturers, and sportsmen provided additional names.

Ten per cent of the better class dealers were selected for purposes of a canvass of market possibilities. They were chosen because of their known success and because they were progressive, had high credit ratings, advertised extensively, and sold only nationally advertised competitive products. The outlets approached included mail order houses, jobbers, sporting goods stores, and similar firms. Mr. Stone believed that these dealers would know the market and trade possibilities. He also felt that information obtained from these sources would be more valuable than available statistics of sales, because it was up to the minute and included the best judgment of the trade.

By mail, telephone, and personal interview, the distributors were asked what their total sales of this class of marine equipment were likely to be in the following year; their opinion of products already on the market; the advantages and disadvantages of these competitive items; their reaction to price level, and what the difference in sales might be at various prices.

The replies provided information on the demand for the marine items in those outlets. Allowance was made for dealers not contacted by estimating the share of the market they represented and then discounting that portion to avoid inflating the calculation. A total annual market of 200,000 units was thus estimated.

Mr. Stone further concluded from the response that he could

capture one-twentieth of the total, or 10,000 units, if his product proved to possess the major advantages of the competitive items, with none of the disadvantages, while still selling for a comparable or reduced price. This decision was not influenced to any great degree by an offer from one optimistic dealer to purchase the first 12,000 units produced. Nor was the order accepted, because Mr. Stone preferred to sell through a number of dealers, thereby giving wider distribution.

Testing the Market. Forty models were made, and careful cost records maintained. Some of the models were displayed at the New York Sportsmen's Show, and in other similar shows across the country. The salesmen took orders, and noted the type of comment passed by observers. They were also expected to observe and to report the interest shown toward competitive products. Other models were made available to a number of large dealers who agreed to display them for the purpose of taking advance orders and testing customer reaction.

From these orders and the observed market interest, the development budget and production schedule were set up.

The cost of introducing this product was substantial. For smaller and less expensive products, the cost would be much less and might represent a small proportion of estimated sales. Mr. Stone feels, nevertheless, that if a product is worth introducing at all, it is advisable to plan carefully, and to ascertain as fully as possible what the reception will be.[2]

Safety provisions

The manager of any business has responsibilities to his employees, his customers, and the public. These include the maintenance of safe working conditions in the factory or service establishment, and in addition for the retail store, safe premises for customers and the public. For example, the merchant is responsible for injuries to persons passing his store if caused by a defective sign, awning, or other part of the store,

[2] Adapted from Small Business Aids, No. 273, U. S. Department of Commerce, "Measuring Potentials Before Introducing a New Product" (Case Study). Washington: U. S. Government Printing Office, May, 1947.

and for those to customers within the store that result from falls over boxes left in the aisles, cuts caused by sharp counter edges or broken glass, and any of the other possible sources of accidents.

In production, maintaining safe working conditions is a continuous process involving both physical conditions and the human element. Management must eliminate all hazards over which it has control, then "sell" the safety program to employees. Even in the small plant these two steps involve considerable effort. Fortunately considerable experience with this problem makes it possible to recommend definite procedures to follow, common sources of accidents for which to look, and ways to develop an effective safety program.

The most efficient operations are usually the safest. If the owner is fortunate enough to be starting with a new plant, careful planning of the building, layout, and operations can reduce hazards to a minimum. Unless the enterpriser is familiar with the latest developments in safety engineering it will be a good investment during the planning stage to secure competent advice. It is so much more expensive to make changes once the factory is in operation that errors once made tend to remain as continuing sources of accidents and lessened efficiency.

Assuming the business to be in operation, the first step in developing a safety program is to make a careful inspection of the plant to discover existing hazards. Once the danger spots are recognized, appropriate steps to eliminate some and to minimize risks resulting from others will usually be apparent. In making this inspection, the following should be given special attention: layout, housekeeping, maintenance, handling of materials, electrical hazards, and machine safeguards.

Indications of poor layout are: piling up of materials or work-in-process at certain points, crossing of the paths over which work is moved, crowding of workers caused by lack of space, overloading of certain machines or work centers, in-

creasing quantities of scrap or spoiled work at any point, and idling of men or machines at certain work centers.

Lax housekeeping is apparent when there are loose objects on stairs, floors, and platforms; articles that could fall from overhead; wet or greasy floors; projecting objects in aisles; and projecting nails or sharp pieces of metal that could tear workers' hands.

Inadequate maintenance shows itself in the form of defective floors that might cause slipping, tripping, or falling, or handling injuries; dark unpainted corners or projections that could result in collisions or bruises; hard-to-open windows or doors; and equipment, tools, or machinery in need of repairs. In the well-managed plant all portable equipment on which men stand, such as ladders, steps, horses, or scaffold planks, is maintained in first-class condition. Chisels, portable grinders, and drills are kept free of defects or are replaced when necessary. Machine guards are properly made, installed, and maintained, and workers are instructed in their correct use. Machines themselves, as well as pressure vessels, electric wiring, and other equipment, are kept in first-class condition, both to increase production and to promote safety.

Moving materials by hand that could be moved faster, cheaper, and more safely with mechanical equipment will result from improper management attention. Such inattention may also cause careless stacking of materials in poorly located places; carrying materials in such a manner as to endanger other employees; and failure of workers to wear protective clothing and equipment, such as safety shoes, goggles, and gloves, on jobs where such protection is needed. Capable management usually supplies these items and insists on their use.

Electrical hazards may not be so much in evidence as other danger areas, so it is advisable to supplement the plant inspection with technical inspection and maintenance. Among the hazards that are readily observed would be exposed wiring, unprotected switches, improvised attachments or "repairs" to

electrical equipment, and safety doors or attachments not properly in place.

During the plant inspection the owner should look for two things with respect to safeguarding machinery—the disuse of guards that have been installed, and the need for additional safeguards. Frequently workers will remove guards under the mistaken belief that they are "sissified" and unnecessary. It is management's duty to convince such workers that the guards are needed for everyone's protection. Experience shows that the correct kind of guards invariably increases production by enabling machines to be operated more steadily, or faster, or both. In many cases an alert observer can detect places where the installation of guards may be needed. Possibly the machine was built before guards had become standard equipment; perhaps it is being used in such a way that unusual hazards exist. And there is always the opportunity for discovering new ways of reducing machine hazards.

After management has made a thorough plant inspection and done everything possible to remove or lessen accident hazards, it is in a favorable position to enlist the coöperation of employees in a continuous safety program. By first proving the sincerity of its own desire to protect the workers, management is much more likely to receive the full support of the entire organization.[3]

In later chapters we will consider in some detail the major functions a merchant must perform efficiently. So many people consider store operation to be a simple matter, especially managing a grocery store, that attention is called here to the number of details involved just in attaining the one objective of good customer relations. The following is a check list covering many of these details.

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[3] Small Business Aids, No. 457, U. S. Department of Commerce, in coöperation with the Bureau of Labor Standards, U. S. Department of Labor, "Reducing Accident Costs in Small Industrial Plants Through Maintenance of Safe Working Conditions." Washington: U. S. Government Printing Office, April, 1948.

Check List for Retail Grocers' Customer Relations [4]

Store, Outside

1. Are sidewalks kept clean and streets free of litter?
2. Are windows clean and necessary signs neatly arranged, with plenty of free space for the customer to see inside the store?
3. Are produce displays in windows neatly arranged?
4. Do doors fit snugly; open and close easily?
5. Do door stops work properly to keep doors closed?

Store, Inside

1. Are floors kept clean every day?
2. Are sufficient carts, in proper repair, with baskets neatly arranged, available for customers?
3. Is top basket of cart level with check-out counter, for ease of handling?
4. Are bins, compartments, and shelves filled after closing each evening and replenished when necessary during the day?
5. When necessary to open cartons to replenish stock during day, are empty cartons and boxes immediately removed?
6. Is special care taken to remove all spoiled fruits and vegetables?
7. Are aisles kept clear of carts and boxes and extraneous material?
8. Is effective action taken regularly for extermination of pests and insects?
9. Are animals kept out of store?
10. Is all sweeping done after closing hours?
11. Are all scales checked daily to assure accuracy, and arranged so that customer has full view of weight?

Store Layout

1. Are names of all departments clearly marked high enough to be visible from all parts of store?
2. Are all items logically arranged and grouped?
3. Are all items within convenient reach of customer?

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[4] Small Business Aids, No. 358, U. S. Department of Commerce, "Retail Grocers Customer Relations." Washington: U. S. Government Printing Office, October, 1947.

4. Are price tags clearly visible on all items?

5. Are checks made regularly during the day and missing price signs replaced?

6. Is store well aired and free of odor?

7. Is winter heating properly controlled?

8. Is lighting sufficient but not glaring?

9. Are steps taken for noise elimination wherever possible?

10. Are there sufficient checking stations and are plans prepared for staffing all stations when lines are long?

11. After food has been removed from carts are they pushed through to a point where they can be secured by incoming customers?

12. Are the cashiers pleasant, cheerful, courteous, and friendly? Are final impressions such that the customer leaves the store in a pleasant frame of mind?

Clerks

1. Are clerks always neat and clean?

2. Are they pleasant and courteous without familiarity?

3. Are they patient and considerate?

4. Do they refrain from combing hair and applying make-up while on duty?

5. Do they refrain from chewing gum and smoking on duty?

6. Do they keep hands away from hair and face?

7. Are easily readable name tags always worn?

Customer Relations

1. Is an effort made to learn customers' names?

2. Are they greeted cheerfully by name?

3. Is an effort made to learn their buying habits, call their attention to special values, and make suggestions in a friendly way?

4. Are clerks alert to note all requests for items not in stock, as a guide in selecting new items for your store?

5. Are suggestions encouraged? Do complaints and criticisms receive proper attention? If they are justified, is prompt action taken and the customers thanked for their suggestions? When next they visit the store are they told what action has been taken?

6. Is the telephone answered promptly and pleasantly, and is a complete list of prices at hand?

7. When ordering by telephone, is customer permitted to order leisurely and to terminate the conversation?

8. Is telephone selling practiced and are staples and related items suggested?

Delivery

1. Are all orders carefully packed?

2. Are customers advised if substitutions are made?

3. Is the delivery boy especially trained in courtesy and politeness, as an additional means of increasing sales?

4. Is the delivery boy especially careful not to carry dirt into the customer's home?

5. Are cash prices plus an equitable delivery fee charged for delivered orders?

Credit

1. Has the credit policy been carefully determined?

2. Are all requests for credit handled by the manager?

3. Is a written statement of credit terms and collection policy given to each accepted credit customer?

4. Are you pleasant but firm in insisting that terms be met?

Management aids

With so many and such varied duties to perform, the manager of a small business needs an understanding of how all jobs can be done effectively without wearing himself out trying to do everything personally. As the Executive Secretary of the Farm Equipment Wholesalers Association said in a recent letter to the authors:

> Most men who start in the wholesale business in a small way tend to keep themselves tied down to routine tasks long after they should have delegated these to others. As the volume of detail work fluctuates greatly from season to season, there should be a few general utility people who can move from department to department in order to keep things going smoothly. Especially do dealers appreciate getting their invoices promptly, which means extra help on pricing and billing at times of stress.[5]

[5] Excerpt from letter of August 6, 1948, from C. E. Woodward, Ex-

Work simplification is one solution to the problem of delegating tasks, especially with reference to the large amount of paper work involved in operating a factory or wholesale business.[6] A more general approach is to realize that the management of any business involves four processes: direction, supervision, control, and coördination.

Management functions

Direction is concerned with setting the objectives and guides to be followed. Policies, executive decisions, instructions, and "orders" given by management are examples. (Modern management recommends suggestions rather than orders, carrying out the idea of leadership or the positive approach.) A case in point is a retail store which states that its policy is to serve young people with "fashion right" merchandise. The manager declines an invitation to stage a private fashion show for a matron's club because this would be inconsistent with the company's policy. To accept would mean special purchases of merchandise appropriate for matrons, thus diverting the business from its predetermined goal.

Supervision has at least three aspects that are important even in the small business. First, to supervise implies observation to see that duties are being performed or that work is being done correctly. This means that jobs or responsibilities have been assigned to individuals and that the supervisor knows the correct way of doing the work. For example, the manager observes a salesgirl demonstrating an article to the customer. Was the demonstration correct? To answer, he must know the most effective or approved ways of demonstrating this particular article. This example suggests the other aspects of

ecutive Secretary, Farm Equipment Wholesalers Association, Minneapolis, Minnesota.

[6] For further study see Small Business Aids, No. 361, U. S. Department of Commerce, "Work Simplification." Condensed from "Work Simplification," by James D. Anderson. *N.A.C.A. Bulletin*, June 1, 1946, New York, The National Association of Cost Accountants.

supervision; assume that the girl used a method of demonstration totally new to the manager. If so, it was either good or bad. If bad, the manager would take the first opportunity to discuss it with the girl and show her the correct or more effective ways to demonstrate this merchandise. This is the second aspect of supervision, the training or remedial phase. In the absence of supervision, the girl's sales record would eventually show that something was wrong (see "Control"), but it would not disclose the reason for lost sales.

If the new demonstration had been especially effective, the manager would have complimented the girl and adopted her method for future use, also telling all the other salespersons about it. This illustrates the third aspect of good supervision—"upgrading" of work by making all improvements general practice.

Control requires three steps: setting standards or objectives for accomplishment, maintaining current operating records for comparison with standards set, and acting promptly when operations deviate too much from the goals established. Control systems deal with the measurable quantities like money, units of production, or sales. Managerial control requires an appraisal of the *reasons* for operating results being different from those planned, and intelligent decisions as to what action is needed.

Production control in a small factory plans a daily output of thirty units, based on anticipated sales department needs. Daily reports show actual production to be averaging only twenty-five units. Investigation discloses recurring delays because of repeated breakdowns of one machine. Review of sales estimates verifies the need for thirty units daily. Immediate action by management will prevent an increasing amount of back orders, broken promises, and lost sales. If possible, the defective machine should be repaired or replaced at once. Otherwise it would be better to slow down on sales immediately so as to meet current ability to produce than to have disappointed cus-

tomers and the other likely results of failure to coördinate sales and production.

Coördination is both a basic function of good management and an *ideal* seldom, if ever, achieved. Management is always striving, however, through direction, supervision, and control, to secure the maximum possible coördination of all the activities of the business. Each important decision must be made in light of its effects on all divisions of the business. Policies are important coördinating devices because they set common goals or objectives toward which various departments work. Budgets, schedules, and other types of control assist in securing coördination because they help management to plan and secure a balanced relationship between the operation of different divisions of the business. Coördination represents the culmination of effective management—nearly perfect balance between the elements of sales and production, of expansion and resources available, and of revenue and expenses plus profits.

Organization—an aid to management

Even the smallest business needs good organization. Basically, organization involves two steps: a division, by analysis, of the particular business into the functions or activities that must be performed, and assignment of each to certain individuals. It is one of the most powerful tools of management. Organizing ability is universally accepted as a characteristic of the successful manager.

A simple approach to organization is to write down what the business must accomplish to be successful, and from this to subdivide or list *all* the activities that *must* be performed. These should then be grouped into *related* activities commonly called "functions," such as selling, producing, and recording. For a new business effort should be made to secure individuals well qualified to perform each of these functions. For an established business the job is to assign functions and sub-functions to members of the firm according to their respective abilities,

capacities, and interests, being careful not to overload the better-qualified individuals.

In assigning duties to individuals, there are certain principles that extensive experience has proved to be of vital importance. Authority and responsibilities should always be assigned equally. If you make an individual responsible for a certain job, give him the authority necessary to do it. Also, do not permit any individual to exercise authority—that is, to give orders or make commitments for the business—unless that person is held accountable for results. One's own relatives should never be excepted from this rule.

Division of authority and responsibility in the small business is especially important in the case of a partnership, since the acts of either partner with respect to outsiders are usually legally binding. Also, employees recognize each partner as an owner and will take orders from him. If no agreement has been reached between the partners as to their division of authority, conflicting orders often result.

Another principle useful in securing employee loyalty and coöperation is to give each member of the firm some authority and responsibility. This helps to build men as well as business. In the small business the tendency is for the owner to retain all authority, thus truly making it the so widely criticized one-man enterprise. Unless steps are taken to counteract this human tendency, growth of the business is retarded, employees are just "hired help," and the manager is so burdened with detail as to be unable to give proper thought to planning and other important matters.

When the manager considers his responsibilities and their delegation, and when these responsibilities are discussed in a conference, he should study them not only from his own personal viewpoint, but he also should recognize how proper delegation can help him become a better manager *within his organization.* The successful manager constantly considers his responsibilities (1) in terms of those which he can delegate whenever possible, and (2) with respect to the effect of his

actions on his own work, on his assistants, and on the rest of the organization.

In practice, organization must be the answer to a particular problem. This means that the conditions existing in the business are more important determinants of the set-up than arrangements illustrated by generalized organization charts.

One of the author's former students and his brother bought a small town general store. Three main classes of goods were handled: foods, hardware, and apparel—the third consisting mostly of men's and women's work clothes—but divisions or departments were not clearly recognized. One brother was experienced in food merchandising but had not had business training or executive experience; the other had college training in marketing and accounting. Neither of the men had had experience merchandising hardware or wearing apparel. The two were able to employ a lady familiar with the women's wear lines, who was put in charge of that merchandise division. The college-trained brother had done enough rough carpentry work to be fairly well acquainted with the general line of hardware items and work clothes carried, so he took over the merchandising of these lines. Naturally his brother took charge of the groceries and meats. A "typical" organization would have consisted of three (or four) merchandise departments—foods, hardware, and apparel, whereas the practical solution in this case is more truly typical of most small businesses in that the organization is built around the abilities of the individuals.

As co-owners with different training and experience, the two men divided the other management functions accordingly. In view of his training, the one took charge of accounting and finances, leaving his partner to look after layout and displays. Both determined store policies after consulting their banker and their major suppliers and after discussing each question with the manager of the women's department.

The college-trained brother is an extrovert, aggressive, and very likeable. Within a year after taking over the business he organized a local chamber of commerce. He was elected the

first president. Within six months after its formation the chamber of commerce had succeeded in attracting new industries to the town and had promoted other civic developments.

Since the net profits and other achievements of this partnership have been well above the usually optimistic estimates of beginners, its organization and the policies followed have been discussed at some length.

Special problems

The founders of the partnership just discussed were more fortunate in one respect than many small businessmen who may be under pressure to employ in-laws, or a particular type of worker who has become traditional for certain jobs in the community.

Sometimes the small business manager feels the burden of contributing to community activities to be relatively heavy. As a businessman he wants to participate in civic development and belong to local service clubs. Often these activities consume a large amount of his time. Also, because he is known personally in the town, he may be called upon quite frequently for donations toward community development. Whereas the larger organization with sales of $100,000 might contribute $10.00 to some "cause" and feel virtuous about it, the little fellow with $20,000 sales would probably feel ashamed to contribute only $2.00.

Although there is no single solution for each of the problems just mentioned, there is a plan that, if followed tactfully, will solve most such difficulties. First, the manager, in conference with specifically qualified individuals, should formulate policies covering each of these topics. Then the owner may truthfully say to a job-seeking relative that on the advice of his suppliers and banker he has adopted a policy of not employing relatives. Similarly, to the friend soliciting contributions he may reply that on the advice of the chamber of commerce (or some other group) his firm has adopted a policy of making contributions in the same relative proportion to those of large concerns in the

same field as the corresponding ratio of sales volume to sales volume. It is much easier to handle these situations in this way than to give direct personal decisions. Many small businessmen have found this plan to be very satisfactory.

Leadership

Modern management stresses leadership and the human element. Recognition of good work by the manager usually does more to encourage employees than incentives that are less personal. Criticisms, when necessary, should be made privately, sympathetically, and constructively for each employee. Great care is taken by the real leader to treat all employees fairly and understandingly, as individual human beings. Employee suggestions are welcome; they are actively sought by alert managers. In the more progressive organizations employees are consulted on management problems, and they are furnished with management information formerly of a confidential nature. This employee-management coöperation is one way for the small business to attract and hold personnel of excellent quality.

Sometimes owner-operators of small businesses have the capacity for leadership, but do not exert it. Usually the reason for this is that they are too concerned with minor details, are unable to see their real opportunities, or they lack the energy that forthright leadership demands. To expand, or even protect, their businesses under such conditions becomes almost impossible. Small business management in such a predicament can do little more than resolve to stay extremely small or to obtain the necessary management assistance.[7]

The leader's guide to human relations

Mr. B. W. Elsom, Personnel Superintendent, the Boston Store, Milwaukee, Wisconsin, offers the following excellent advice:

[7] Lund, Russell D., "Personal Traits, The Test of a Good Manager." *The Co-Operative Merchandiser*, January, 1947, Vol. 12, No. 1, page 40.

1. The most dangerous policy in handling subordinates is to ignore them.

2. The "mental wage" is low if the employee is not interested in his job.

3. There is more "mental wage" in a request than in an order.

4. The "mental wage" is low when the worker's suggestions are ignored.

5. Prompt decisions by supervisors add to the "mental wage."

6. "Mental wage" goes up as working conditions are improved.

7. Workers are hungry for commendation; a "pat on the back" stimulates effort.

8. An indirect method of praise is to ask the worker for his opinion as to the methods or progress of a job.

9. One of the most potent forms of "mental wage" for employees is the certainty that they can have a sympathetic ear for their grievances.

10. People resist change. Tell workers in advance of changes which will affect them. Surprises upset people.

11. Intelligent employees have the right to know the reasons that lie behind rules and company policies and organizational set-ups.

12. Tell employees as much as possible about department plans and results. This adds interest and stimulates a sense of responsibility.

13. Give each worker an answer to his ever-present question, "How am I doing?"

14. It is better not to have a rule than to permit frequent violations of one.

15. Every employee is entitled to thorough instructions in the duties he is to perform; best methods to use; standards his work will be judged by.

16. Corrections should be made with fairness and consideration.

17. Criticism in the presence of fellow workers is unnecessarily embarrassing.

18. Ambitious employees are eager to broaden their knowledge, storewide.

19. Belief that the boss shows favoritism is highly destructive of morale.

20. Whole-hearted employee coöperation is never built on a foundation of fear.

21. We all want "a place in the sun." Every employee should have a feeling of pride in the worthwhileness of his contribution to the business.

22. No promise that the boss makes is unimportant.

23. Discipline should be consistent.

24. "Mental wages" pick up when the worker is given more responsibility and a chance to show initiative.

25. The worker's sense of security, his knowledge of reasonable regularity and continuance of employment, is essential to personal efficiency.[8]

Conclusions

Good management is the key to success in business. In the small business, management—the owners—formulates the policies, arranges the initial financing, selects the location, building, and fixtures, and determines layout, besides operating the business. Throughout the book more than twelve special aspects of management, such as those just mentioned, have been recognized as important enough to warrant discussion in a separate chapter. Yet they are all special phases of management.

When the wide range of duties required of the manager of a small business is considered, the need for some outside aid is apparent. He must: balance every division and activity of the business; plan for the future while busy with pressing matters of the present; provide the right insurance; select, train, and supervise employees; conduct or direct research; and *manage* all activities of the business. Surely our two basic statements regarding small business may well be used here to emphasize the need for careful attention to management, namely: (1) management is the one essential for success, and (2) time is the number one problem of the small business.

[8] Elsom, B. W., "25 Ways to Build Sales Morale." An address delivered before the National Marketing Conference, U. S. Department of Commerce, Washington. Reproduced as an article with the same title in *Home Furnishings Merchandising*, April, 1947, Vol. 89, No. 3, page 94.

In this chapter an effort has been made to present typical management problems, to stress the fundamentals of good management and the basic principles of organization through which efficient management operates, leaving to their respective chapters the more specialized application to important divisions or activities of the business. Management has been developed to a fine art, and organization to a near science. Each has a body of well-established principles, practicing specialists, professional organizations, and literature comparable to that of the other recognized professions.

Management deals with the *direction, supervision, control,* and *coördination* of all activities of the business. Organization deals with the *structural arrangement* or *interrelationships* between different parts of the business. Since a business organization is operated by individuals, most of the important principles of organization are expressed in terms of the human element. We think of managing a group of people, rather than of running a machine. The group of people may be well organized, the machine well built.

Since management is a highly skilled art involving a range of knowledge and abilities infrequently found in the average small businessman, many proposals have been made, and some steps taken, to assist the little fellow to improve in this respect. The "outside staff" discussed in this chapter is a step in the right direction. However, a word of caution is in order. Good management is not just "dished out" or sold like a bill of goods. It must be acquired—learned, practiced, perfected. There is some danger that various plans to furnish management aid may go the way of other panaceas. More than "aid" is needed. Appreciation, acceptance, active support, and utilization of such aid by the small businessman himself must exist if such plans are to accomplish their objective.

Review and Discussion Questions

1. Name at least ten ways the owner-manager can create good will between himself and his employees.

2. Discuss supervision of employees—the right and the wrong ways.

3. List the steps in organizing the personnel and departments of a business.

4. How can a business organization be "audited" to find its weak points? Discuss.

5. Discuss some of the major organization problems often met in a manufacturing business. Service business. Retail business.

6. Compare "leadership" with "management."

7. Show how the four basic functions of management would vary in application, if at all, for each of the three fields of business. Explain.

8. Cite illustrations where overlapping or conflict of authority is likely to develop in any type of small business organization, and discuss what could be done to prevent or reduce it.

9. What departments, or functions, are usually considered to be staff functions? Discuss the reasons for, and consequences of, such functions being restricted to staff activities.

10. In what, if any, respects would the fundamentals of management and basic principles of organization as discussed in the chapter not apply to some type of small business? Discuss.

11. Consider some activities performed in manufacturing but not in merchandising or service businesses, and show how topics discussed in the chapter apply to these activities. Do the same for the service industries, or for certain types of service businesses.

12. Look up some of the standard texts on industrial management, or "scientific management," and compare the principles covered with those in this chapter.

13. Show how, if at all, the contents of this chapter would apply to a one-man business. Discuss.

14. How, specifically, is the present chapter related to the topic of personnel? Explain.

Chapter XI

EMPLOYEE RELATIONS

The reputation a small business acquires in the community is closely associated with its employee relations. Customers are quick to sense the way employees are handled. A contented, well-treated staff of workers will reflect their loyalty and enthusiasm in dealings with customers and with the public. Good employee relations can be a major asset to the small business.

In the first place, every progressive business seeks some point of superiority or distinctiveness over its competitors. In the small business the major competitive advantage may well be its high-quality personnel. Materials, equipment, machines, and other things used by business are available to all competitors at approximately equal prices. It is the firm's personnel that is unique and susceptible to the greatest individual management development. The result of good employee relations —a loyal, efficient group of workers—cannot be copied or purchased by competitors. If an equally good staff is to be developed, it must be earned by similar effort, but it will still have a different business "personality." Because of the close personal contacts between management and workers, the small business should be able to do a superior job of maintaining good employee relations.

Furthermore, the increased worker efficiency which usually accompanies good employee relations is of greater importance in the small business than in the large concern. In the manufacturing and service fields the latter is better equipped with

more expensive machinery and mechanical aids. In merchandising the large stores have staff departments as well as better mechanical equipment to aid employees. The small business must rely more heavily on its personnel alone.

The human element in the small business is complicated by the close personal acquaintance that normally exists between the owner and his employees. It often happens that many of the employees are relatives or lifelong friends of the owner. The result is likely to be an unwillingness to follow approved personnel practices developed in larger organizations, either because the owner feels that they are too impersonal for his small group of intimately known workers or because he lacks understanding of modern personnel practices and how they can be adapted to the needs of the small firm. Offsetting the difficulty of using modern personnel practices in the small firm is the owner's greater knowledge of each of his employees and the feeling of mutual friendship that often exists. These are *real advantages.* Actually one of the main reasons for the development of most so-called "modern personnel practices" has been the need of the larger organizations to make up for this lack of personal contact and understanding between management and employees. However, an even more important reason, for the small business at least, is the importance of separating business from personal and family relations. This objective should be a major incentive for using modern personnel methods in the very small company.

The methods to be discussed briefly are "standard practice" in large concerns but may appear to some readers as unnecessary in the small firm. This unfortunate attitude has caused many small businesses to fail to capitalize their advantageous position in developing employee relations. People are human beings, whether employed by large or small firms. The little fellow who limits his choice of methods to those used by other small operators will probably simply repeat their mistakes and make very little progress. If one small shop appears to have good employee relations without using any organized person-

nel procedures, the reason probably lies in the personality of the owner—something very difficult for other businessmen to duplicate. Another small business may have very little labor turnover and employees who seem to be contented and satisfied with their positions. Closer analysis might disclose an employer lax in his supervision and requirements of worker efficiency. Employees realized this and were satisfied to enjoy the easy going. A favorable lease may have made it possible for the firm to show a modest profit in spite of relatively inefficient but not disgruntled employees. Similar cases could be given to illustrate various ways in which a small business can exist without actually cultivating worker support, but they would prove only that inefficiency of operation is fairly common among many small concerns that have not as yet felt serious competition, or that many small businessmen are content with mediocre results. Good employee relations in such cases would convert these "average" concerns into more profitable, growing companies—and do so to the mutual benefit of employer and employee.

The following discussion of personnel practices must of necessity be brief, leaving to the suggested references and other writings on the subject more comprehensive treatment, particularly of several of the specialized topics that will be little more than mentioned here.

A logical starting point for any personnel program is job analysis and description. Job analysis involves for each position a study and recording of the nature of the work done, types of physical objects handled (such as machines, tools, equipment, materials, or merchandise), and how each job is related to others and to the entire organization. Job description translates job analysis facts into specifications relating to the skills, effort, responsibility, aptitudes, experience, knowledge, abilities, and physical and personality traits of the individuals best suited to perform the jobs successfully. Selection, placement, training, transfers, and remuneration of all em-

ployees should be based largely upon these job analyses and job descriptions.

In the company with relatively few employees each "job" will naturally involve more duties than would be expected of one individual in the large concern. In making a job analysis it is well to take all employees into one's confidence and explain the purpose of the study. Each individual is then asked to make a complete list of all his duties or responsibilities; kinds of work performed; machines, equipment, tools, or merchandise handled; relations with other individuals in the organization; and difficulties and problems commonly encountered. Often this listing will be made in coöperation with a supervisor or department head.

At this stage of the job analysis it may be advisable to undertake some methods studies for the purpose of job improvement before actually preparing the job analyses and descriptions. Simply stated, methods study involves an earnest, intelligent effort to find the best way of doing the job. Depending upon the nature of the work, it may stress saving time, examining motives, or determining the psychological factors involved in selling or creative activity. Although large companies, where subdivision of labor is already highly developed, find it necessary to employ methods study "experts," the average small businessman can often make improvements resulting in a 50 per cent increase in efficiency by simple observation and analysis.

Each time a method of doing a particular job is improved it should be made standard practice, and coöperation in using the new way should be secured from all employees concerned.

Job evaluation is the next logical step. In this procedure various jobs are evaluated with reference to one another and to their importance to the company in terms of skill, effort, responsibility, and similar factors. Although used primarily to secure equitable pay for each job, it also provides a reliable basis for estimating labor costs and helps to reduce a common source of employee grievance—namely, a belief that he is underpaid relative to other workers. Job evaluation has many addi-

tional advantages to both management and employees. After many years' use in production, this personnel technique has spread to retailing, service industries, and many white collar occupations.[1]

Selection

The small business is usually limited to the locality in recruiting employees and often further handicapped by the fact that the best local talent is likely to prefer employment in big business. By paying wages comparable to those offered by large employers and by stressing promotional opportunities or a better chance to learn the business the small employer can largely offset this handicap. Aggressive solicitation and selling of the company by the small businessman can further lessen some of these limitations and help to secure an adequate supply of the right type of job applicants.

Big business can afford to send representatives to contact local sources of desirable employees only once or twice a year, but the small operator can keep in fairly continuous touch with them. Enterprising small local firms frequently "sell" the best prospects on the advantages of local employment before national organization representatives appear on the scene. One point of special importance to the small business is to select and seek rather than wait for applications.

Even when applications for employment are aggressively solicited, regular employment procedures should be followed, though more informally in the small business than in the large one. The application blank to be filled out and studied by the prospective employer is the first of these. An application blank is a record of statements (presumably of facts) made at the time of seeking employment. Any efforts to use it as a

[1] For further study see: Birney, George, " 'White Collar' Job Evaluation." *Credit and Financial Management,* May, 1946, Vol. 48, No. 5, pages 17–20; Brisco, Norris B., *Retailing,* 2nd ed., pages 346–348. New York: Prentice-Hall, Inc., 1947.

test should also provide for recording the necessary employment facts.

The application blank should include *all* information that will aid in deciding whether or not to employ the applicant, as well as certain facts that may later be useful if he is employed. Any circumstances peculiar to the particular company, if relevant, should be included, such as union membership or willingness to join if company policy requires this, family and financial status if these have been found to be important requirements for success in the organization, and a record of previous employment, with references.

Among the important uses of the application blank are to aid the interviewer, to furnish such information as references, to provide an initial record of employment if questions of fact later arise, and to serve as a permanent record in which added experience and training find a place.

References given should be investigated, either in person, by letter, or over the phone. The telephone check has gained in favor.[2] Naturally, the applicant will select persons who he thinks will give him the best recommendations. Usually all relatives, church officials, and politicians should be eliminated from further consideration, for the very nature of their positions precludes securing useful information regarding the applicant from them. Other references, such as former employers, school officials, businessmen, or acquaintances, require further appraisal. In most cases the situation will be fairly simple. If the applicant is seeking a better position, has a good record of progress with former employers, and includes no politicians, church officials, or relatives in his list of references, it will be sufficient to secure recommendations from his former employers or, in the case of recent graduates, teachers. Two

[2] For further study see Small Business Aids, No. 275, U. S. Department of Commerce, "Checking Job Applicants' References by Telephone." Condensed from "How to Check References," by Lawrence Stession. *Forbes Magazine of Business,* May 15, 1947, New York, B. C. Forbes and Sons Publishing Co.

other situations sometimes arise, however, and deserve further consideration.

The logical references for an applicant to give are readily apparent to any employer: his present or former employer, banker, business associates, school officials (in the case of recent graduates), and possibly a few business acquaintances. An applicant's giving references other than these may indicate a desire to conceal certain "unfortunate" episodes in his past experience or it may indicate a thoroughly justifiable situation. In doubtful cases the prospective employer should exercise judgment supported by human understanding. The applicant who has a continuous record of job shifting and always blaming the "boss," with nothing to support his own claims of ability and references of a few fellow workers only may usually be suspected. References should be secured from the "boss" or former employer as well as from other competent persons if it is necessary to consider such an applicant for employment.

The other situation is more difficult to handle. Human beings, even supervisors and employers, are often wrong in their evaluation of an employee, and an unfortunate set of circumstances—personality conflicts, accidents, and so forth—may distort their opinions. In such cases the individual affected may justly prefer to give as references unbiased coworkers or others rather than his immediate "boss." Organizations of all types and sizes have "internal politics." Often publicity given to this condition in a particular organization or a knowledge of its existence by various individuals will give the clue needed as to which recommendations should be used by the prospective employer.

In cities all over the country there are manufacturers, financial houses, retailers—all types of business firms—who have found a new way to make employee selections, a surer method of choosing between apparently equally-qualified candidates for an open position.

These companies no longer rely entirely upon the naturally biased

statements of job applicants. They eliminate practically all doubt as to whether a man of 42 has accidentally stated his age as 38, or whether a short and unsatisfactory employment period has escaped mention. They get all this and much more normally inaccessible information quickly and accurately in a "Personnel Report"—right from the local Credit Bureau.

In its lowest-priced questionnaire form (in some areas as economically rated as $3.00) the Personnel Report reveals much helpful information on any type of prospective employee. In the more elaborate narrative forms (the cost of which may run to $100 or more, depending on the amount of detail desired) the Personnel Report presents a detailed and comprehensive history adequate for judging top executive material. In fact, there are a number of instances where men contemplating business partnerships have drawn such reports on each other.[3]

An example of a widely used form is No. 17, Personnel-Employment Credit Character Form. This report covers a specialized investigation on prospective as well as present employees designed to cover important antecedent questions such as peculiarities, educational advantages, ability to get along with other employees, home conditions, whether a steady worker or subject to considerable absenteeism, and related topics. An illustration of this form is presented in Figure VII.

Three general types of tests or examinations are often used during the selection process: mental tests, performance tests, and the physical examination. There are numerous varieties of the first category, some designed to measure intelligence or the ability to learn and others to rate aptitudes, interests, attitudes, and particular personality traits. Opinions differ regarding the value of such tests, although their use is steadily increasing. The novice using psychological tests should be warned against the many charlatans offering testing services.

[3] Small Business Aids, No. 231, U. S. Department of Commerce, "Service Provides Information on Prospective Employees." Condensed from "Pre-Test Your Employees," by Bert Dale. *Forbes Magazine of Business*, February 15, 1947, New York, B. C. Forbes and Sons Publishing Co.

Factbilt REPORTS ARE BETTER

ASSOCIATED CREDIT BUREAUS OF AMERICA
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Personnel-Employment Credit-Character Report ACBofA No. 17 compiled by member bureau

CONFIDENTIAL

1 REPORT ON: DOE (Surname first) MR. (Mr. or Mrs.) JOHN ALBERT (Given Name) MARIE (Spouse's name)

2 RESIDENCE ADDRESS: 4180 Maine (Street Number) Anytown (City) Any (County) Anystate (State)

IDENTITY	3. Number of years covered: A. In file	A. 15 yrs.
	B. In investigation	B. 10 yrs.
	4. A. Age (if near 21, confirm)	A. 38 yrs.
	5. A. Marital status	A. Married
	B. Number of Dependents?	B. Wife, 2 sons and 1 daughter
	6. Any disease, injury, deformity or peculiarity of appearance?	None with exception of glasses
	7. How far did subject progress in school?	Grade and High School graduate
CHARACTER	8. Is subject well regarded as to character, habits, morals, etc?	Yes
	9. Is relation with fellow employees, agreeable?	Yes
	10. A. Is home environment favorable?	A. Yes
	B. Any domestic troubles?	B. No
	11. Any suspicion of gambling, speculation, unfavorable associates?	None
	12. Any suspicion of excessive drinking or use of drugs	None, social drinker only.
RESOURCES	13. A. Income from employment (state if estimate or exact)	A. $6,250 annually
	B. Estimate other income such as rentals, investments, etc.	B. Rent $10 mo. from upper apartment
	C. Estimate income of others in household	C. None
	14. Own home, rent or board?	Owns home
	15. Any items of public record in file?	None

CREDIT RECORD:

Trade Line	How Long Selling	Date of Last Sale	Highest Credit	Terms of Sale	Amount Owing	Amount Past Due	Manner of Payment
Department	5 yrs	11/2/48	14.70	Open	00	00	30-60 days
Men's Clothing	3 yrs	10/14/48	75.30	Open	00	00	60 days
Shoe	2 yrs	1/8/49	7.50	Open	00	00	2 weeks
Ladies Wear	6 yrs	12/6/48	15.64	Open	00	00	30 days
Hardware	7 yrs	12/18/48	11.30	Open	00	00	30 days
Furniture	7 yrs	4/1/48	160.75	Lease	00	00	as agreed

REMARKS: (A) Name and address of present employer. (B) Former employment history. (C) Amplification of incomplete information.

A) Mr. Doe is employed at the present time by the Pump Manufacturing Company, 531 S. First St., Anytown. He is in charge of production, and his duties are entirely of a supervisory nature. Has been employed by his firm since 9/12/35.

B) He was formerly employed by Howald Machinery Company as clerk in the production department from 5/25/28 to 9/10/35. Previously was office clerk at Stove Manufacturing Company at the time he graduated from high school, until 5/28.

C) References report him to be a conservative type man, interested in his home and family. He is not active in civic or social affairs, with exception of his Church.

D) He owns his home, which is a two-story brick dwelling.

Report for Dakota Packing Company, Huron, Anystate

Date 11/15/49 Prepared by Credit Bureau (Name of member reporting bureau) Anytown (City) Anystate (State)

The confidential information given in this report is in answer to a request for same. This report is compiled simply as an aid in determining the propriety of extending credit, or the value or continuation of an existing credit and is based upon information obtained from sources deemed reliable, the accuracy of which, however, is in no manner guaranteed. The inquirer, in accepting this report, agrees to hold same in STRICT CONFIDENCE for his own exclusive use, never to be communicated, and to be personally responsible for any damage arising from a violation of any of the above provisions.
(Printed in U.S.A.)

Figure VII. Personnel-Employment Credit Character Form

No such test should be administered or interpreted without expert guidance, which is available from many educational institutions, professional personnel institutes, and practicing psychologists. Performance or achievement tests should be used, even in the small business, if the nature of the work for which an individual is applying permits. These need not be elaborate; often a mere tryout preliminary to actual employment is sufficient. The physical examination should be used much more generally than it is, especially when the job requires strength, good vision, hearing, ability to stand continuously, stamina, or other qualities above the average and wherever the health and safety of the public or fellow workers are involved.

The interview is probably the only selection procedure almost universally used. Although an interview is ordinarily necessary to determine such characteristics of the applicant as appearance, poise, and speech, it has many weaknesses. Chief among these is the exaggerated belief of the interviewer that he is a good judge of human nature. To lessen the proved subjective weaknesses of the average employment interview certain procedures have been developed. Before the main interview is started, the application blank should be studied and the job descriptions likely to be needed should be at hand. The interviewer should make a few reminder notes of important points to look for or ask the applicant about. He should have handy an interviewer's rating scale upon which he will enter evaluations of all the traits listed, which may be a few or many. This device is like a woman's shopping list, useful to insure complete coverage of essential items, to serve as a reminder, to guard against diversions, and to assist in directing and distributing effort.

The interview should be conducted in a suitable place, such as the office or a quiet part of the building. The applicant should first be put at ease. Often asking general questions designed to start the applicant talking and to "break the ice" is sufficient. Informality consistent with the dignity or impor-

tance of the interview is the goal usually sought. The trend in larger companies is to use two or three interviewers. Even the smaller employer may well have an applicant interviewed by different members of the organization. In addition to seeking information from him, the interviewer should furnish all important information regarding the company, the job, employment conditions, pay, company policies, and similar data, as well as answer questions the applicant may ask. If employed, the newcomer should be given specific instructions and encouragement. If rejected, he should leave with a feeling of good will toward the company.

Placement

Many small employers could use their wage dollar more efficiently than at present by capitalizing fully on the special abilities of each employee when assigning duties and planning layouts and other matters.

The man who would wear an expensive new pair of dress shoes when digging a ditch is the man who would use a $60-a-week pharmacist or mechanical specialist to sell chewing gum or shoe strings. Since the time of either worker is worth at least $1.20 per hour, or two cents per minute, and selling costs are probably a typical ten per cent of sales, the employee would have to sell four packages of gum each minute for the store to break even! In most stores a salesman at that salary must produce twenty cents in sales volume every minute if his wages are not to eat into overhead beyond their proper share of ten per cent, more or less.

This example indicates that chewing gum, laundry soap, and hair pins must be sold by inexpensive help or self-service and that the expensive help required to sell cosmetics, dresses, dinner sets, and washing machines should devote their time to "big ticket" items exclusively.

A store can carry both high- and low-priced items and have low-salaried people to sell one and qualified specialists to sell the other. Employee differentiation may be studied in the

modern chain drug store, although not all small retailers could carry the application of this principle to the same degree.

The department store's pattern is similar. Certain departments selling demand items, such as notions, have a low average sale. These departments need not pay high wages to secure qualified clerks. Some merchants feel that these goods will sell themselves and that no great volume is at stake if a few sales are lost through lack of sales ability. In the higher unit sale departments, however, the reverse is true, and earnings are high. The possibilities of an application of this principle to the hardware store or the apparel shop are obvious.

The one- or two-man business may not find this plan of labor specialization advisable. It may be that it must sell all price lines and that contacts in selling small items serve as "leads" for the sale of large ones. Yet the possibilities for efficiency in applying the principle remain and are nothing new, having begun, perhaps, when the father restricted his son, or the master his apprentice, to the handling of transactions in which no great loss was possible through mishandling, the craftsman applying his own and his journeyman's talents to the most profitable items.

The first few days in a new position are usually the hardest. A newcomer should be introduced to his fellow workers, shown the location of employee facilities, informed of any regulations, and encouraged to ask for additional information as it may be needed. A good plan is to assign an older, more experienced worker to act as sponsor or "host" until the introductory period is over. The "boss" himself should follow up on the new employee by occasional visits with him until he feels at home in the organization. Consideration and reasonable attention at this time are a good investment in employee relations.

Training

Often some preliminary training in company policies, system, work standards, and regulations is part of the introduc-

tion to the job. The need for improvement training, which should be offered as required, is fairly continuous in most cases. Training may be remedial or developmental. The former seeks to correct errors or mistakes made by individual workers regardless of how long they may have been employed. It is usually based on error reports of individuals, on reports by the immediate supervisor, or on indicators of the operations of each department, such as amount of spoiled work, rejects from the inspection department, lost sales, breakdowns, schedule delays, accidents, and similar measures of a department's deficiencies. Either group meetings or individual conferences may be used in remedial training according to the circumstances.

Development training assumes that every job can be done better, that there is always something more an employee can learn about his job, and in many cases that certain workers wish to prepare for advancement to better positions. Continuous on-the-job training is recognized as an integral part of the responsibility of every supervisor and executive. Unfortunately it is a responsibility often neglected. The Job Instructor Training plan developed during World War II may be needed to "train the trainers how to train." More formal, organized group training of workers is often desirable even in the very small concern.

There is no longer any need for the small business to neglect employee training because executives lack time or experience as teachers. Federal- and state-sponsored vocational training covering a wide range of jobs is available at no cost in nearly every community. Three such programs of interest to the small business are: Trade and Industrial Education (T. & I.), Distributive Education (D. E.), and Diversified Occupations (D. O.) training. In certain cases the Vocational Agriculture program may be useful.

In general, training under the vocational acts is limited to employed persons and is related to the work they are doing and preparation for advancement to the next logically related occupation. Instructors are supposedly qualified by experience

in the field and have received teacher training in vocational training methods. All courses are under public supervision and control; that is, they operate through the state's Department of Vocational Education and the public school system in each state.

Trade and Industrial (and Agricultural) training were first established with the passage of the Smith-Hughes Act in 1917; Distributive Education was added by the George-Deen Act in 1936. These are all permanent vocational training programs not dependent upon postwar training assistance to veterans, although G.I. on-the-job training was set up to operate through the regularly established vocational training agencies.

In general, T. & I. is concerned with training for skilled crafts, construction, production, repair, and other service occupations (non-professional); D. E. deals with selling, managerial, and other customer contact positions in merchandising. Because the original T. & I. program limited training to those occupations comparable in training needs to the old apprentice system, T. & I. courses were available only in communities with a fairly large industrial development. The newer industrial areas, especially smaller communities in the South, needed a more diversified program under which a group of fifteen trainees might be employed in six to a dozen different occupations, the entire group being under one teacher or coördinator. This resulted in the Diversified Occupations program. Obviously the instructor could not be a master of six or more trades, but he could be experienced in one or two lines and well trained to direct or coördinate the training needed in other lines.

In any of the three fields of small business, training of employees and management may be obtained if the D. O. program is operated in the state. In some states training assistance for the small manufacturer may be limited or unobtainable under the vocational programs except for members of his marketing division, salesmen, routemen, and others in customer contact positions. For the small business in the merchandising and many service fields the D. E. program should

be available for all communities of the country. Naturally, every small town with only one or two individuals desiring training cannot support its own full-time program, but such will be available in some nearby larger community.

Employee or group meetings weekly, monthly, or as needed should be part of the training within the business. The manager, foremen, department heads, or other *qualified* members of the organization may lead these meetings. It is better to have no meetings than to allow an incompetent person to attempt to conduct one. Bring in outsiders if necessary—representatives from wholesalers, manufacturers, the trade association, school system, or other agencies. Each meeting should have a definite purpose and one major objective. It might be to acquaint employees with some new development, product, machine, or equipment. Some contest or event planned by the firm might be the theme of another meeting. It is far better to make each meeting interesting and reasonably brief and to accomplish one single objective—something worth-while to workers and management alike—than to have more ambitious objectives and risk a "flop."

In many cases training films can be used to advantage in these meetings. They may be obtained from suppliers, government agencies, educational institutions, film renting concerns, or the trade association. Training films are of four types: sound motion pictures, silent motion pictures, and sound and silent strips. The latter resemble a continuity strip. Each frame or picture is a "still" projected on the screen for a few seconds or more before the next picture in the sequence appears. Sound film strips have a record played like a phonograph record on which each picture in the series is explained or discussed. Silent film strips are accompanied by an instructor's guide or manual so he can furnish comments needed for each picture.

Many additional training aids are available, such as manufacturers' printed matter, charts or diagrams furnished by both governmental and commercial agencies, training articles on

specific topics published frequently in trade journals, and "courses" sold by certain commercial training organizations. Whenever visual aids—films, charts, and so forth—or any of the prepared courses or aids are used, it is of the utmost importance that the person who is to conduct the meeting become thoroughly familiar with them in advance. Every film should be previewed. Even complete courses prepared in lecture form should be mastered by the leader before each meeting. Nothing is more deadening than to have some "big shot" read one of these prepared "lectures" and expect the group to profit by it. Unfortunately this is likely to happen unless carefully guarded against. "Telling is not teaching," and reading a lecture prepared by someone else is far worse: it is a crime!

Transfers and promotions

Neither employees nor jobs are static. They should be continuously adjusted to meet changing conditions of both worker and job. This phase of personnel work has at least three situations to deal with: transfers, promotions, and continuous worker-job adjustments involving no transfer or promotion.

Transfers are changes in the occupation of workers not properly considered as promotions. Need for transfers arises from one of four conditions: elimination of a job, request for change by an employee, belief by management that a worker has been misplaced, and fluctuations in the need for certain kinds of jobs.

When a job is eliminated through no fault of the worker, every reasonable effort is made to place him elsewhere in the organization. If this is impossible, his employer will help him secure a satisfactory position with some other company. For various reasons employees sometimes ask to be shifted to another job. If the reasons given for the request are plausible, it is usually granted. In other cases management may take the initiative when it appears that a particular worker would be better suited to a different job. Usually a satisfactory transfer can be made in such cases if the reasons are discussed with the employee, but sometimes this is not possible.

A surprisingly large number of workers resent any change in their job or duties, even when it involves a promotion, increases their income, or is otherwise to their own benefit. However, two conditions often make frequent shifting of a certain number of employees desirable: variations in the amount of work needed in different departments and training for advancement. To meet these needs many companies use a contingent or "flying squadron" composed of a few above-average employees who are willing and often anxious to shift from one job to another as needed. When regular employees are used, they often receive extra compensation for serving with such groups. When trainees or those preparing for promotions are used, this rotation of experience is an important part of their on-the-job training.

In some cases certain locations for a desk or even a work place in the shop acquire "prestige" for employees, and those favored by such locations show resentment when moved. Output of the "displaced" workers is likely to decline. "People are funny," but only to those who fail to understand human nature.

In making promotions recommended provisions of the personnel policy discussed in Chapter IX should be observed. Since merit and ability are of primary importance, provisions for evaluating these qualities are useful in measuring an individual's mastery of his present job. Operating reports should be supplemented by periodic ratings by supervisors or others in a position to make impartial evaluations of qualities like attitude, initiative, personality, self-development, and preparation for promotion. Even ratings made at regular intervals by the owner of a small business are valuable compensations for such human tendencies as making last-minute impressions and overemphasizing certain events. Often promotions may well be preceded by one or more trial periods in the new position for both experience and testing. Promotions should normally be accompanied by increased pay as well as greater responsibility and authority.

Remuneration

The small firm is likely to find the simpler systems of payment better suited to its needs. These are straight salary or time payment, straight commission or piece rates, and simple bonus plans, such as regular salary plus a definite reward or bonus for achievement beyond a standard or quota agreed upon in advance.

Incentive systems based on time and motion studies or other measured output, with various formulas for calculating the incentive wage, may be used effectively in the small business if restricted to jobs where such plans are appropriate and if kept simple. Benefits to be derived from such systems must be compared with the added expense entailed and employee attitude toward the method.

An incentive wage plan should give the worker more pay for the same amount of time worked, give management a lower labor cost (or a predetermined unit cost for pricing and budgeting), be understandable and acceptable to the worker, and be economical for management to operate. The attitude of many workers toward incentive plans launched by management is sometimes difficult for the inexperienced manager to understand. Not all employees are ambitious. Many prefer their present income to prospects for a higher income if this involves changing established habits. Probably the majority of workers are suspicious and fearful of new plans to increase output even though they will share in the larger returns.[4]

The two major objectives of an incentive wage plan can be achieved as in the following case.

The Diamond Cleaner was established 30 years ago in a midwestern city. The business grew and now employs 60 people in cleaning for both retail and wholesale business. For a number of

[4] For further study see: "How to Get Employees to Accept Production Standards." *American Drycleaner*, February, 1946, Vol. 12, No. 11, pages 56–64; "A Plantowner Tells What Wage Incentives Did for Us in 60 Days." *American Drycleaner*, November, 1945, Vol. 12, No. 8, pages 28–31.

years the owner thought about the problem of increasing his employees' earnings without increasing unit operating costs, which keen competition required to be carefully controlled. He finally concluded that a wage incentive system might meet these needs.

Each operation was carefully studied. Standard methods of performance, with a minimum of lost time and effort, were developed, and tentative standard rates of output were determined. Calculations were made for each type of garment processed, since the processing time required varied considerably. A series of experiments helped determine the number of each item that could be handled on each job in one hour. The standard hourly production was determined by reducing these figures by a ten per cent allowance for personal time and by ten per cent for rest time.

The plan adopted uses the "standard point" system with a basic unit of 100 points an hour equal to the standard number of pieces that can be processed in one hour on each job. The number of points per piece for each type of garment can then be calculated.

Each worker keeps a record of his output on daily report sheets which are verified by supervisors. Payments are calculated on daily production or on each 800 points of output. A worker's pay is increased by the percentage by which his output exceeded the daily standard for his job. Thus, whatever his daily rate, if he satisfactorily processes garments with a point value of 880 points, his pay for that day is increased by ten per cent. Workers are informed daily of their previous day's results, and the premiums for extra output are added to the basic wage for that week.

To protect quality, the firm instituted extra inspection routines as part of the new plan. The one-half of one per cent this added to total operating cost was considered cheap insurance that only satisfactory work would be accepted. The knowledge that careful inspection is conducted provided the restraint needed to keep output at levels that permitted the workers to give careful attention to quality. Failure to turn out acceptable work is penalized by making the worker do the piece over with no allowance for the extra time involved.

All workers in the department were called together and the plan was carefully explained. Those unfamiliar with such plans expressed their opposition. However, by assurances of prompt revision

if the plan did not work they were persuaded to try it. As soon as the advantages of the incentive plan became apparent other departments requested installation. After two and one-half years the plan was extended to all production workers.

Results have been gratifying. The management feels the great deal of work involved in setting up the incentive plan has been justified by the increases in wages and the 30 per cent increase in output.[5]

Probably more employees in small firms are interested in the stability and regularity of their incomes than in opportunities to enter higher income brackets. The following cases illustrate how this need can be met by good management.

Bottling soft drinks is a business affected by pronounced seasonal fluctuations. During the spring and summer the demand for salesmen is strong and remuneration high. When business declines in the fall, many salesmen have been in the habit of seeking positions with other companies, expecting their old jobs to be available again next spring. The Chase Company developed a plan that has enabled it to retain its salesmen throughout the year.

Analysis of the problem convinced management that salesmen became accustomed to the high standard of living made possible by the seasonally high incomes received during the warm months. When their incomes declined under the former method of paying salary plus commissions based on current sales, most men become dissatisfied and quit. The new plan provides for a stabilized drawing account that is paid weekly and is the same throughout the year regardless of seasonal fluctuations in sales. Under this plan each of the company's 12 salesmen draws a fixed sum of $60 per week throughout the year. This actually serves as a "salary," although it is charged against his commission earnings, and does not vary regardless of the salesman's actual earnings.

[5] Adapted from Small Business Aids, No. 449, U. S. Department of Commerce, "Wage Incentive Problem for Dry Cleaning Plant" (Case Study). Washington: U. S. Government Printing Office, 1948.

During the boom season for bottled drinks, some of the men earn more than $100 per week; but during three or four of the cold months sales go down considerably and the men's earnings fall as low as $30 per week. Chase salesmen, who draw their $60 a week right through the slow winter months, feel no particular temptation to seek other jobs, since their salaries do not slump with the season. The plan adopted by Chase might solve this phase of the wage problem for other small firms.[6]

In a different field of small business, rug cleaning, a similar problem of coping with seasonal fluctuations was solved by diversifying services offered and adding the selling of merchandise. During the seven dull months of the year one company promoted personalized cleaning and renovating services in private homes and institutions. The fact that such services brought company representatives inside these homes and institutions provided an opportunity for them to suggest the sale of remnants and other materials observation showed to be needed. Results were gratifying. After the adoption of the new plan, sales of merchandise represented 30 per cent of total receipts and the combined sales of merchandise and service have permitted retaining key personnel throughout the year.[7]

Profit sharing, which has been gaining ground among small businesses, has many advantages, in theory at least.[8] In many respects it is better suited to the small than to the large enterprise. For it to be successful, there must be a feeling of mutual trust and confidence between management and employees. The company's books must be open to inspection by those included

[6] Small Business Aids, No. 42, U. S. Department of Commerce, "Pay Plan Aids Men in Dull Season." Condensed from "Pay Plan Aids Men in Dull Season," by Ruel McDaniel. *American Business,* June, 1946, Chicago, Dartnell Publications, Inc.

[7] For further study see Small Business Aids, No. 145, U. S. Department of Commerce, "Finding Work for the Dull Seasons in the Rug Cleaning Industry" (Case Study). Washington: U. S. Government Printing Office, 1947.

[8] Roberts, Arthur, "Profit-Building With Profit-Sharing." *Hardware World,* January, 1947, Vol. 44, No. 1, pages 48–50, 82.

in the profit sharing, although not indiscriminately. A basis previously agreed upon for sharing the profits must be established and followed, and a satisfactory wage and salary scale must be maintained. Profit sharing should not be used as a deferred wage payment plan.

There are certain basic questions regarding profit sharing, especially for all employees, that should be considered before adopting such a plan. Profit, which is a residual after all costs and expenses of the business have been paid, fluctuates widely, often as a result of causes external to the business, such as general economic conditions, competition, and government policy. Even under favorable conditions only a few employees are likely to be in a position actually to increase or decrease the company's profits. For these reasons, profit sharing is not a form of incentive wage, except in a limited sense for the few persons in a position to affect profits materially. Profit is the reward to owner managers for both risking their own capital and exercising good managerial ability. The owners bear losses when they occur; profit sharing does not contemplate loss sharing by those who participate in the profits when there are any. And finally, it is discouraging to employees who anticipate sharing in the profits and who may even have done extra work to help the company make a profit to discover at the end of the year that there are no profits to share.

Morale building

Non-financial incentives have a place along with incentive payment plans in stimulating and rewarding employees. Recognition by management of good work or of valuable suggestions by employees is an important example. Soliciting worker participation in management is another that has been receiving increasing consideration. Profit sharing, although often classed with payment plans, probably belongs equally well in the employee-management coöperation group.

An axiom in all human relations is that most major troubles result from neglected minor grievances. In the small business

CHECKLIST OF WORK CONDITIONS [9]

Noise ☐ Average ☐ Should be lessened How _____

Illumination ☐ Adequate ☐ Inadequate Where correction is needed _____

Ventilation ☐ Good ☐ Fair ☐ Bad How to improve _____

Access to snack bars, vending machines, drinking fountains ☐ Easy ☐ Difficult
How to improve _____

Dust ☐ Some ☐ None ☐ Too much How to improve _____

Floors ☐ Clear ☐ Littered How to improve _____

Monotony of jobs ☐ None ☐ Some ☐ Too much Name jobs _____
How to improve _____

Parking facilities ☐ Good ☐ Fair ☐ Bad How to improve _____

Toilets, wash basins, towels, soap, hot water ☐ Adequate
☐ Inadequate How to improve _____

Time clocks ☐ Enough to prevent long waits ☐ Too far
Where to increase number of clocks _____

Arrangements for wage payments ☐ No long waits in line ☐ Present system inadequate
How to improve _____

Accident hazards ☐ Normal ☐ Need further correction How, where _____

Lunch places (where no lunch rooms exist but employees eat on company grounds) ☐ Adequate ☐ Inadequate
How to improve _____

Tool boxes ☐ Adequate ☐ Too far—too long to wait How to improve _____

Spacing of machines ☐ Adequate ☐ Too close How to improve _____

this is more serious than it appears. Employee grievances have serious effects on the community's attitude toward the employer concerned. Because of the very personal nature of most employer-employee contacts, many workers will be reluctant to talk about their "gripes."

Big business has organized systems to secure and use employee complaints for better employee relations. The small businessman who relies upon his "close personal contacts" in this area is courting unnecessary risks. He has three main avenues to use in arriving at the best solution to this problem. First, he can make an objective study of all conditions in his business likely to be irritating to employees. A check list such as that presented below will be a useful guide for this approach. Second, he can use the exit interview technique—that is, find out from each employee who quits just what his complaints about the company were. And third, he can institute a continuous plan of employee suggestions with frequent conferences and requests for ways in which the firm can improve employee relations. If done sincerely, this procedure is really effective. Again the small businessman has the big advantage of being able to establish a close bond of confidence and trust with his employees if he will take the initiative in doing so.[10]

Personnel in Merchandising

Retailing is a complicated industry in spite of the well-meant but uninformed general opinion to the contrary. University schools of retailing, like those of law and medicine, are on the

[9] Small Business Aids, No. 462, U. S. Department of Commerce, "Checklist for Industrial Workers' Complaint." Condensed from "Workers 'Griping'? Here's a Remedy," by Lawrence Stessin. *Forbes Magazine of Business,* March 1, 1948, New York, B. C. Forbes and Sons Publishing Co.

[10] For further study see Small Business Aids, No. 138, U. S. Department of Commerce, "Benefits of a Good Grievance System." Condensed from "Watch These Employee Personal Grievances," by Clinton J. Sammond. *American Carbonator and Bottler,* January, 1947, Atlanta, Loyless Publishing Co., Inc.

graduate level. In many states the leading retail stores have several employees whose salary exceeds that of the highest-paid educational official of the state. Naturally these salaries are not mere gifts but pay for ability of exceptional quality. The general attitude is understandable, however, because, like early advertising, retailing for many years has put its worst foot forward for public criticism and its worst aspects have been constantly before the public.

Few lines of business compare with retailing in the wide fluctuations of need for personnel on an annual, monthly, daily, and hourly basis. The "stand by" capacity demanded of retail personnel is enormous. This is both a challenge and an opportunity to management. Because customers want prompt service when they do appear in the store, the merchant must always be prepared to handle unexpected busy periods. Fortunately, most fluctuations are regular and known in advance. On a daily and hourly basis, part-time employees can often be used to meet peak demands at certain hours of the day and on the busiest day of the week, usually Saturday. This arrangement gives the merchant an opportunity to try out or develop prospective full-time employees, but it also increases the work of training and personnel management. An excellent source of afternoon and Saturday workers is the local Distributive Education program operated in connection with the senior high school. The local superintendent of schools can furnish information on this program.

Although training for both part-time and regular employees in all activities except specialized clerical work for a particular store may also be obtained through the Distributive Education program in most cities and in many small towns, the merchant should be familiar with other training methods and sources of information. The sponsor system and "flying squadron" already mentioned are both used extensively. Most stores use error reports and customer returns as a basis for individual remedial training.

In addition to general sources of training material, the

retailer in most lines will find excellent help in publications by the Research Bureau for Retail Training of the University of Pittsburgh and the School of Retailing, New York University. *Better Retailing,* published by the National Cash Register Company, Merchants Service Bureau, Dayton, Ohio, is valuable for employee and management alike.

The following application of the Job Methods Training program will be a useful guide in most cases.

How to Instruct New Workers (or Old Workers) on New Jobs in Retail Stores

First Step: Preparing the Learner
- Put him at ease.
- Gain his interest and confidence.
- Find out what he already knows.
- Show task's importance, appeal to pride.
- Show task's relationship to entire job.

Second Step: Presenting the Task, by Steps
- Tell, show, and explain patiently.
- Be sure each step is understood.
- Stress key points, one at a time.
- Mention "tricks of the trade," knacks.
- Welcome the learner's questions.

Third Step: The Learner's Tryout
- Have him perform the job himself.
- Be ready to help avoid mistakes.
- Keep him at ease, criticize diplomatically.
- Have him explain steps as he goes.

Fourth Step: Test and Follow-up
- Put him on his own, doing the job.
- Check his performance after some practice.
- Have him re-explain key points, knacks, and so forth.
- Cause him to feel free to ask for further help.
- Taper attention to him down to normal supervision.

Miscellaneous Suggestions

1. Have a plan—something to shoot at!
   What do you want the learner to know?
   Have you considered time, ability, details?

2. Get the place and materials ready.
   Have the right supplies and equipment.
   Arrange things as they are under working conditions.

3. Get the job ready to be taught.
   Break it down to essentials, efficiency, safety.
   List key points and knacks in order.

Many trade associations provide training for retail employees. The merchant should investigate such programs before completing his plans for training.[11]

Retailers use two special types of incentives, discounts ranging from 10 to 30 per cent on merchandise purchased in the store and P.M.'s. The P.M. (premium merchandise, premium money, "spiff," or "stim") is used to encourage the sale of certain articles. When these are slow sellers, experience shows that a P.M. of from ten cents to a dollar will be up to four times as effective as a markdown in quickly disposing of the goods. However, it leads to pushing off poor merchandise on unsuspecting customers, usually to the detriment of the store. When used for "trading up," encouraging customers to buy higher-priced, better-quality merchandise, it may be justified in many cases.

One area in which retail personnel work of the future may make valuable contributions is that of store hours and working conditions. These often deter high-quality individuals from engaging in retail employment.[12]

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[11] For further study see Evans, Harriet, "How Associations Provide Retail Sales Training." *Printers' Ink*, March 21, 1947, Vol. 218, No. 12, pages 50–56.

[12] For further study see: Small Business Aids, No. 139, U. S. Department of Commerce, "Training Retail Employees Pays." Reprinted from

Personnel in the Small Factory

Large manufacturers have long recognized the importance of good personnel practices. At one time personnel management was widely considered as a preventive of unionization. More recently unions have taken the lead in working for better personnel management.[13] Extensive experience during World War II with Labor-Management Committees demonstrated the valuable help contributed by unions.[14] Unions have been spreading their influence and have already entered many small factories. Some small manufacturers see in the introduction of a personnel program a means of forestalling the unionization of their plants. In the authors' opinion, this is the wrong approach.

Management has developed methods, tools, machinery, and skills to process and utilize materials efficiently. Little, and often nothing, is done to secure the maximum productive efficiency from the manpower involved. This should be the aim of a personnel program. Excessive labor turnover makes it difficult to achieve.

Labor turnover costs are not so intangible as many suppose. First, there is the direct cost involved in training new employees and in the period during which the employee is on the payroll

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"Efficient Management and Store Operation." One of 17 booklets making up *Better Retailing,* 1941, Dayton, Ohio, National Cash Register Company; Small Business Aids, No. 91, U. S. Department of Commerce, "Selection and Training of Deliverymen." Condensed from "Deliverymen—Use Care in Selecting and Training Them," by Frank Stafford. *Feedstuffs,* August 3, 1946, Minneapolis, The Miller Publishing Company; Small Business Aids, No. 251, U. S. Department of Commerce, "Selecting Salesmen for the Shoe Department." Condensed from "Shoe Sales Personnel Requirements." *Apparel Arts,* October, 1946, copyright 1946 by Esquire, Inc., 919 No. Michigan Ave., Chicago, Ill.

[13] For further study see Slichter, Sumner H., *Union Policies and Industrial Management.* Washington: The Brookings Institution, 1941.

[14] See the various conference reports of the American Management Association for this period. These are available in some libraries or may be obtained for a nominal price direct from the American Management Association, 330 West 42nd Street, New York, N. Y.

but not producing at full capacity. This cost varies with the length of the training period. There are also costs from an increase in spoiled or wasted material, lowering of employee morale, and increased overhead. From this standpoint alone it is well to develop a personnel policy and program designed to attract the most desirable employees and to keep them with the company.

In a small shop there is a limit to specialization. It may be impossible to have even one man whose sole responsibility pertains to personnel management. Hiring and training may be the responsibility of one member of the organization, whereas sickness benefits, employment records, and savings associations may be handled by the auditor or an accountant; or, as is frequently the case, each department foreman may do his own hiring and personnel record keeping.

It is important for employees to know who heads the personnel function. They must know who is responsible for their job relations and to whom they can take their problems. It is of utmost importance that authority be established and that supervision, management, and labor be fully informed about it.

Employment records are an important tool. An efficient but easy-to-manage record system makes use of an individual employee envelope measuring 9″ x 11½″ with the name of the employee on the tab and his application and birth and citizenship certificates inside. Personnel report forms are used by supervisors to report only when such things occur as an outstanding work performance, breach of discipline, progress of employee on the job, development of new skills, absence, change in work attitude, or any other important phase of the employee's work activity. This information is written on the personnel report form, dated, signed by the supervisor, and given to the individual in charge of personnel, who files it in the employee's envelope. This tool accomplishes two objectives: it keeps the personnel authority informed about the employee and it forms with a minimum of record keeping and red tape a permanent

file of the employee for use in promotions, counselling, discipline, and any union negotiation of a grievance.

There are many direct benefits from a workable training program. It reduces labor turnover, improves the quality of work performed, reduces absences, tardiness, and accidents, facilitates the discovery of promotion-worthy employees, and tends to lower the unit costs of labor. The training program should be under the direct supervision of the personnel authority. Supervisors in the small shop must be called upon to give much of the preliminary on-the-job training. Training the new employee should begin with an explanation by the supervisor of company products, policies, regulations and an explanation of the importance, in their manufacturing setup, of the first job the employee is to learn. Key workers in each department should then take over the actual job instruction of the employee. Worker instructors should be carefully selected, not only for craftsmanship, but also for their ability to explain and show how the job is done.

One practical plan for the small shop to use in building morale and interest is the establishment of a Labor-Management Committee. Such a committee is made up of three to six workers and an equal number of management executives. If there is a union in the plant, the president of the union is the most important man to include among the labor members of the committee. The other labor members should equitably represent all departments in the plant and may be elected by their coworkers or appointed by their union president. Members of the committee should serve from six months to a year. Management's representatives should come from the operating, financial, and engineering departments, and each member should be a responsible executive with authority to speak for management and ability to express management's viewpoint. It is best to hold meetings weekly. Such a committee is not concerned with establishing company policy toward sales, finance, or the administration of the business. Its function is that

of personnel and employee welfare, *i.e.* morale, since it is this phase of management that primarily concerns the workers.

A Labor-Management Committee is a "sounding board" for management and a "safety valve" for employee unrest. The committee is an important source of ideas and efficiency suggestions and also serves as a checkup on department functioning.

A Labor-Management Committee can carry on many of the necessary personnel functions, particularly in the way of building up employee morale. Labor-Management Committees have made real contributions to plant efficiency and general cost cutting through committee-conducted "suggestions plans."

A safe shop is good business. Accidents are costly to management in lost time, in the weakening of employee morale, and in direct cash outlay. There are in general two causes of accidents, personal and impersonal. Personal causes account for accidents due to improper attitude, lack of knowledge or skill, physical handicaps, and poor health. Impersonal causes include hazardous work-handling arrangement or procedure, defective mechanical equipment, unsafe clothing, crowded aisles, improper lighting and ventilation, and inadequate guarding.

It is good practice for the executive in charge of plant safety to hold weekly meetings with his employee-safety inspectors. These inspectors should report to him on any unsafe conditions and careless workers in their departments. The individual employee is a large factor in safety engineering.

Regardless of size or type of shop, good employee relations are vital to any organization. The human element in manufacturing has long been slighted as an important factor in production costs.

Small manufacturers who have their own sales organization are in danger of slighting this department because of their greater interest in production. The selection and training of salesmen is, therefore, of special importance. Since a high volume of sales and production is of industry-wide concern,

industrial groups and trade associations are coöperating in collective sales-training programs. These provide for each company better training at less cost than individual firms could secure working alone. Careful selection of salesmen is emphasized.[15]

Personnel in the Service Business

Good personnel is important in all service fields, but the special needs and problems vary for each of three main groups. In one group the service rendered is highly personal and the caliber of employees may be the deciding factor between success and failure. Most professional services, such as medical and dental care, and many semi-professional services are in this group. For our purpose the beauty shop may be used to illustrate the *employee relations* problem of this class of establishments.

It is well known that patrons will follow their favorite beauty parlor operator from shop to shop. Many operators pride themselves on their personal clientele and do not consider it unethical to take customers with them when they change places of employment. To the shop owner, however, this is a serious problem; he usually condemns it as an unethical practice. The owner has the legal responsibility for conditions in the shop and for the performance of operators, provides the capital and facilities needed to run the establishment, takes the risk of loss when business falls off, and usually pays employees a minimum wage and shares with them all receipts above a standard amount.

To cope with this problem the owner should not encourage a new employee to bring her clientele with her. Patrons secured in this manner are likely to be lost the same way. No shop should hire only the type of operator who has a personal fol-

[15] Small Business Aids, No. 194, U. S. Department of Commerce, "Selecting and Training Manufacturer's Salesmen." Condensed from "What's New in Sales Training." *Modern Industry*, February 15, 1947, New York, Magazines of Industry, Inc.

lowing. Nor should an establishment become dependent upon any one operator. Sometimes it is possible to make occasional shifts of operators with plausible explanations to patrons. This helps to counteract the habit of following operators and shifts customer confidence to the shop instead of permitting it to reside with individual employees. The owner can also take a personal interest in each patron and make friends with her. If an operator does leave and many patrons follow her to the new establishment, experience shows that something can be done about it. Frequently if the owner calls the former patrons, lets them know they have been missed, and inquires as to their reasons for not having been in recently, many will make appointments and return as regular customers.

Most states and communities have legal requirements governing employees' qualifications and sanitary working conditions for beauty shops and similar personal service establishments. These are minimum standards and the shop owner will endeavor to exceed them whenever possible. Usually operators must be licensed. Equipment and physical facilities must pass inspections. The owner, however, is more concerned with maintaining both personnel and plant standards well above legal requirements than with merely satisfying them.

Although *skill* is the greatest single ability required of a beauty shop operator, personality, voice, manners, and appearance are very important. The ability to sell both the services and merchandise offered by the shop is a valuable asset for most employees. Knowing when to be a good listener is often more desirable than skill as a conversationalist.

Personal service establishments will vary both in the degree of specialized service offered and in the extent to which individualized handling of each patron is encouraged. Beauty shop employees must be selected according to the shop policy of general or specialist service. Work should be assigned to each operator to take full advantage of special skills possessed. Most owners find it good practice to strive throughout the shop for

standard procedures and methods, in which new employees should be instructed.

Good working conditions are especially important in the beauty shop. Not only do such conditions impress patrons favorably, but they also help to keep employees happy and satisfied. The fact that most operators in this country are women is another factor contributing to the importance of maintaining pleasant working conditions.

It is usually desirable for a shop owner to follow customary methods of remunerating employees unless exceptional circumstances justify the use of some other plan. A popular method of paying beauty shop operators is known in the trade as "50 per cent over double." This means that the employee receives the standard going wage in the community plus one-half of her weekly receipts on all over double the base wage. For example, an operator on a base wage of $22 per week who sells $60 would receive $30, determined as follows: $22 plus $8 (that is, one-half of the difference between $60 and $44, which is double the $22 wage).[16]

A second group of service businesses, considered from a personnel viewpoint, is composed of service stations, many repair shops, restaurants, and similar enterprises. This group shares to some extent the customer concern with the type of employees already noted for personal service establishments like beauty shops, but not to the same degree. Likewise many employees in this group have average working conditions and opportunities to meet the public. In these respects businesses in this group differ notably from those in the third classification as represented by laundries and dry cleaning establishments.

In general, service stations, repair shops, and restaurants have not played up the superior skill of particular employees. Rather, they tend to strive for reputations based on the quality of service

[16] Gordon, Edith E. (under the direction of H. G. McCoy), *Establishing and Operating a Beauty Shop,* pages 116–124. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 25, 1946.

rendered by the business. Surveys have shown frequently that factors relating to employees have been among the chief reasons why service stations have lost customers. Important reasons given by motorists include indifference of attendants, haughtiness, ignorance of products, overinsistence in sales efforts, and attempted substitution.[17] Both the care exercised in handling customers' cars and courtesy in customer contacts are recognized as important factors influencing patronage of garages, parking lots, and automobile repair shops. Likewise, unless a restaurant has an outstanding reputation for superior-quality food, customers tend to be very sensitive to the appearance, personality, and general attitude of the hostess and food service employees.

As a class both service station and restaurant employees are likely to have frequent contacts with tourists and other strangers to the community. Employees usually need special training to be able to answer questions asked by tourists even though many of these inquiries relate to the employee's home community. Short courses intended to provide this type of assistance are offered by the Distributive Education staff in many states. In addition to receiving special training, employees in such positions may need simple aids like local maps, mileage charts, and folders describing and illustrating nearby places of interest.

In the restaurant business it is well to have all applicants for employment pass a physical examination that gives special attention to venereal disease and the possibility that the applicant may be a carrier of diphtheria, typhoid fever, or other contagious diseases. Local regulations, such as the requirement that each food handler possess a health certificate, should be complied with.[18]

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[17] Sevin, Charles H., in coöperation with the members of the petroleum industry (under the direction of Walter F. Crowder), *Establishing and Operating a Service Station*, page 138. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 22, 1945.

[18] Bryan, Mary de Garmo, Macfarlane, Alberta M., and Hawkins, E.

Behind the scenes in the average restaurant, where the cooking and dishwashing take place, it is often difficult to maintain pleasant working conditions. Every effort should be made to achieve such a goal, however, both for sanitary reasons and to increase employee morale.

Many repair shops also have this problem of keeping workplaces clean and attractive. In the small shop employees may share or rotate the responsibility for maintenance work, but in all shops each mechanic should be trained to be a neat and orderly worker. Tools, materials, and parts should be kept in their proper places at all times. For some workers this may require supervision as well as instruction. A good motto to observe is, "A clean shop is a safe shop." Management must do its part by painting the premises frequently and disposing of all accumulated junk. Adequate facilities must be provided for storing tools, materials, and parts. All tools and equipment should be maintained in first-class condition. Machine, electrical, and other hazards must be kept at a minimum.

Repair shops tend to have a seasonal pattern of business characteristic of the type of products serviced. Automobile repair and air conditioning shops are busier during the summer months, whereas radio and heating unit repair shops do more business during the cold weather. Some employers have found it profitable to have workers rebuild during the dull season parts or units that are normally purchased for repair jobs during the busy season.[19]

Service industries in a third group have special problems of employee relations. Establishments such as laundries and dry cleaning plants illustrate the nature of these problems. Fre-

R. (under the direction of Walter F. Crowder), *Establishing and Operating a Restaurant,* page 28. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 39, 1946.

[19] Toboldt, W. K., in coöperation with William H. Myer, Etteline Flehr, and O. Schreiner, Jr. (under the direction of H. B. McCoy), *Establishing and Operating an Automobile Repair Shop,* pages 90–95. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 24, 1946.

quently the plant is located in a congested district of the industrial type; this by itself makes it difficult to attract and retain desirable employees. Working conditions are not likely to be pleasant and competition keeps wages relatively low. There are fewer opportunities for meeting the public than in retailing and for learning important industrial skills than in manufacturing. This makes it especially important in such cases to use all available personnel techniques as effectively as possible. Among these might be fair dealing, recognition of good work, friendly relations with employees, suggestion systems, employee service activities such as recreational facilities, and many others.

Although it is conceded to be difficult to make working conditions in laundries and cleaning plants as attractive to employees as those in many other lines of business, the situation can be improved in most cases. Probably one reason improvements have been slow in coming is the understandable tendency of the small plant owner to be so imbued with the pride of ownership that he has failed to see his shop as the employees see it. An objective appraisal would probably disclose antiquated rest rooms, inadequate dressing rooms, and no satisfactory place for employees to eat lunch. In many cases a little painting and some minor remodeling might improve employees' quarters substantially. Improvements in ventilation and lighting also may be needed. In similar ways the small plant owner can often make unsatisfactory working conditions fairly pleasant once he realizes the importance of this problem.[20]

Conclusions

Although every business operates through its personnel, probably less has been done to utilize this valuable resource effectively than has been done for the other factors of production. Since payroll is usually a major and often the largest

[20] McLennan, V. I., "Selling the Jobs in Your Plant." *American Drycleaner*, July, 1946, Vol. 13, No. 4, page 61.

item of expense in any business, the opportunities for financial improvement through better personnel relations are great. In addition, a firm's personnel is one thing competitors cannot copy, duplicate, or equal without incurring equivalent trouble and expense. Materials, merchandise, advertising and display ideas, and even product designs are generally available to all businessmen on approximately equal terms, but this is not true of a good group of employees. Only the workers' time can be purchased or hired; their attitudes, loyalty, coöperation, and productivity must be earned. This is the aim of good personnel work. *The many advantages small business has over big business in handling employee relations should be developed to their fullest extent.*

Small business also has some special problems in securing and maintaining competent personnel. Fortunately the more important ones can be solved if they are recognized and given proper attention. Often apparent handicaps, like limited opportunities for promotion, can be turned into advantages by stressing the greater range of training and experience to be secured by employment in the small company. This has a strong appeal to men who later hope to enter business for themselves.

Big business has developed many techniques of personnel management that can be used to advantage in the small business. A worker is a human being whether employed by a large or small concern. Methods developed during World War II for training workers or supervisors, like the Job Methods Training and Job Instructor Training programs, or for enlisting employee coöperation, like Labor-Management Committees, are available for use by the small businessman. In addition, material on personnel in both book and periodical (trade journal) form is extensive. Finally, the vocational programs in operation throughout the country can furnish practical and related training even to the smallest concern without cost to the owner-manager.

Review and Discussion Questions

1. Make an employee application blank for a small business.

2. Interview two friends for a position in a men's clothing store and fill in the application blanks. Which person is better suited for a position as salesman? Why?

3. How can a small businessman obtain well-trained employees who might otherwise go to a large concern for employment?

4. How can a businessman evaluate the answers on an application blank?

5. Do you think tests or examinations are worth-while to the small concern? Why or why not?

6. Outline an employee training program which could take place within each of the following businesses: service business, manufacturing concern, and retail store.

7. What advantages can you see in the Job Methods Training program over traditional methods?

8. In what respects are *all* supervisors and executives responsible for personnel activities?

9. Talk with your local representative (coördinator or high school superintendent) of the vocational training program regarding assistance available locally for small businessmen and their employees.

10. Select some job and outline in detail how you would make a job *evaluation* for this position.

11. In your opinion does each company have more of a monopoly on the quality or characteristics of its own personnel than it does on advertising ideas, production processes used, or merchandise handled? Discuss.

12. In a business large enough to have one man or a department responsible for "personnel management" this is considered to be a staff or advisory function. What does this imply? Discuss.

13. Are the non-financial incentives, as compared to wage and bonus payments, relatively more important in the large or in the small company? Explain.

14. Do you think a small business has a better chance of making

a success of profit sharing or of the guaranteed annual wage? Discuss.

15. Explain how management and personnel relations are connected. How do policies fit into this relationship?

16. Is the personnel policy more important to the unionized factory or to the non-unionized retail store of comparable size? Discuss.

17. What are the opportunities for and limitations of employee-management committees in each of the three fields of small business?

18. It is generally considered that small firms pay lower wages than large concerns. Is this true? If so, why? Is it an advantage or disadvantage of small business? Discuss.

19. List and compare the advantages of employment experience in a large versus a small concern as preparation for starting your own business. Be specific. Cite actual cases wherever possible.

20. How do you think personnel management in small business will affect the future prospects of this area of our economy (not merely how its own personnel relations will affect each small concern)?

21. What is meant by "job analysis"? In what ways is it of use to the small businessman?

22. Visit local merchants and obtain application blanks that they use in their businesses. If you find one that does not use application blanks, get an outline of the form of interview he uses. Which appears to have the best personnel in his employment? Discuss and compare your findings.

23. Discuss the different aspects of Trades and Industries, Distributive Education, and Diversified Occupations. Give the disadvantages and advantages of each and the conditions under which each thrives.

24. Locate one business in your community using each of the three simple types of payment listed in the text as generally used by small businesses. Find out why each businessman uses that form of payment. Discuss whether you agree with his opinions or not.

25. Do you think that a Labor-Management Committee would solve most management-personnel problems? Discuss fully.

CHAPTER XII

RELATIONSHIPS WITH RESOURCES

ALTHOUGH BUYING IS a function that must be performed in all businesses, maintaining favorable relationships with sources of supply [1] is one characteristic of successful buying that is particularly important in the small enterprise. "A business is as strong as its suppliers" is a widely accepted principle that applies whether resources are furnishing merchandise to the retail store, raw materials to the factory, or supplies to the service establishment. "A business is as strong as its customers" is also a generally accepted principle of business. This interdependence between business, its resources, and its consumers emphasizes the need for extremely close working relationships between these three groups. In many areas of business efforts to improve procurement have often been responsible for the development of well-established organizations specializing in the activity. Most of these of interest to the small businessman represent some form of group buying or coöperation in merchandising; management counsel or other services may or may not be provided. In addition, the system in these organizations usually involves the acceptance by all parties concerned of some program for closer coöperation and better working relationships between the business and its sources of supply.

Resources and Policies Available to the Small Business

Before the small businessman can effectively formulate his

[1] Business terminology is not well standardized, and "resources," "supplier," and "vendor" are words commonly used to refer to the sources from which a business secures its merchandise, materials, or supplies.

buying policies or undertake the actual purchase of goods needed to operate his business he must be familiar with the different types of suppliers available to him, the advantages and limitations associated with each type, and the conditions under which it is better to concentrate most of his buying with one or a few suppliers as compared to making purchases from many sources.

Types of resources

Three groups of suppliers are usually recognized and most small businesses will find that they must make some of their purchases with representatives of each group: producers, merchant middlemen, and functional middlemen.

Producers. Manufacturers, miners, farmers, or processors of natural products all may be classed as producers. With the exception of farmers, the business units so classed usually may be of any size, ranging from very small to very large. Naturally, advantages claimed for concentrated purchasing would not apply with respect to purchasing from many of the smaller producers. Another consideration is that many businesses, especially the larger manufacturers, have their own methods of distribution and may not be available for direct dealings with the small enterprise. Their products may be purchased, but only through middlemen or representatives used by the particular manufacturer.

Merchant middlemen. Merchant middlemen will constitute the chief source of supply for most small firms in any field. These are marketing institutions that buy and take title to goods, for resale. Familiar examples are wholesalers or jobbers, supply houses, and merchant truckers. In many "hard lines," especially where the goods carried are used both by industry and retail-service businesses, "supply houses" are comparable to wholesalers. In the laundry and drycleaning fields resources are called the "allied trades."

Wholesalers, especially in the general merchandise fields, are conveniently classified, according to the services provided for

their retail customers, into two broad groups: cash-and-carry and service wholesalers. Many service wholesalers also operate cash-and-carry departments. Since small businessmen often patronize local wholesalers, the opportunities available through purchasing by the cash-and-carry method are significant.

The fundamental reason for the use of the cash-and-carry policy is to reduce prices to retailers by lowering some of the wholesaler's operating expenses. The method also enables the buyer to inspect his purchases, keep his payments up to date, and eliminate the clerical work necessary for buying on a charge basis. However, cash-and-carry takes the buyer away from his business where he may be needed, involves more working capital than many small businessmen have, and is usually confined to a more limited assortment of merchandise than that carried by the service wholesaler.

Advantages claimed for the service wholesaler were recently stated to include the following points: ability to purchase from a single source products made by hundreds of producers; assurance at all times of a supply of new items made available locally through the wholesaler's constant scouting of all markets; quick delivery of goods as needed; opportunity to buy on credit; service and advice rendered through salesmen who visit the store; assurance of the wholesaler's interest in the retailer's success because this is the only basis upon which the wholesaler can continue in business.[2] The last advantage listed would also apply to the cash-and-carry wholesaler.

In merchandising, the small independent retailer has learned from experience that a reliable wholesaler is one of his best assets. The amount of confidence most retailers have in their wholesalers would surprise anyone not familiar with the field. This trust and confidence has been earned by the ever-

[2] Small Business Aids, No. 198, U. S. Department of Commerce, "The Services of the Service Wholesaler." Reprinted from article of the same title, *Modern Merchandising*, December, 1945. National Association of Tobacco Distributors, New York.

increasing interest wholesalers have exhibited in the welfare and success of their retail customers.

Merchant middlemen differ in their product specialization, such as general wholesalers versus drug houses, as well as in the range of services offered. Some wholesalers of this type give all services expected—credit, delivery, advice, salesmen calls and order taking; others, especially in the grocery field, offer only limited services, such as cash-and-carry. The majority of merchant middlemen wholesalers do not have any well-organized plan of voluntary coöperation for buyers such as the voluntary chain, although many will work more closely with customers who concentrate their purchases than with those who do not.

Merchant truckers, another type of wholesaler, operate in many lines of goods, such as raw and processed foods, bottled drinks (route men), and some hard lines. Some are erratic sources of supply, but often they have "good buys," whereas others carry regular lines and follow fairly definite schedules of calling on buyers.

Functional middlemen. Small businessmen may also have occasion to purchase from functional middlemen. These are suppliers who do not take title to the goods for which they perform certain marketing functions such as selling, buying, or transporting. Familiar examples are brokers, selling or buying agents, manufacturers' representatives, resident buyers, purchasing agents, and freight forwarders. A broker serves either a buyer by seeking out sellers, or a seller by locating buyers. He brings buyer and seller together, and often has a wealth of market information available for both parties.

Small enterprisers will ordinarily use brokers when: (1) brokers are traditional in the field, such as in the canning and certain subdivisions of the textile or food industries; (2) the goods of a particular producer are available only through brokers (or other sales agents and manufacturer's representatives), and (3) on certain occasions when they are trying to locate a seller of goods not readily available in the established

channels of trade. Resident buyers or purchasing agents are used by retailers and smaller wholesalers.

Apart from providing market information, most functional middlemen are not in a position to offer merchandising plans, although in some fields they are highly respected as technical advisors regarding uses of the product with which they deal.

One or several suppliers?

A question of policy to be decided in each unaffiliated business is whether or not the firm should concentrate on one or a few resources. Perhaps it should remain free, unencumbered, and able to seek, find, and utilize any new lines, services, terms, or other facilities that may appear in the market. The qualifier "unaffiliated" is used because in some businesses all goods are necessarily bought from the same resource. Retailers or service businesses holding dealerships or franchises, service agreements, or a voluntary chain affiliation usually are under obligation to concentrate purchases with the coöperating supplier. Only one resource is used by manufacturers where a monopoly of supply exists or where the nearest supplier is traditionally the least expensive source of materials.

In selecting suppliers, most small businesses free to choose will have several objectives in common; among these will be the following:

1. Obtaining goods of the required quality, type, or model.
2. Availability of goods at desired prices and terms and in quantities needed.
3. Reliability—goods should be continuously available.
4. Reasonable and customary protection of the buyer's interests should be provided—quality guarantees, right to make legitimate returns, protection against likely risks from resale or use, limited agency or similar franchise rights all are important.
5. Good service, not only in making deliveries, but also in handling transactions and making adjustments.

6. Appropriate provisions for managerial or merchandising aids and technical assistance when needed.

7. Suppliers' representatives should be the type with whom the businessman can work and coöperate successfully.

Whether to diversify or concentrate purchases will involve additional considerations, many of which are special applications of the foregoing standards. In any instance where the owner is a shrewd buyer who enjoys trading and procurement activities, when he wants various suppliers competing for his business, and believes that he is in a position to take advantage of any variations in lines, prices, or services different suppliers may offer, diversification would be the logical policy to follow. Another advantage is that this policy enables the business to match popular lines carried by competitors, with the exception of exclusively franchised or otherwise restricted lines. Finally, it protects the small business in case any one supplier should cease business, change its lines, or change its business policies.

To the small businessman advantages of concentrating purchases may be stated briefly as follows: By carrying the same lines continuously, his customers are not shifted from brand to brand, nor his employees from materials of one kind to another. As a good customer of one resource he may receive special favors or cumulative quantity discounts, valuable advice and assistance in merchandising the goods, tips on market changes, and special considerations during times of difficulty.

Those are the advantages on each side. There are, however, disadvantages not directly implied in either of the lists. Dangers encountered in diversification include stocking too many lines, perhaps attended by difficulty in maintaining complete stocks in any one, and inability to capitalize fully on the advertising program of any one brand of merchandise or on technical advice regarding the use of certain materials or supplies.

The businessman with a close working relationship with his resource must acknowledge these drawbacks to such an arrangement: inability to take advantage of unusual offers in

other lines; some loss if the supplier changes policy or becomes poorly managed; and the risk that the merchandising advice, assistance, and guidance offered may become irritating or of no use. Experience has shown the last weakness to be present, unfortunately, in some voluntary chain groups.

Fundamentals of Buying for the Small Business

The art of careful buying involves six basic processes: (1) determining needs, (2) locating suitable sources of supply, (3) negotiating terms, (4) maintaining favorable relations with resources, (5) receiving, checking, and marking, and (6) follow-up. Often the last two are considered separately, but in the small business they are so closely related to actual buying that they are discussed briefly here.

Determining needs

Too much buying in the small business is based on hunches instead of adequate information. Often it is spasmodic rather than planned. However, neither of these undesirable conditions need exist, even in the one-man business.

Determining needs means finding out the kind, type, quality, brand, size, or other varieties needed, and the quantities of each. For the merchant this involves a study of the demand of his particular customers. Even for the same class of trade, demand may be quite different in two locations even though they are not far apart. Customer wants change, and the alert merchant will keep abreast of these changes—anticipating them whenever possible, perhaps by reading the same magazines and seeing the same movies as do his customers. Wholesalers and trade journals are valuable aids to the small merchant in anticipating customer demand.

For the small manufacturer and service operator the intended use for materials, parts, and supplies is the important factor. Even when the small enterpriser knows the technical side of his business thoroughly he should watch for opportunities to use new, improved, or even less expensive materials that will

do the job equally well. Trade journals, suppliers' representatives, and manufacturers' catalogs or descriptive printed matter will help him in this task. Also, his own production workers often offer valuable suggestions if they are consulted.

In determining the correct quantities to buy, the close relationship between inventory or stores control and purchasing becomes apparent. Estimated needs minus quantity on hand (from inventory control records) gives quantity to buy. In merchandising the usual guides are followed: basic stock list and past sales records for staples, the model stock for shopping goods or other lines involving an assortment like size or color, and sample tests before placing complete orders for novelties.

In manufacturing, estimated sales or planned production of each article is the starting point. Then a list of materials and parts is used to determine the quantities needed for each unit. By multiplying planned production in units by the quantity of each material or part required per unit, the various quantities to purchase are calculated. For example, a small home accessory requires the following materials and parts for each unit produced: 3 pieces one-quarter inch White Pine plywood, each one foot by two feet; 2 pieces one-inch grade A White Pine, two feet by two feet; 12 half-inch wood screws; 4 two-inch iron corner braces; 1 piece one-eighth inch tempered masonite, two feet by two feet; and 12 quarter-inch brads. Sales are estimated at 10,000 units per year. Obviously 30,000 pieces of plywood, 20,000 pieces of one-inch grade A White Pine, and so on would be required, plus allowances for materials damaged and other waste. However, since all of these materials are standard items normally obtainable on short notice, quantities actually ordered at any one time would be limited to, say, one month's needs. Plywood, masonite, and White Pine are sold in standard stock sizes to which actual orders would conform. Other factors like transportation charges, if any, quantity discounts, and manufacturer's packing amounts would be considered before deciding the specific number of each item to order at one time.

Locating suppliers

Once needs have been determined, the next step is to locate suitable sources of supply. Resources available to the small businessman usually are more limited than those for the big company. Often the former is restricted to the particular market representatives or channels of trade used by the producers from whom he wants to buy. Sometimes he is limited to the immediate area in which his own business is located. Regardless of these limitations, he will nearly always have some choice between competing suppliers.

In selecting a resource, he will consider which supplier carries the quality and variety of goods best suited to the needs as previously determined. Other important factors will be price for the quality needed, time required for delivery, transportation costs, services rendered by the resource (including willingness to sell in the quantities desired), and market strategy. An example where consideration of the last factor plays an important part is a furniture retailer in Fort Smith, Arkansas—a furniture market—who does almost all of his buying in Chicago so as to have merchandise different from that offered by his competitors. Too much attention is often paid to price. Goods should also be bought with an eye to quality, past performance, and customer needs. The aim should be to obtain the lowest price, the most favorable terms, and the most adequate service, all consistent with satisfactory quality.

Both in selecting a resource and in choosing particular items, the buyer should be as well informed as possible regarding important properties of the goods. In merchandising, the following points are considered important: materials, construction, reasons for different qualities, comparative values, intended uses, and care required. These are the factors of greatest concern to intelligent consumer buyers. When style or fashion is characteristic of the merchandise, its stylishness may be of even greater importance than other elements. It is not necessary for the merchant to be an expert on all kinds of materials, nor for him to attempt tests. Reliable suppliers provide this informa-

tion through their salesmen, on labels, in descriptive advertising, or by other means.

Small manufacturers and service operators will be concerned with the way different materials and supplies act in their production processes. Again, suppliers' representatives will give valuable information if requested, or permitted, to do so.

Buying techniques

In negotiating prices and terms, the small buyer will do well to steer a middle course. If he really is an expert on the goods purchased, he needs no advice, but the average man should try to be a careful buyer, to keep as well informed as possible on current prices, and to insist on fair treatment. Any attempt to pose as a know-it-all, however, or a reputation for trying to beat down prices, is likely to invite trouble. Nearly always the salesman is better informed on qualities and prices than is the small purchaser, and some salesmen enjoy "putting it over" on the "smart" buyer. The exact quality needed for the purpose, at a fair price, should be the standard to follow.

Terms available to the small buyer are of two principal types, cash discounts and "datings," or the length of time before the net amount of the invoice is due. Often the trade will have its customary terms, or they will be fixed for the little fellow. When opportunity for bargaining does exist, however, too many small businessmen are more interested in datings—that is, the length of credit extended—than they are in the cash discount. Unless a business is in dire financial straits, the cash discount is usually more important than the length of credit extended.

Maintaining favorable relations with resources

The topic of this chapter is not "Buying," but "Relationships With Resources." Merely to buy goods is easy. To maintain favorable relations with vendors seems, at times, to be especially difficult for the small businessman. But it is always

worth the effort. The smaller the business, the greater the importance of cultivating friendly relations with resources. In contrast to the big buyer, the small operator has far less to offer vendors in the way of total profits. But he can be considerate of salesmen, prompt in paying his bills, and fair in all his dealings with suppliers.

Receiving, checking, and marking

Receiving, checking, and marking goods purchased are routine activities in most cases, and they may be performed carelessly unless provisions are made for their proper handling. In the small business this involves recognizing the importance of careful checking on quantity, condition, and transportation charges. Quality should be inspected in most cases. An alert small buyer has a good opportunity to build a desirable reputation, and to cement favorable future relations with his resources, by the way he handles these activities. All overages as well as shortages should be reported promptly to the seller. All too often the only report vendors receive from small buyers is a complaint about shortages or damaged goods. Damage claims should be made, in so far as possible, to the party responsible—either the vendor or the transportation company. In either case they should be made promptly and supported by adequate proof. Care in observing little details like these will help considerably in setting the small operator apart from the vendor's other customers, and stamping him as a "big businessman on the way up."

The way goods are marked upon receipt varies by type of business, the firm's policy, and other factors. Merchants should always mark each item or container with the date received. Whether size, cost, selling price, vendor's identification, or other data are marked on the goods will depend on many factors. Small manufacturers and service operators may need very little marking, unless points like identification of kind or grade and source are significant.

Follow-up after purchase

It seems to be a characteristic of most Americans to exert strenuous efforts to get something, which when once received loses most of its former interest. Since in a small enterprise the man *is* the business, this trait frequently shows itself in buying for the firm. Goods once purchased and received are likely to be forgotten. Thus a bad buy is often repeated, and merchandise or materials already on hand in ample supply are reordered.

Follow-up relates to the history of the goods once they have been received. In merchandising it includes data on how the article sold, rate of turnover, markdowns, customer complaints, returns, adjustments, and allowances. It is an always up-to-date moving picture of the item from the time it entered the store until it was finally disposed of. The small wholesaler will watch this record closely in terms of re-orders by his retail customers. In either case, retailer or wholesaler, one of these situations will develop: The article will be a "hot" item to be re-ordered at once; it is an average piece of merchandise, or it is a "buyer's mistake."

In small manufacturing and service establishments follow-up is more difficult and more frequently neglected. Of course, if a particular purchase turns out to be a "dud," appropriate action is taken. However, in the small firm most purchases are moderately satisfactory and too little effort is exerted toward tracing the success of each. Small operators could well give more consideration to their follow-up, on the purchase of materials and supplies especially.

When any firm has reached the size at which purchase records beyond those required for legal and accounting purposes are needed, a "resources file" is indicated. In this file is kept a card for each supplier that carries a complete record of the success of all transactions with him. It also contains data on prices, unit packages, discounts, and other purchasing information. Such a file serves as a current history record, which is a valuable guide to re-ordering.

Buying by the Small Retailer

Buying for the retail store has been developed to a highly skilled occupation, utilizing many aids and scientific methods —but it is still an art based on individual ability and supported by all available information. Buying is the foundation for success in retailing. Small-scale retailers, since they are, at best, handicapped because of limited experience and buying power, should capitalize on the experience of larger stores, or should affiliate with some reputable voluntary and coöperative group. Our discussion will follow this plan, first considering proved buying guides, and then the voluntary and coöperative groups.

Consumer demand for many goods varies from one community to another as well as from time to time for the same group of people. The successful retailer understands the dynamic nature of consumer wants and makes strenuous efforts to keep his merchandise offerings adjusted to current demand. To do so usually involves anticipating what his customers' needs will be so that goods will be on hand when they are needed.

Determining customer wants

Three main methods are used to determine what merchandise customers are going to want:

1. Analyzing sales records.
2. Making consumer surveys.
3. Studying trade information.

Chain stores that deal in staple merchandise, such as grocery and drug chains, have developed a simple system of maintaining adequate stocks of articles in steady demand. Headquarters first prepares a list of the items each store should carry. Once each week the store manager compares his actual stock on hand with original quantities for each item on the check list. For example, if the stock on hand of one brand of soap is ten bars and the entry for the previous week shows twenty-two were on hand, one dozen were sold during the week if none

were received. Thus, without recording sales daily, the manager knows the rate of sale of each item and orders goods to keep his stock in balance with sales. Small retailers can use this check list system by securing basic stock lists from their suppliers.

A different system is needed to provide information about the sale of merchandise whose style changes rapidly. Retailers who handle such goods find it advisable to record each sale and to make frequent (sometimes daily) analyses of these sales records. Thus they know what styles are selling rapidly and should be re-ordered at once, as well as the styles for which demand is declining. For the latter a small price reduction made in time may help to sell the goods before customers have lost all interest in the merchandise.

Small merchants will not ordinarily make formal consumer surveys but may accomplish approximately the same objective by observing and talking with customers in the store. Trade journal staffs sometimes conduct surveys of consumer buying habits and report their findings.

Studying trade information. A retailer has available to him many sources of information about developments in his field. Examples are trade papers written for other dealers like himself, fashion magazines, bulletins prepared by Merchants Service Bureaus, special market services that undertake to keep retailers informed about new merchandise and trends, manufacturers, brokers, and other salesmen. Many of these sources of trade information may reveal a customer demand in other localities before the merchant's own customers have expressed themselves.

Trade papers are especially helpful for informing a merchant of new goods for which there is as yet no active consumer demand, but which are likely to become popular later on. Such information is presented both in the form of articles and as vendors' advertising. If he is to avoid costly mistakes in buying unwanted goods, each retailer must know his own cus-

tomers well enough to judge what new merchandise will, and what will not, be acceptable to them.[3]

For style goods, and other lines where balanced assortments are of great importance, the model stock is the usual buying guide. A model stock plan means carrying a predetermined assortment of merchandise that is in proper balance by types, sizes, and colors with the sales of the line of goods. If the model stock plan were perfect, it would include the exact quantities of the right sorts of goods in relation to the desired rate of stock turnover. In other words, if the estimates of the model stock plan were entirely correct, the merchant would sell all the goods projected in the plan; and in doing so, he would achieve exactly the stock turnover rate for which he had planned.

Changing consumer wants make past sales far from a perfect guide to what and how much a retailer should purchase. Changes in trading areas, such as increases or decreases in population, make it impossible to use past sales alone as a reflector of future demand for certain sizes and for staple articles. A change in business conditions also to some degree nullifies the past as a guide for the future, except with respect to sizes and staples. When prices are changing rapidly, past records in terms of units sold should be used, instead of dollar sales volume, to forecast future needs. Changes in demand with respect to fashion, color, and material likewise weaken past sales records as a barometer for future purchases. The retailer should use market trends and sales forecasts to modify his decisions based upon past sales records.

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[3] For further study see: Small Business Aids, No. 249, U. S. Department of Commerce, "How the Retailer Determines Customer Wants." Condensed from "How to Analyze Consumer Demand," by R. G. Walters and John W. Wingate. *Fundamentals of Selling*, 1944, Washington, War Department Education Manual—EM 789, Chapter 5; Small Business Aids, No. 246, U. S. Department of Commerce, "The Retail Jeweler Gauges the Market." Condensed from "The Retailer Gauges the Market," *Jewelry*, Feb. 17, 1947, New York, Ellis Publications, Inc.

Determining market trends

Several of the sources discussed as useful in determining customer demand will be helpful in forecasting market trends—especially trade journals and manufacturers. The latter are in a favorable position to aid dealers in this activity because producers must forecast such trends for themselves if they are to experience profitable operations. Also, like wholesalers, manufacturers are continually receiving orders and inquiries from many territories. This furnishes them with the data needed to observe important trends.

Salesmen who call upon the retailer are usually well informed about trends, particularly changes affecting the line of goods carried. Suggestions given by traveling salesmen are often very helpful to the small merchant. Of course he should be careful not to let himself be oversold on certain goods an unscrupulous salesman may want to dispose of. Salespersons in the store also can furnish information on current trends in customer preference for certain merchandise.

Some retailers have each salesperson record every customer request for merchandise that is not in stock. Want slips are frequently used for this purpose, although some merchants, especially druggists, prefer to use a want book. Care should be exercised in using information recorded on want slips. First it is important to be sure that requests come from regular customers rather than from transients or from shoppers employed by other stores or even by vendors. Next the retailer should be satisfied that there are enough calls for the merchandise not in stock to indicate a trend and to justify placing an order for such goods.

Competitors, especially progressive large stores, may be studied by the small retailer to determine market trends. The advertising and displays of such stores provide many clues both as to increasing and declining popularity of certain merchandise. In using this method, the merchant should select a store that is normally slightly in advance of his own in the merchan-

dise acceptance curve. This means that the customers of the store selected for observation usually buy new merchandise before his own customers do. Even if such a store is not available in the community, the method suggested will be useful provided a large, progressive store is selected for observation.[4]

Voluntary and coöperative groups

Especially since the rise of the chain store, which has brought the efficient merchandising methods of big business into direct competition with the independent retailer in his own home town, there is more need for outside assistance in management and merchandising than is realized by many small-scale retailers. Since the chain stores, along with other types of large-scale retailing, tend to go around the wholesaler and buy direct from manufacturers, the wholesalers are also concerned about their loss of markets.

A development of major importance has been the formation of many coöperative arrangements, either between a wholesaler and a selected group of his retail customers or among a group of retailers in the same line of business. The former arrangement is called a "voluntary chain"; the latter is a "coöperative chain." Although both types of organizations were formed originally for the primary purpose of buying merchandise in larger quantities and on terms more nearly comparable to those offered large-scale competitors, extensive experience has proved that managerial and merchandising aids made available by the central headquarters for each store are usually of an importance to the members at least equal to the buying advantages. Another lesson learned by these groups is that the retail outlets all must be of one kind. This means that the various retail

[4] For further study see: Small Business Aids, No. 295, U. S. Department of Commerce, "Using the Model Stock Plan in a Small Store." Condensed from "The Model Stock Plan in Small Stores," by N. H. Comish. *The Journal of Marketing*, April, 1947, New York, American Marketing Association; and Edwards, Charles M., Jr., and Howard, William H., *Retail Advertising and Sales Promotion*, Revised edition, Chapter 21. New York: Prentice-Hall, Inc., 1943.

stores comprising the group must be approximately similar as to class of trade, merchandise carried, and other factors that would have a bearing upon joint merchandising and management through common policies. Size differences are less important than the quality of management, provided extremes are not included. Examples of such extremes would be stores too large to need group aid, or those too small to appreciate and use it.[5]

There are four different types of organizations classified as voluntary and coöperative groups: (1) retailer coöperatives or coöperative chains,[6] (2) wholesaler-sponsored voluntary chains, (3) manufacturers' voluntary chains, and (4) agency or franchise stores sponsored by the corporate chains. The retailer coöperative is owned entirely by the retail merchants, operates entirely for their benefit, usually has its own warehouse, and sells exclusively to member stores. In some respects, such as in the use of patronage dividends, it resembles the consumer coöperative types of organization.

Wholesaler- or jobber-sponsored voluntary chains usually carry the wholesaler's own or "private" brand merchandise, have a common name and appearance of the store front, and offer advertising and other merchandising aids that vary with each organization. The retail stores are individually owned but agree in joining the voluntary to assume certain obligations such as to feature the company's merchandise, to coöperate in advertising, and to maintain acceptable standards of appearance for the store front and interior. Most organizations specify the minimum amount of merchandise that must be purchased through the sponsoring wholesaler.

Voluntaries sponsored by manufacturers operate principally in the auto accessory and shoe fields. Considerable expansion

[5] Cook, Gordon, "The 1947 Position of Voluntary and Coöperative Groups." *The Voluntary and Coöperative Groups Magazine*, February, 1947, Vol. 17, No. 2, page 37.

[6] Organizations in this field seem to prefer the term "group" to "chain" in describing their type of operation.

has taken place recently in the former. Products not manufactured by the company may be purchased through its buying organization more economically than if the local retailer were to buy them independently. The large tire companies that have gone in for this type of expansion also purchase related merchandise for franchised stores and follow a policy of giving preference to the locally-owned store wherever one that meets their standards can be found. It is only when the company desires an outlet in a town where this condition does not exist that company-owned stores are operated.

Several years ago some of the corporate chains appeared to be interested in launching their own voluntary or agency groups. A few did so. One large mail order house chain, after arranging for agency outlets, later abandoned the plan because results were not satisfactory. It now concentrates on its own stores exclusively. However, two prominent examples of chain store-sponsored voluntaries in such diverse fields as auto accessories and drugs (The Western Auto Authorized Dealer Plan and the Walgreen Agency), as well as many cases that closely resemble such combinations, point to the possibilities of this type of distribution. Those resembling this type of operation include the large tire manufacturers that have both their own retail chain and agency stores, and large wholesalers like Butler Brothers, who operate company-owned and voluntary chain outlets.

A survey conducted in 1947, covering all four types of chains mentioned, led to the conclusion that most corporate chains of the regular merchandising (non-manufacturing) type were not interested in establishing voluntary or agency affiliates. Information received from 33 of the best known corporate chains disclosed that only four were operating independently-owned retail affiliates, and one other was considering doing so (men's furnishings). The four operating voluntaries were: Walgreen's in the drug field, Western Stores in auto accessories and general merchandise, United Cigar—Whelan Stores in the tobacco and drug fields, and one shoe manu-

facturer who had a plan for women's shoe departments in specialty and department stores, as well as in its company-owned chain stores. By commodity fields the others were distributed as follows: junior department and general merchandise, 7; variety, 7; grocery, 4; shoes, 3; women's wear, 3; food service, drugs, candy and cigars, 1 each.

It is interesting that two of the three companies having plans for independent affiliates are also manufacturers who distribute their products through company-owned chain stores as well as through voluntaries. At least in one case, that of Walgreen's, a major reason for the agency plan is to increase the outlets for company-manufactured products, especially in towns of less than 20,000 population, where a company-owned store could not be justifiable. Large tire companies, like B. F. Goodrich and Goodyear Tire and Rubber Company, that operate both company-owned and voluntary chains are also concerned primarily with maintaining outlets for their own brands of products.

The following brief discussion of several of these voluntary plans for independent merchants, from a representative selection of fields, is intended merely to present the outstanding features of the four types of program. All descriptions have been adapted from printed material published by the sponsoring organizations or from letters addressed to the authors.

Groceries. Clover Farm Stores, with headquarters in Cleveland, Ohio, a wholesale-sponsored voluntary group, was begun in 1926. Its plan, as described in a letter to the authors, follows.

This organization is a voluntary coöperative, owned by 31 wholesale grocer members, who operate 33 Clover Farm Divisions. In these divisions there are approximately 2500 Clover Farm retail stores, who are franchised by the sponsoring wholesalers. These wholesalers are selected and approved by the Board of Directors, who in turn are elected by the wholesalers from their members.

When a wholesaler affiliates with the Clover Farm organization, he pays a moderate fee and acquires full membership and full participation benefits. A definite territory, in which the wholesaler

will operate, is part of the agreement and the wholesaler agrees to abide by the principles of the corporation and the corporation agrees to furnish certain services and benefits to the wholesaler.

The wholesaler solicits the stores for his division and we set standards for admittance which are in keeping with those of the whole Clover Farm organization. They are discerning in their solicitation and acceptance of retail members, for unless that retail member is going to be a 100 per cent Clover Farmer, the wholesaler does not want him in his organization, nor would it help Clover Farm Stores' system as a whole. The retailer members are secured in the local divisions by the salesmen and servicemen of that particular house. The retail franchise agreement covers fee, initiation, advertising and promotion, the use of store-front signs, use of brands, remodeling, etc. All of our new retail stores are remodeled before they are opened as Clover Farm stores. We have a green and ivory color scheme which is worked throughout the store and an overhead sign is placed in front. We have field representatives who supervise this work and the layout of these stores in preparation for their opening sale. These opening sales occur at one time in a new division and as many as 100 may open on one particular day with the appropriate fanfare and advertising before the opening.

We have our own record of account system, which our retailers are expected to use and also our own copyrighted credit and collection system. We expect that the retailer in joining Clover Farm will replace gradually at least 40 per cent of his stock with Clover Farm Brands and keep 60 per cent of his merchandise in nationally advertised brands.

We have a complete line of private brands which are: Clover Farm and Glendale, sold in Clover Farm stores in a particular neighborhood or territory, Clover Farm merchandise being top quality and Glendale for second quality. We also have a Foodland and Mrs. Lane's label, Foodland being top quality and Mrs. Lane's being second quality. These brands are for use by our wholesaler grocer members who service other trades in addition to Clover Farm stores and provide them with labels for both Clover Farm stores and stores other than Clover Farm.

Clover Farm stores are the only ones carrying Clover Farm merchandise and all of our trade marks are registered in every state in

the union as well as federally. The greatest percentage of our retailers have been affiliated with this organization since its inception and the majority of our wholesalers have also been members since the birth of this firm, 20 years ago.[7]

The Clover Farm field representatives help wholesalers and retailers with their individual problems—finances, selling, operating efficiency, and so on. Headquarters publishes a monthly magazine, *The Clover Farm Bee,* which contains articles, editorials, and advertisements. It also publishes the *Four-Leaf Clover* for advertising to the home; this newspaper, although edited by the main office, is printed and distributed without cost by the various divisions. The retailer receives the *Clovergram,* a mimeographed publication containing information about store operations, promotion, merchandising, and clerk training. In addition to this, Clover Farm headquarters sends posters, price cards and pennants, and other advertising material to the various divisions.

Other well-known retail food voluntaries include A. G. (Associated Grocers), St. Louis, Missouri, with 467 members; Jack Sprat Food Stores, sponsored by the Western Grocer of Marshalltown, Iowa: I. G. A. (Independent Grocers Alliance), with headquarters in Chicago and several thousand retail and wholesale members; and H. G. F. stores, sponsored by the H. D. Lee Company of Kansas City, Missouri. Organizations such as these have membership contracts and usually collect dues; they feature their own private brands, but also carry national brands; and they furnish merchandising and management assistance in varying amounts to franchise members. Advertising and promotional aids, as well as some help on layout, accounting, and sales clerk training, are furnished in most cases, but the use of supervisors varies among the different firms.

Variety and general merchandise. Butler Brothers entered the voluntary field in 1927, revised their plan in 1943, and today

[7] Excerpts from letter of May 26, 1947, from Mr. R. E. McGeorge, Clover Farm Stores Corporation, National Headquarters, Cleveland, Ohio.

have over 2,000 variety and dry goods merchants using their Distributor Store program. These are in addition to their company-owned chains—Scott Stores in the variety field, and Burr Stores in general merchandise.

Two types of voluntaries are sponsored: Ben Franklin, home-owned variety stores; and Federated, home-owned department stores.

Before recommending that a prospect invest in a particular store, Butler Brothers make a careful study of facts pertaining to his background, experience, likes, and dislikes. Every precaution is taken to see that each prospect is a perfect "fit" for the store he takes over. Special attention is given to an owner's retail suitability, to the type of community for which he is best suited, whether or not he has the proper personality for meeting the public, to his ability to meet capital requirements for stores of the size under consideration, and to similar factors. A prospective merchant without sufficient experience in retailing is given an opportunity to take a complete course in operating a store under the supervision of experienced retailers. Detailed surveys and analyses are made of recommended towns to determine their exact mathematical opportunity for success. Population, trade areas, shopping habits, spendable income, scientific traffic counts, building required—these are only a few of the many important factors studied before establishing a Distributor Store. Butler Brothers lease-location men are responsible for sound lease protection to provide each Distributor Store owner with security and the certainty of having an adequate building at a fair rental. This Distributor Store organization is serving a growing list of store owners in exactly the same way the Butler chain stores' headquarters serve their individual units. The Distributor Store organization matches —man for man, function for function—the organization and supervision found in the chains.

Distributor Store men—experts in retail management, merchandising, advertising, display, and sales promotion—now devote their entire time to servicing this proved program and to

keeping retailers abreast of the best that competition can offer. Today's trend of rapid development in retailing makes professional guidance for individual store owners as imperative as having a dependable merchandise source. That is why Butler Brothers found it necessary to provide both for independent owners.

Store superintendents make periodic calls on each owner in order to give him every assistance possible on any problems of merchandising, financial control, personnel, displays, and other management duties. The total charge for this printed and personal service amounts to about ¾ of one per cent of the store's annual volume.

Upon entering the Distributor Store plan, the owner agrees to purchase merchandise of the type and quality offered by Butler Brothers, and to put into practice all the guidance and retail "know how" provided by the program.

The merchandising division makes available almost all of the well-known nationally advertised brands. In addition, Butler Brothers has a packaging and brands department for the purpose of providing Distributor Store owners with exclusive brands that can be obtained only in their stores. Since these brands cannot be purchased from local competitors, it is to the owner's advantage to create a demand for them.

Butler Brothers has regional offices located in Chicago, St. Louis, Baltimore, Minneapolis, Dallas, and San Francisco. Distributor Store headquarters are in Chicago. If a person is interested in becoming a Ben Franklin or Federated owner, he should contact the Development Manager in any of the above regional offices.[8]

Auto accessories. Western Auto Supply Company of Los Angeles started in 1916, when the first store was opened in Los Angeles, and it had 173 stores in the chain by 1935 when the

[8] Comments regarding Butler Brothers adapted from a letter of May 12, 1947, by Mr. K. C. Meyer, Assistant General Production Manager, Butler Brothers, Chicago.

Western Dealer Plan went into effect. Later the company merged with Gamble-Skogmo, Inc., sponsors of Gamble Stores voluntary chain. Western Auto Supply Company of Los Angeles is now the western division for Gamble Stores, whose headquarters are in Minneapolis. There are 320 independently-owned dealer stores now operating under the Western name; this same plan is in operation under Gamble Stores, who have over 1500 authorized dealers throughout the Middlewest. Together the two groups are comprised of a total of over 1800 independently-owned dealer stores from Ohio to the Pacific Coast.

No charge is made to dealers for the privilege of belonging to the organization. The primary objective is that each dealer operate a representative Western Dealer store. A number of lines of private brand merchandise are, and always have been, distributed through Western Stores, and these lines the dealers also carry.

Several large tire companies, including Goodyear, B. F. Goodrich, Firestone, and others, have authorized dealer plans operated on a franchise basis with merchandising and management aids comparable to the voluntaries in other fields. These companies manufacture thousands of products that are sold through their dealers' stores. In addition, many of the tire companies have secured distribution rights for other well-advertised companies' lines, such as General Electric and Kelvinator refrigerators, for sale through dealer stores.

The following excerpts from a letter written by Goodyear Tire and Rubber Company are sufficiently representative of these plans:

> Goodyear is a dealer company and our distribution has always been primarily through dealers. We have approximately 12,000 direct franchise dealers.
>
> The essential provisions of our plan as to qualifications of retailers for affiliation are primarily that the dealer have or be capable of developing the proper reputation in the community, the necessary

management and merchandising ability, and sufficient finances to warrant his being extended the proper line of credit.

The buying advantages offered consist of our supplying our dealers with products we manufacture bearing our own name and with certain other lines of nationally advertised merchandise which we do not manufacture, but which we offer to our dealers in order to round out their selling opportunities and to give them a complete business franchise.

Many merchandising and management aids are available to our dealers—these include the personal advice and counsel of our field representatives, special representatives on certain products (such as truck tires, farm tires, batteries, and brake lining), district operating managers, district credit managers, district sales managers, and budget supervisors.

In addition to the personal advice and counsel by the qualified people just mentioned, our dealers get the benefit of comprehensive employee training programs, both in meeting form (consisting of movies, sound slide films, charts and quizzes) and of printed booklets, folders, etc.

The obligations or responsibilities assumed by our dealers consist primarily of taking full advantage of the sales and profit possibilities of our complete business franchise, backed up by the merchandising helps available, and of seeing that the people to whom they sell Goodyear products are given the right kind of service to assure the products delivering all the service mileage and value built into them.

It is expected that our dealers will buy from Goodyear those lines of merchandise we have which the dealers want to handle. We have no objection to a dealer handling lines of merchandise which we do not carry, and these, of course, he may buy from any source he desires.[9]

Usually the tire companies encourage franchise dealers to capitalize the instalment credit business, and often they furnish a company representative to develop this department in the dealer's store. In contrast to voluntaries in other lines, the

[9] Excerpts from letter of May 12, 1947, from Mr. J. A. Lewin, Manager, Dealer Department, The Goodyear Tire & Rubber Company, Inc., Akron, Ohio.

nature of tire products leads to a dual system of dealer outlets—the retail store and the service station.

Drugs. Probably the most comprehensive real voluntary in the drug field is the Walgreen Agency Plan, inaugurated in 1931. It is a complete merchandising plan for independent druggists. There were well over 1,000 Walgreen Agency Drug Stores functioning shortly after World War II, and hundreds of applications are constantly being processed.

The Walgreen Agency may be established in registered drug stores, if they fulfill the requirements of the plan in regard to location, size, and layout. All the facilities of the company are available to the agents—construction and layout plans, advertising, display, and merchandising helps. Other services may also be obtained on an advisory basis.

Agents operate under a franchise for the exclusive sale of Walgreen merchandise within their trade area. Selected sundry items are also sold. A minimum purchase requirement is stipulated, based on population. The usual term of an agency agreement is ten years.

Usually Walgreen agencies are located in towns whose population is less than 20,000 where the company does not operate its own stores and wants outlets for its 1,500 or more manufactured items. Agency stores are expected to conform to certain standards. They must bear approved identification and are urged to modernize, both inside and out, to make their stores merchandising units. Recommended displays and advertising services [10] are furnished by headquarters at a nominal charge. Agencies are invited by the company to join in certain sales promotion and merchandising events throughout the year. The Walgreen Agency Plan does not disturb the regular jobber-retailer relationship in so far as national brands are concerned, but Walgreen merchandise is stocked in addition as an exclusive.

Working in coöperation with Walgreen, the agents secure

[10] Advertising mat services are explained in Chapter XIV.

standard store installations. Because concentration of purchases of fixtures and equipment allows mass production methods, agents usually can lower the cost of improving their stores.

Figures volunteered by agents indicate increases up to 40 per cent in total store volume after conversion of the typical non-affiliated store to a Walgreen Agency.

Conclusions. There are hundreds of voluntary and coöperative groups in existence operating principally in the major fields covered in the foregoing discussion. Organizations selected for specific comments probably are representative of the better known plans. In certain localities other groups might well be better suited to a particular independent merchant's needs. In every case the individual considering affiliation with one of these organizations should (1) personally contact the firm under consideration, and (2) secure the advice and experience of other businessmen familiar with it. The latter is suggested because experience has shown that what the sponsor *thinks* his organization is accomplishing for independent retailer members does not always agree with what some of these retailers believe to be the benefits they derive from their affiliations. Members and former members of retail voluntaries, when interviewed, expressed certain evaluations: In the variety field the *convenience* of buying all items from one reliable resource was stressed as a major advantage; among the grocers the *protected brands* available only through their voluntary ranked as the foremost benefit—being cited as of even greater value than possible economies from group buying.

Market representatives

Both large and small retailers located at some distance from the main central markets find it highly desirable to maintain contact with a representative situated there from whom they secure a large part of their merchandise. In the "soft lines"—wearing apparel, dry goods, and department store merchandise—these representatives are referred to as "resident buying

offices." In hardware and "hard lines" the term "purchasing agent" is frequently used.

With proper modification the following discussion will apply to purchasing agents as well as to resident buyers, although it deals primarily with the latter. Important differences between "hard" and "soft" lines are: a larger number of manufacturers, greater weight per unit of merchandise, and fairly stable styles for the former; and frequent style and price changes, light unit weight, many new producers, and a somewhat smaller number of manufacturers for the latter.

Resident buyers of interest to the smaller merchants are of two principal types—the paid buying officer and the merchandise broker. The latter were formerly called "commission buying offices."

Paid buying offices. The paid or independent offices maintain continuous contacts with a selected group of retailers on an annual fee and contract basis. In addition to buying merchandise for subscribing stores, the paid office furnishes a wealth of market information and forecasts. Many stores large enough to afford a paid office seem to be more interested in this market information service than in actually buying much merchandise through the office. However, when buyers from these stores go to market they work closely with the merchandise experts in their resident buying office, which saves the buyer's time as well as keeping him in touch with the latest trends and best resources. The buying office is normally used as the store buyer's temporary headquarters when in the market.

Although there are several hundred resident buying offices in New York City, and many in other major markets such as Chicago, St. Louis, Los Angeles, San Francisco, and Dallas, about 17 have long been in operation and are widely known throughout the country. In general, these offices serve only one client (subscribing retail store) in any community. The usual practice is to charge an annual fee of approximately one-half to one per cent of the subscriber's net sales. In pricing their services to individual stores, a few of the offices consider,

in addition, the relative amount of the merchandise expert's time needed by the store. Some offices have minimum fees, which have been as low as $900 to $1,200 per year. Even the smaller of these figures would indicate a store volume of $90,000 or more per year to keep this fee within the customary one per cent standard. Recently an organization located in New York City has been advertising itself as a paid buying office for small stores doing a volume up to $250,000.

The Association of Buying Offices, composed only of paid offices, recently stated its objectives as follows:

1. To keep our member stores informed through timely bulletins of the latest fashion and market trends, as well as opportunity purchases and new items presented in the various markets.
2. To assist our member stores in the screening of resources and values.
3. To act for and represent member stores in the market in the interim period between buyers' trips.
4. To follow up and speed deliveries on outstanding orders.
5. To assist our member stores in the planning of promotions and regular selling events in line with prevailing market trends.
6. To foster good relationships between trade factors and our member stores.
7. To provide merchandise in adequate quantities and increasingly improved quality, as reasonable as possible, to the ultimate consumer.
8. To counsel and advise with the management of our member stores in planning their stock and merchandising operations.
9. To consult with store managements on their organization problems, their personnel programs, and analyze store figures in many constructive ways.
10. To offer through branch offices a nation-wide knowledge of important markets and merchandise.[11]

Merchandise brokers. Merchandise brokers buy for retail stores, securing their revenue as a discount or brokerage com-

[11] The Association of Buying Offices, "The Buying Office Faces the Future—and the Facts." *Women's Wear Daily,* December 26, 1946.

mission from the vendors; they make no charge to their retail clients for their buying services. As of 1949, there were nearly 200 merchandise brokers with offices in the New York City market, as listed in the Manhattan Classified Telephone Directory. J. S. Phelon and Company, 32 Union Square, and Nugent's Directories, published by the Chelton Company at 100 East 42nd Street, both in New York City, are other sources of information about merchandise brokers. The following description, furnished by Arthur Mincer Company, Merchandise Brokers, of New York City, is probably representative of the work done by these representatives.

A Merchandise Broker usually has one customer in a city. This situation is brought about by the fact that the broker represents a great many sources of supply and the retail merchant would want to be the Broker's only customer in the specific town in order to avoid conflictions with his competitor.

The predominant factor in selecting or accepting a retail account is the credit standing. Merchandise Brokers occupy the peculiar position in the market of having a reputation of choosing their customers carefully, looking into their credit standing and financial condition, and the wholesale markets therefore deal with brokers with confidence.

There are no agreements or contracts between the Merchandise Broker and his retail customer and could not be because the Merchandise Broker's contractual relations are with the source of supply.

There are a great many advantages for a retail store to use a Merchandise Broker's office, for the broker saves him a great deal of time on his market trips by presenting such a large number of lines from which he can make his selections. The broker also sends him bulletins and flashes on merchandise that is available from the source of supply with whom there is a contractual relation.[12]

The following additional points were provided by Bernstein and Wolff, Manufacturers' Representatives For Wholesale Ready to Wear, New York City:

[12] Excerpts from a letter of June 5, 1947, from Mr. Arthur Mincer.

1. The commission is paid to the office by the manufacturer at a stipulated rate of commission on the net amount of merchandise shipped and paid for by the retailer. When purchasing goods through a commission office, the service is rendered "gratis" to the retailer.

2. There are some offices which will accept accounts with purchasing power from $3,000 and up a year—then again, there are offices which will not take on any accounts below the figure of $25,000 per year.

3. Market bulletins are sent to the stores showing outstanding lines and keeping the account informed of new items from time to time. The office also advises the account of the best time to come to the market to make his purchases, if he plans on a trip.

4. The offices specialize in various lines of merchandise. For instance, one office may buy only millinery, another men's wear, but one like Bernstein and Wolff handles ladies' and children's ready-to-wear, such as coats, suits, dresses, millinery, bags, undergarments, and kindred lines.

5. In the event that the buyer of the store is in town, the office takes her to the outstanding houses and aids her in selecting her merchandise, and makes sure the best values are obtained at all times.[13]

Buying by the Small Wholesaler

As a class, wholesalers are supposed to have large businesses. Actually many small wholesalers find it difficult to purchase in carload lots or other quantities of sufficient size to secure the low prices and economical transportation needed to justify their status as wholesalers. This has often led to the use of pooled buying, ordering through resident buying offices, and transportation arranged by freight forwarders or shippers who consolidate several less than carload shipments into car lots to secure lower transportation rates. Actual examples of practices followed by small wholesalers known to the authors are described in the following paragraph.

[13] Items 1 through 5 are adapted from a letter of April 15, 1947, from Mr. Morris M. Bernstein, President, National Association of Merchandise Brokers.

Three brothers, each operating an independent, non-competing wholesale grocery, pool their buying to secure a five per cent discount permitted for purchasing in car lots. A feed and flour wholesaler pools his buying with a few large retail customers. Another seed wholesaler buys on contract from growers, sends scouts out to locate sellers, and orders from catalogs. A produce dealer uses truck drivers to scout for "good buys"; a small packer sends his buyers to the local stockyards on sale days; a radio wholesaler waits for visits by salesmen but does some ordering by mail. One small hardware wholesaler does not stock heavy, bulky, expensive items but buys them only on customer orders. These few examples illustrate the diversity of buying methods likely to be found among wholesalers in many average towns. Several of these practices are quite similar to those followed by retailers.

In at least one other respect many small wholesalers resemble retailers; by virtue of it, they are, in fact, both retailers and wholesalers. Throughout the country, but especially in the small towns in the less densely populated states, small businessmen in fields like groceries, meats, hardware, electrical supplies, and some others, function as both wholesale and retail distributors. In such cases the wholesale division is influenced greatly by the needs and policies of the retail in matters such as brands carried, price lines, and quantities to order. Much less frequently the wholesale activities have set the pattern for the retail store.

Policy decisions regarding brands to carry, assortments, number and completeness of merchandise lines, when to add new items, and the extent of quantity buying, are much more acute for the small than for the larger wholesaler although similar for both. Limited financial resources and a smaller market are the chief reasons for this condition. Also, the relative importance of short-run considerations as compared to long-run factors is greater for the small wholesaler.

In gauging demand, the small retailer-wholesaler may have a slight advantage over his large counterpart. Consumer de-

mand is immediately reflected through the retail store. However, the man who is exclusively a wholesaler would anticipate this demand and would have stocks on hand to fill orders of retail customers as they come in. In practice many wholesalers try to maintain continuous contact with consumer demand, and trends, by means of frequent visits of their representatives to retail stores. In addition to this first hand observation, small wholesalers should use all available sources of demand forecasting, including the advice of their resident buying offices, reports on market trends, and tips received from manufacturers' representatives.

At least partly because of this need to forecast market trends further in advance than retailers, wholesalers are more tempted to engage in speculative buying. For the small operator this is especially dangerous. One wrong guess and he may be wiped out. A study disclosed opportunities for improved buying as follows. The buying mechanism might well be improved, since the buyer must examine the records to decide when and how much to purchase. Moreover, the records do not provide a tickler for timing the buying action. Except where the standing order is actually in effect, the buyer has to await advice from the warehouse as to when to buy. He decides only on how much.[14]

In selecting resources the small wholesaler finds that available ones vary by lines of goods, methods of distribution used by particular manufacturers, and location. The wholesaler's buying power may also have a bearing on the best resources to use. Concentration is more common for staples, limited lines, and exclusive agencies. Orders are placed through selling agents. Diversification exists when there are a large number of small producers, such as in dry goods, and where style changes are frequent.

[14] Industrial Series No. 62, Office of Domestic Commerce, U. S. Department of Commerce, *A Study of Tobacco Wholesalers' Operations*. Washington: U. S. Government Printing Office, 1946.

Another factor that may be of relatively greater concern to the small wholesaler is the distribution policies of competing manufacturers. Some producers sell directly to chain stores and other cut-price retailers, thus undermining the market for the wholesaler. Others protect their independent wholesale distributors.

Additional factors that enter into the choice of resources are transportation rates and the vendor's speed of delivery, ability to supply quantities desired, prices, services rendered; also his financial standing, credit policies, reputation, and types of protection he may give to small wholesalers.

To a greater extent than do retailers, small wholesalers order from catalogs and price lists by phone or mail. In the hardware and grocery fields, and for some electrical goods and other similar lines, this is common practice. Soft goods wholesalers seem to prefer market visits or salesmen's calls.

The small wholesaler may seem like big business to his retail customers, but he is actually a relatively small operator, and a newcomer, in an established field where the age and size of the average concern are both quite large. Accepted business practices are well established. Confirming a small telephone order in writing, for example, may seem like a waste of time to the small wholesaler. Failure to do so would be acceptable in many retail fields, but in wholesale it is a serious mistake. All orders should be in writing, with proper duplicate copies as needed. Other well-established business practices, such as the use of purchase schedules, card indexing of vendors, prompt discounting of all invoices, dealing ethically with vendors, and observing trade customs, are expected to an even greater extent from small wholesalers than from retailers.[15]

The importance to the small wholesaler of maintaining favorable relations with his resources was aptly stated by Mr. Charles E. Woodward, Executive Secretary, Farm Equipment Wholesalers Association, in a letter to the authors as follows:

[15] Beckman, Theodore N., and Engle, Nathanael H., *Wholesaling*. New York: Copyright 1937 by The Ronald Press Company.

The thousand or more factories who are the suppliers for our members usually call not less than once a year on their present and prospective wholesale customers. A small wholesaler who wants to grow, however, must return the favor by calling on the factories whose lines he would like to handle. Trade connections between manufacturers and wholesalers are not made in slap-dash fashion, but often follow an extended courtship. By the same token, these connections usually continue, some of them for many years. We know of one case where a distributor in California has handled for 52 years a line made in Philadelphia.[16]

Buying for the Small Factory and Service Business

All manufacturing and most service establishments require materials and supplies to carry on their operations. Whereas the merchant buys for resale and frequently will purchase new items on his judgment that they can be sold at a profit, purchases for a factory or service establishment are made only in response to the expected needs of using departments. Assuming these needs to be reported or estimated accurately, purchasing aims to keep the inventory of materials, parts, and supplies in proper balance with the needs of the company.

Many shops, during the beginning years especially, do not confine their operations exclusively either to manufacturing or to rendering certain services. The small business doing processing or performing a service frequently also sells some parts or merchandise. A manufacturer of metal products needs raw material and supplies like fuel and oil. Because he maintains a stock of various kinds of metals, or parts, he often sells some of these with or without processing. Plumbing contractors, repair shops, beauty parlors, and other small establishments often derive a sizable proportion of their total income from the resale of materials, parts, or merchandise used in their kind of business.

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[16] Excerpt from letter of August 6, 1948, from Mr. Charles E. Woodward, Executive Secretary, Farm Equipment Wholesalers Association, Minneapolis, Minnesota.

To some degree at least, these small businessmen have a dual purchasing problem—buying for use and buying for resale. Purchasing for these small operators usually is not a specialized function requiring the full time of one man or department. It is ordinarily done by the owner or under his close personal supervision. Because the owner-manager is more likely to be interested chiefly in the processing side of the business, buying may easily be slighted or carelessly handled. Unless the owner is capable of doing the job properly himself, and is willing to do it, definite responsibility for purchasing should be vested in one person who is also given adequate authority and facilities to do the job correctly.

Although the same fundamentals of buying operate—determining needs, locating suitable sources of supply, using approved techniques, maintaining favorable relations, receiving, and follow-up—their application to different fields varies to some extent. In the following discussion several fields have been selected to illustrate these differences as well as to call attention to important considerations in each. Except for the comments regarding the small factory, most of the material has been adapted from Department of Commerce small business manuals cited in the footnotes.

Purchasing for the small factory

Purchasing for the small factory aims to maintain inventories that are balanced in terms of production needs. If only one product is made and the rate of production is fairly constant, purchasing can be simplified to become nearly a routine operation once the qualities needed and the identity of suitable suppliers have been ascertained. Even in such a case some of the following purchasing techniques may be useful.

When items needed can be obtained regularly as wanted within a predictable time limit, it may be sufficient to establish maximum and minimum stock limits and the quantity to order at one time. However, when deliveries are uncertain, two additional guides may be needed: "lead time" in placing

orders, and "not before" and "not after" dates. On these two methods one author has commented:

As to "lead time," if the purchasing agent is on a sound footing with his suppliers, it is perfectly proper for him to write to them and say, "You know the internal operating conditions in your plant and we don't. So that we can get our supplies from you on a proper scheduling basis, please tell us how far in advance we must place our orders with you. We shall give you whatever notice you ask for, but we shall not stand for 'dumping' ahead of our delivery schedule." This leads us to a consideration of the "not before" or "not after" principle. If these two dates are not set too close to one another, no supplier can properly object to making deliveries in the scheduled period provided the "lead time" is correct.[17]

Sheet metal business. A sheet metal shop may make several articles for stock, such as standard-sized flashings, ventilators, stock-size sheet metal pipes, and other items. Usually most of the work is to customer specifications. Greater opportunities to improvise when one part or material is in short supply exist than in many kinds of business. Good practice is to buy basic materials and sizes. Nevertheless, experience shows that a tendency to overbuy exists among many small operators. The following advice is pertinent.

It is understandable that the new shop owner is likely to feel quite proud of himself and his new plant. Thus he may try to impress salesmen with his importance unless care is exercised to hold himself within the practical limits of his financial status and inventory needs. A good practice to follow before placing any large orders is to recall commitments already made—notes due next week on equipment purchases, bills to be paid next month for rent, utilities, stationery, payroll, and to the sign painter and other local fellow businessmen. It is well also to remember previous mistakes in buying, such as placing a large order for materials in anticipation of landing a big job that was

[17] Alter, L. W. Scott, "Purchasing at the Management Level." *The Stove Builder*, July, 1947, Vol. 12, No. 7, page 45.

not secured, or padding an order to bring its shipping weight up to the carrier's minimum.

The goal should be to purchase minimum amounts of indispensable materials and operating, maintenance, and office supplies until the business is well established and modern stock control procedures can be used to guide effective buying. During the beginning period of limited financial resources it is desirable to seek a rapid turnover of inventories, and to keep all slow-moving items at an absolute minimum so as to have ample working capital available for financing the fast-moving, profitable items.

The usual practice of salesmen on their initial visit is to attempt to stock the shop with materials sufficient for any possible type of work that may be undertaken. This frequently makes it difficult for the beginning shop owner to be conservative in his buying.[18]

Purchasing by the small producer can sometimes be limited to materials actually needed for orders already on hand. For example, a small dress factory located in a town of 13,000 several hundred miles from its nearest supplier has solved the problem satisfactorily. This company manufactures dresses that are sold from a catalog by two agents. An inventory of material amounting, on the average, to only $400 is carried. Most materials are purchased as soon as an order comes in from one of the agents. Deliveries are made so that materials needed are on hand by the time actual work on the order is about to start.

Purchasing for the small service business

At least three factors will influence the importance of purchasing in different kinds of service establishments: (1) the percentage of total revenue obtained from the resale of mer-

[18] Myer, William H., Beck, William L., Way, Howard E., and Schreiner, O., Jr., *Establishing and Operating a Metal Working Shop*, pages 109–121. Washington: U. S. Department of Commerce, Industrial Series No. 16, April, 1945.

chandise, (2) the ratio of material and supply costs to labor costs, and (3) the range of qualities available from different suppliers. All three factors will be present in varying degrees in most cases.

Many service establishments secure almost half of their total revenue from the resale of merchandise. It is likely in such cases that materials, parts, and supplies used in conjunction with services performed will also make up an important part of the total "service" charge to customers. Examples include television, radio, and electrical repair shops, plumbing contractors, and some beauty parlors. In establishments of this type purchasing is a function of major importance. In many personal service types of business, such as bookkeeping or advisory services, the cost of materials and supplies used bears such a small ratio to labor costs as to reduce the importance of the purchasing function to a minimum. Whenever the service is performed upon the person of the client or upon his property that is of high unit value, there may be significant quality variations in available materials and supplies that would lead to considerable differences in the quality of the resulting "service." An expensive garment cleaned with a cheap solvent that was inadequate for the task would be one example. By contrast, some establishments, such as sheet metal shops, work with materials that are so close to a standard that considerable improvising or substitution is possible.

In the following examples many of the foregoing points will be developed. It is well to remember that even where purchasing is of minor importance in a certain type of business, it must be performed efficiently for the firm to be continuously profitable.

Plumbing and heating contractor. A small shop engaging in repair and maintenance business should carry a minimum stock of heating and plumbing materials of the type suitable for this kind of work but should not attempt to carry a stock of fixtures except for display purposes. The latter are too diverse to justify such an inventory and may be obtained readily

as they are needed. If remodeling or modernizing is to be undertaken, however, a small stock of staple fixtures will be desirable, but elaborate or expensive fixtures should not be included. The goal should always be to keep inventories in proportion to sales for each item so as to secure rapid turnover and maximum profits. In both types of businesses it is well to deal with reliable suppliers. Defective workmanship is just as easy for the manufacturer of fixtures, parts, and supplies to conceal as it is for the contractor in doing his work.[19]

Automobile repair business. Automobile repair shop operators determine the kind of parts to carry according to their market or the types of cars they expect to service. Accessories and supplies for resale are likewise selected to suit the shop's class of trade. The amount of stock to carry depends, in part, on the location of the wholesaler and the service he is able to render. In many shops small inventories are satisfactory if orders are placed for repair parts as quickly as their need is determined. For example, as soon as a motor is dismantled orders are placed for the items needed. By the time the repairman is ready to use them they are at hand. This, of course, assumes that there is a supply house nearby.[20]

Service stations. The service station operator has a different set of conditions with which to deal. At the time of starting business he probably selects the brand of gasoline and other petroleum products to handle. This choice may depend upon the location selected as well as upon the brands available.

Two general types of suppliers may be used in buying products for resale—producers, and wholesalers who specialize in

[19] Mutter, Lawrence P., and Davis, Kenneth R. (under the direction of H. B. McCoy), *Establishing and Operating a Heating and Plumbing Business,* pages 73–75. Washington: U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, Industrial (Small Business) Series No. 36, 1946.

[20] Toboldt, W. K., Myer, William H., Flehr, Etteline, and Schreiner, O., Jr., *Establishing and Operating an Automobile Repair Shop,* pages 44–49. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 24, February, 1946.

this type of merchandise. Petroleum products will probably be purchased from an established and reliable oil company or jobber. Tires, batteries, automotive accessories, replacement parts, and supplies for service stations may be obtained from either type of supplier. In any case, a reliable company should be selected; one that guarantees the quality and performance of its products, provides advertising, prompt and efficient delivery service, and the assistance of a capable and experienced sales force to help in solving merchandising problems is recommended. In buying petroleum products, the service station operator who deals with a reliable supplier is protected against over- or under-stocking, product obsolescence, and similar problems often encountered in buying other merchandise. Oil companies and jobbers have solved these problems through systematic deliveries of gasoline and almost obsolescence-proof packaging of other products.[21]

Electrical appliance and radio business. In contrast to the service station operator, the owner of an electrical appliance and radio shop cannot safely neglect matters of price level, obsolescence, overbuying, and transportation. Demands for types and quantities of appliances differ greatly in various communities, influenced principally by one or more of the following factors: (1) size of average family income, (2) size of average home, (3) type of community—industrial, mining, urban, suburban, or farm, (4) extent to which electrical or gas appliances are used, (5) activity of the electric or gas utility in promoting the use of appliances.

In gauging consumer demand in a community, it is advisable for the beginner to consult the local banker, utility company, electric or plumbing contractors, and friendly competitors. The banker knows incomes and buying power of residents; the utility company knows the number and location of pro-

[21] Sevin, Charles H., in coöperation with the members of the petroleum industry (under the direction of Walter F. Crowder), *Establishing and Operating a Service Station*, pages 97–98. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 22, 1946.

spective customers. Contractors know consumers' needs; friendly competitors know many peculiarities of the community that they have learned from experience. These four sources have the background of knowledge and experience that beginners opening a new appliance and radio store lack, and which they badly need if they are to avoid mistakes in buying a stock of merchandise.

Cases that illustrate unexpected differences in consumer demand include an appliance company that had operated successfully in Washington, D. C., for several years before opening a store in Baltimore, only 40 miles away. The same type and brand of appliances were stocked, the same sales policy and methods of operation were followed in both stores. However, it was necessary to close the Baltimore store after two years because losses were so great. Consumer demand had not been analyzed. The average family income and buying habits were different in the two cities.

In addition to frequent reordering to maintain staple stocks, the proprietor may want to place orders for seasonal items and new models when these are introduced by the manufacturers. He may also decide to add new items to his stock from time to time in response to customer demand. Both in buying new models and adding new items the small shop owner should be guided by what his customers will accept rather than by his own preferences.

A study of alternative methods of transportation may be important to the shop owner because of the ease with which radios and electrical appliances are damaged in transit. Several choices may be available, including railroads, motor freight companies, and carloading companies, and possibly express, parcel post, and air express for emergency orders. Usually there will be differences in time required for deliveries, in the care with which goods are handled, and in the speed and fairness exercised in adjusting damage claims. Once the most appropriate transportation agency has been selected, it is well

to concentrate all possible business with one company and to play fair in all dealings with it.[22]

Restaurant. In the restaurant business cost of food is the largest expenditure. To it is allocated from 35 to 50 per cent of total income. Because of the perishable nature of food, and sanitary requirements, careful buying is of the utmost importance.

In deciding what and how much to buy, the following factors should be considered:

1. The menu.
2. Prices.
3. Geographic location, local habits, and food tastes.
4. Market supply.
5. Availability of seasonal and out-of-season goods.
6. Storage facilities.
7. Frequency of deliveries.
8. Inventory of staples.
9. Quantity and quality standard of the restaurant.

Once the general guides to be followed as formulated in accordance with the foregoing factors have been decided upon, actual purchasing should follow recommended practices relating to quality, quantity, and trade customs.

In each purchase the quality selected should be suited to the intended use. Products to be chopped up for salads, such as green peppers, need not be so uniform in appearance as those to be used for stuffing; a less expensive quality is satisfactory. Commercial grades have been established for all important foods and should be used in buying whenever practical. The grade indicates the quality of a product at the time of grading as compared to certain standards. In the case of perishables the condition at the time of sale may be different for products of the same grade. Some fresh fruits and vegetables, especially

[22] Parris, Donald S., and associates (under the direction of H. B. McCoy), *Establishing and Operating an Electrical Appliance and Radio Shop*, pages 55–56. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 28, 1946.

those grown locally, may not be graded before they are offered for sale. The food buyer must know enough about the goods he is buying to judge quality and condition for many of his purchases.

For many foods, especially milk and dairy products, the sanitary conditions under which they were produced and distributed are very important.

Buying should be done by specifications formulated in terms of commercial standards. A specification is a statement of particular in specific terms, for example: "peas—Extra Standard, 3-Sieve, Early June, No. 10 cans." Specifications will be used to define the specific variety and type of a product to be purchased so as to secure the exact quality desired when placing orders by telephone or with salesmen who call at the restaurant. Specifications and grades are useful both for comparing competitors' prices and for studying the yield obtained from different products. It will frequently be found that the best grade gives the greatest total yield and that the more expensive item on the basis of the unit of purchase proves the least expensive from the standpoint of cost per serving.

Successful food buyers prefer to purchase by weight rather than by quantity measures like bushel, box, bag, or crate. When count is used, size and minimum weight should be included for such items as citrus fruits, apples, tomatoes, and melons.

Small restaurants, even though ample storage space may be available, should aim to keep reserve stocks just large enough to meet normal requirements. Thus they may obtain satisfactory turnover and keep the risk of loss from spoilage to a minimum. Each type of product should be stored under proper conditions of temperature, humidity, and other variables.

Upon receipt, goods should be inspected for quality and checked for quantity by a competent person. Scales should be located in a convenient place so as to encourage their use. The vendor should be notified promptly of any products that do not meet the standards specified in buying.

Buying may be done by visiting the market, placing orders with salesmen who call at the restaurant, by telephone, or by mail. In smaller towns seasonal products grown locally may be purchased from farmers who call on the buyer with samples. Merchant truckers may be another good source of supply in many cases.[23]

Beauty parlor. Operating a beauty shop offers many opportunities for brand selection and for the purchase of profitable merchandise for resale. Supplies needed will be determined by the services to be rendered. One of the easiest ways to find out what will be required is to list, under departments, the various services the shop is to offer, and then to itemize the supplies necessary for each department. Also, it is advisable to consult catalogs of beauty shop suppliers. These catalogs present complete lists of supplies for all types of service. In the reference given at the end of this section a fairly complete check list of these supplies is presented.

The shop owner may buy from beauty supply houses or jobbers, mail order beauty supply houses, and from many manufacturers. Certain supplies, such as shampoo soaps and oils, wave-set solutions, nets, combs, hairpins, and other items in constant use, should be purchased in large enough quantities to take advantage of quantity discounts as well as to maintain adequate stocks on hand at all times.

In selecting cosmetics for resale it is advisable to choose a line that is complete as well as one that has an established reputation in the community. Such a line can be featured in the shop, can be made the source of repeat business, and is more economical to order and to handle.[24]

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[23] Bryan, Mary de Garmo, MacFarlane, Alberta M., and Hawkins, E. R., *Establishing and Operating a Restaurant,* pages 129–132. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 39, October, 1946.

[24] Gordon, Edith E., *Establishing and Operating a Beauty Shop,* pages 58–63. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 25, February, 1946.

In the preceding discussion little has been said about two aspects of purchasing in the small factory or service shop. Too many small operators buy supplies as needed at retail instead of arranging for their purchase at wholesale prices and planning needs well enough in advance to warrant such consideration. Often group buying is also possible. In several instances small non-competing shops have successfully pooled their buying of many items.

Conclusions

American businessmen have a wide range of choice available to them in purchasing materials, merchandise, and supplies. This fact often leads to overbuying, and to dissipation of the already limited buying power of the small business. Although good arguments may be presented in favor of distributing orders among many suppliers, *it is usually better policy for the small business to concentrate and work closely with one major resource.*

Moreover, for the small business buying is so often associated with valuable assistance from the supplier in many management activities that the importance of purchasing is further increased. Voluntary and coöperative chains in the merchandising fields enable the small independent to compensate for the buying power and headquarters aids of chain store competition. Relationships with resources for most businesses are fully as important as relationships with customers or employees.

Review and Discussion Questions

1. Discuss the relative importance in small business buying of quality and price alone, as compared to other considerations such as services rendered by various suppliers.

2. Compare the arguments for and against concentration in buying for each of the fields of small business. What conclusions do you draw from these?

3. Assume you plan to enter a particular kind of small busi-

ness. Describe how you would decide whether to diversify or to concentrate your buying.

4. What is meant by "relationships with resources"?

5. How, if at all, does the relative importance of buying and selling differ among the major fields of small business? Explain.

6. How do a small firm's relations with its resources vary in relative importance during periods of good times compared to periods of business depression? Why?

7. Which type of resident buying office would be better for a retailer just large enough to use either? Discuss.

8. If you were starting in a business where voluntary chains were in existence, would you prefer to affiliate with one or to "go it alone"?

9. Why have "voluntaries" not developed in the manufacturing or service fields?

10. Explain how buying and inventory control are: (1) more closely related, (2) less closely related, for: (a) manufacturing, (b) merchandising.

11. What additional discussion not included in the chapter would be of value to the small wholesaler? Explain.

12. From the viewpoint of member independent merchants in the same field, would you expect a corporate chain or a manufacturing wholesaler to be the more useful sponsor of a voluntary chain? Explain.

13. Why do retailers, but not manufacturers, add expected markdowns when calculating what goods are to be purchased during a certain period of time?

14. Explain each of the following as used in retailing: basic stock, model stock, check list, markdowns, style, fashion, staple goods.

15. Talk with several different men in one business about what factors each considers to be most important in buying. Analyze the results and report your conclusions.

16. Interview several retailers who are members of voluntary or coöperative chains as to the relative value to them of buying and

other services rendered by headquarters. Compare your findings with the comments made in this chapter.

17. Select some field of retailing in your territory not at present served by a voluntary, and describe how you would go about organizing and launching one.

18. Repeat the project of the preceding question for a field of manufacturing or service business, possibly giving emphasis to headquarters services in addition to economical buying.

19. What do you think of the opportunities for a qualified person to start a small business as a "voluntary" headquarters? Discuss.

20. List all the ways service establishments in various major groups (such as mechanical repair service shops, laundries, et cetera) could improve their purchasing. Discuss the list with businessmen in each field, and report your conclusions.

Chapter XIII

SALES PROMOTION

Probably no other function of business receives so much attention in business writings as sales promotion. Trade journal editors report an insistent demand by readers for material on this subject. There is always something new and fascinating in this activity, for there is no known limit to the ingenuity of ideas that may result in increased sales. Commendable as this may be, there are always certain dangers involved, among which the following are of special importance: Overemphasis on pushing immediate sales to the neglect of long-range objectives; misdirected efforts; and the slighting of adequate records, expense control, and planned results.

Modern business is highly competitive and customers go to the companies that seek them most intelligently and aggressively. This explains the widespread interest in sales promotion, which involves much more than just "promotion" as the word is commonly used. The expression "sales promotion" has a variety of meanings, some very broad and others narrow in scope. For our purposes the term will be used to cover methods commonly employed by each major field for the primary and specific purpose of increasing sales. With reference to their immediate objective these methods fall logically into two main groups, direct and indirect.

Direct methods include a wide range of special sales promotions, personal selling, merchandising aids by manufacturers, publicity, advertising, and display. Indirect sales promotional devices are represented by customer services, favorable cus-

tomer relations, product styling, packaging, and good public relations. Indirect methods pave the way for the increased effectiveness of direct methods. One of the latter, advertising, has been so highly developed that it is made the subject of the next chapter. Most of the others are considered here.

To be continuously successful sales promotion must be based on customer satisfaction, good customer relations, sound policies, and real value. Only when customer relations are the best will advertising and other direct sales promotional efforts be most successful. Effective sales promotion seeks to build good will as well as immediate sales.

Customer relations

Customer satisfaction is the basis for the continued success of all business; however, casual observation of a large number of companies, big and little, will show the extent to which this fundamental is neglected. A large part of good will, that intangible asset which may be worth anything from less than nothing to several million dollars, is the result of maintaining favorable customer relations. In big business this usually accrues to the company or brand name; in the small business personal attributes of the owner are of relatively greater importance. Good customer relations should be planned as carefully as any other major objective of the business.

An initial step is to define the company's customers so that proper steps can be taken to comply with their likes, dislikes, and interests. Coördination of policies and the activities based on them will be an important means of building and maintaining good customer relations. For example, if a small manufacturer's distribution policy aims to enlist the support of one class of customer, such as individual retailers, or a particular income group of consumers, it may easily be weakened by attempts in the company's advertising or publicity to gain the support of such other groups as chain stores or consumers in a different income class. Other ways in which securing the desired customer relations will involve different aspects or activi-

ties of the business include the following: training in proper customer attitudes for all employees who come into contact with customers personally, over the telephone, or through correspondence; strict observance of the company's product or merchandise guarantees; servicing the product after purchase when required; care and courtesy in handling customer accounts; efforts to provide conveniences and services desired by customers, such as parking facilities; prompt answering of all inquiries; and scrupulous care in observing delivery dates and other promises.

Modern management provides routines and channels through which information regarding customer relations is continuously obtained. Some of these will be impersonal, such as periodic analyses of returned goods and of customer complaints and correspondence, suggestion systems (including customer suggestion contests), and service shopping or other customer surveys; in addition, executives as well as salespeople and other employees have personal customer contacts. For effective use to be made of the latter, proper training in watching for customer attitudes and adequate incentives to report them are required. A western wholesaler in automotive accessories who started with a capital of $12,000 has built a very successful business on this policy of continuously training his employees in the art of customer services. After twenty years of stressing this objective the company still holds organization meetings each month to iron out difficulties that may have arisen and to stress the importance of service to customers.[1]

Merchandising

The small retailer's close personal contact with his customers provides many advantages in developing a well-coördinated program of sales promotion, since this should be based, here

[1] Small Business Aids, No. 201, U. S. Department of Commerce, "Factors in the Success of a Wholesale Automobile Accessory Concern Based on Service to Its Dealers" (Case Study). Washington: U. S. Government Printing Office, 1947.

as in other fields, on customer satisfaction and good customer relations. The right merchandise and services consistent with the store's policies, backed up by qualified personnel, competent salesmanship, and a suitable physical plant, furnish the framework for effective sales promotion.

Most of the retailer's problem in this area may be aptly summarized in the often quoted definition of good retail salesmanship, "selling goods that won't come back to customers who will." Improving the quality of retail salesmanship seems to be a never ending process. A recent survey of why hardware stores lose sales, conducted by the National Retail Hardware Association to help merchants in this field improve their selling, disclosed many shortcomings in the average hardware store salesman. Many lacked merchandise knowledge, were discourteous, and seemed unable to handle women customers satisfactorily.[2] In addition to utilizing results of such surveys made by his trade association, the small retailer can secure help in sales training from representatives of his suppliers and from the Distributive Education program in his community. Everything about the physical plant and equipment—its appearance, "atmosphere," air conditioning, proper lighting, attractive displays, absence of accident hazards, facilities for rapid, uncongested transportation between floors, and other conditions that contribute to customer comfort and convenience—will influence the clientele's attitude toward the store.

The care and courtesy exercised by non-selling employees will also contribute to the customer's attitude. Having merchandise delivered in good condition at the promised or expected time by courteous, neat-appearing employees using attractive delivery equipment is one example. Customer irritation may be reduced through proper planning by providing for such special situations as the following: what to do with "charge send" packages when the customer is not at home at

[2] Patterson, Constance, "How Sales Are Lost in Hardware Stores." *Hardware Retailer,* June, 1948, Vol. LXXIV, No. 6, page 150.

the time of attempted delivery; what procedure to follow on C.O.D. sales when the customer offers a personal check or does not have quite enough money to meet the payments but insists that she needs the merchandise at once. These are merely suggestive of the situations that may arise.

A common source of customer irritation is slow selling service. A Denver, Colorado, retailer solved this problem by getting a large number of his customers to trade in the store during the normally slack periods of early morning and late afternoon. Showmanship was used to put the idea across. "Green Light Hours" are the two periods in morning and midafternoon when all sales personnel are on the floor but customer traffic is light. Clever signs went up all over the store and in the display windows reading, "For the Best Service, At Kendrick Bellamy, shop 'Green.'" Below on the sign a clock face was reproduced with the words "Peak Rush Period" and "Best Shopping Period." For the "green hours" green wedges were painted on the clock face indicating the time limits within which customers could be sure of being waited upon quickly and with maximum efficiency. The signs began to create dividends immediately. Almost every customer stopped to read them and was ostensibly impressed. "The midday crowd began thinning out noticeably the first week," it was found, and soon there were almost as many customers during the afternoon "Green Light Hours" as during the midday rush. "The store is much more pleasant for salespeople and customers alike," a spokesman summed up.[3]

Alert retailers follow definite guides in their efforts to build favorable customer relations. One investigator compiled sixty of these, including the following:

1. We greet as many customers as possible by name.
2. We have a personal word or two with customers, when possible.

[3] "Keeps Traffic Flowing Smoothly." *Hardware World*, February, 1948, Vol. 45, No. 2, page 126.

3. We greet customers immediately when they enter the store even if we must keep them waiting before serving.

4. We take the greatest of care to assure the utmost courtesy in handling customers, even the difficult ones. All staff members avoid giving a flat "no" to a request for merchandise not in stock.

5. We give special consideration to the tired shopper.

6. We avoid the patronizing phrase "we can let you have" and use instead "we will see that you get."

7. We express genuine regret when unable to supply customer's requirements.

8. We consult customers regarding ways of improving service.

9. We refer customers to a competitor when we are out of an item and are not afraid to express praise of a competitor.

10. We will do favors for customers gladly, not grudgingly.

11. We pay special attention to newly married couples.

12. We study the methods used by chain stores and other stores in nearby towns and cities to see what methods can be adapted to our own store.

13. We maintain spacious aisles, not crowded.

14. We arrange merchandise to encourage self-selection.

15. We set up a self-serve section where it is feasible.

16. We review stock regularly to find out why certain lines are not selling.

17. We display odd and broken lines for quick sale and eliminate all old goods.

18. We add a certain amount of novelty merchandise to brighten up current offerings.

19. We bring prices into line with current competition.

20. We change window displays at regular intervals to avoid a "tired" appearance.

21. We keep making attractive innovations in the store, featuring one section after another to give customers something new to look at.

22. We make use of empty shelving for display purposes by use of display alcoves.

23. We maintain local advertising.

24. We join the organization of merchants for improvement of local merchandising, and to assist in local work.

25. We attend meetings of farm forum radio programs to keep informed on farmers' problems.

26. We influence town officials to provide parking space for farmers and others.

27. We avoid extremes in shortening store hours, having due consideration for farmers' and workers' shopping time.[4]

Although the small retailer is in close personal contact with his customers and thinks that he understands what they want, he may be wrong in this reasoning because (1) many customers do not express their wants or even dislikes and (2) potential customers may be avoiding the store for causes unknown to the merchant. It is good business to study surveys of customers' wants as well as to analyze causes of complaints.

Recent surveys as reported by *Hardware Retailer* point to some definite things that customers especially want:

Adequate parking.

Convenient method of returning goods.

Better salesmanship.

Participation in community affairs.

Attention to rural trade.

Large selection. Customers said they would gladly buy all their needs in their home town if the stores would carry the variety of items they wanted.

Convenient sales days. Many customers say that merchants, as a rule, do not place their sales days close enough to local factory pay days or days on which farmers get monthly checks from dairies, creameries, and so on.

Adequate telephone service.

Better circular advertising. A large number of customers have the idea that too many merchants advertise only inferior stock when they issue sales circulars.

Follow-up on promises. Every merchant at some time has had to tell a customer that he was temporarily out of an item. In such

[4] Adapted from Small Business Aids, No. 82, U. S. Department of Commerce, "60 Ways to Gain Goodwill." Reprint of Chapter 10 of *Your Own Store and How To Run It*, by Robert F. Chisholm, pages 69-72. New York: Thomas Y. Crowell Company, 1945.

a case, customers feel that the merchant should take their names and call them when the article is received.

The truth. Customers believe that clerks often do not disclose inferior quality.

Fair prices. Customers are willing to pay a slightly higher price to buy locally.

More attractive stores. Customers complain that too many stores are not clean enough, are poorly lighted, and have unattractive displays. Some say that when they ask for an article the merchant's stocks are so disordered that even he cannot find what they want.[5]

Many studies have been made relating to the causes of customer complaints. The following is a representative list of causes disclosed by such studies:

I. *Selling Department*
   1. Wrong merchandise
   2. Defective merchandise
   3. Merchandise left out
   4. Mistakes in price
   5. Misunderstandings of price
   6. No record of sales
   7. Order not filled
   8. Delay in filling order
   9. Overcharges due to error or claim of customer that goods are sold for less elsewhere
   10. Incorrect delivery or shipping instructions
   11. Merchandise out of stock
   12. Broken promises
   13. Improper alterations or repairs
   14. Failure to credit return merchandise

II. *Wrapping and Packing Departments*
   1. Wrong merchandise wrapped up
   2. Merchandise left out
   3. Sales check lost
   4. Improper wrapping, marking, or addressing

[5] Adapted from Small Business Aids, No. 45, U. S. Department of Commerce, "What Do Customers Want?" Condensed from "What Do Customers Want?" by Al P. Nelson. *Hardware Retailer,* September, 1946, Indianapolis, National Retail Hardware Association.

5. Delay in wrapping
6. Damaged in wrapping

III. *Delivery*

1. Delay in delivery
2. Loss in delivery
3. Damaged in delivery
4. Delivered to wrong address
5. Packages sent which should be handled as "will call"
6. Failure to make wagon call as promised
7. Goods lost in transit
8. Overcharge or error on C.O.D. sales
9. Complaint about driver; lack of courtesy or attention

IV. *Accounts and Records*

1. Goods charged or credited to wrong account
2. Errors in billing
3. Remittances not promptly acknowledged
4. Bills sent which have been paid
5. Failure to change address when notified
6. Bills sent in wrong envelopes
7. Cash credited to wrong account
8. Correspondence not promptly or correctly answered
9. Dunning letters sent when claim is pending
10. Credits not entered for goods returned
11. Mail incorrectly addressed
12. Refusal of credit in error
13. Goods sent C.O.D. instead of charge
14. Statement sent in error

V. *Miscellaneous*

1. Lack of courtesy or attention
2. Goods sent but not ordered
3. Not at home for package
4. Poor telephone service
5. Poor mail order service [6]

These surveys are interesting, but the small retailer is more

[6] Small Business Aids, No. 227, U. S. Department of Commerce, "Causes of Customer Complaints." Condensed from "Retail Store Service." From Nystrom, Paul H., *Retail Store Operation,* Chapter 16. New York: Ronald Press Company, 1937.

concerned with complaints made by his customers. One merchant had been using a "man on the street" type of radio program for the rural trade in front of his store on Saturdays with apparent success. When discussing this advertising before a group of his regular customers, he was surprised to find that it had annoyed them to the extent that many had already shifted their patronage. After further investigation the program was abandoned because of the numerous complaints from present, former, and potential customers, many of whom would not have taken the trouble to volunteer their objections.

Since the salesperson occupies a key position in maintaining good customer relations, even the small businessman should check his sales force periodically, using some such guide as the following:

1. The way the salesperson approaches the customer.
2. The appearance of the salesperson.
3. The way the salesperson sizes up the situation.
4. The way the salesperson acts upon the situation.
5. The salesperson's actions in the selling situation.
6. The salesperson's action when closing the sale.
7. The salesperson's manner.
8. The non-selling side of the salesperson's business.[7]

Wholesaling

In a survey of retail druggists made recently it was found that good service and favorable relations with customers were more important factors in causing merchants to buy than were low prices and large discounts. Top-ranking reasons for patronizing their major wholesaler were given as follows: quicker deliveries, bought from him for years, fewer shorts, more interest, like salesmen, like house employees. The same survey disclosed as one of the chief complaints that wholesale sales-

[7] Small Business Aids, No. 32, U. S. Department of Commerce, "Points to Check in Your Sales Force." Reprint of "Do Your Salesmen Need Reconverting?" by Leslie Lincoln. *Your Business,* July, 1946, Philadelphia, Liberty Distributors. See also additional references in the bibliography at the end of the book.

men lacked knowledge in pharmaceuticals, drugs, chemicals, and other related items. The salesmen also needed above all, according to the survey, *training in retail sales promotion;* next in importance was training in "deals," stock prices, product knowledge, and retail store management, as well as an interest in retailing.[8]

The importance of the "human element" in customer relations of the hardware wholesaler was aptly expressed in a booklet by the Southern Wholesale Hardware Association. Retail customers have learned to respect the wholesaler's judgment as to the lines of merchandise best adapted to the retailers' territories and to place confidence in the advice and recommendations of his salesmen. Whether it's a long-established line of merchandise or something new and untried, the determining factor in the retailers' decisions is likely to be the recommendation of the wholesaler and his salesmen.[9]

In a survey by Dun & Bradstreet covering retailers' preferences and practices in the distribution of dry goods, 46 per cent expressed interest in wholesalers' plans to modernize the store, to set up basic competitive stocks, and to follow a planned merchandising and promotional program based on close teamwork with the wholesaler. The majority favored selective distribution, even among the small store group. Preference for nationally advertised brands on a quality and style basis over unbranded merchandise on a price basis rated a 70 per cent majority vote. About 14 per cent of the retailers faced with loss leader competition, or selling by competitors of certain items at abnormally low prices, look to their suppliers for

[8] Small Business Aids, No. 165, U. S. Department of Commerce, "What Retail Druggists Want From Their Wholesalers." Condensed from "The Wholesale Drug Salesman," a report by Dr. H. C. Nolen and Claude L. Smith before the 1946 convention of the National Wholesale Druggists' Association, held on September 23–26 at Atlantic City, New Jersey.

[9] "The 'Human Element' in Marketing," page 15. From the booklet *Hardware Wholesaling,* Southern Wholesale Hardware Association. Atlanta, Georgia: W. R. C. Smith Publishing Company, October, 1947.

defensive assistance, although not necessarily for competitive loss leaders.[10]

Wholesalers in other fields have experienced a similar need for assistance by their retail customers. One coöperative study found the principal cause of failure among 15,000 retail candy and confectionery stores to be lack of sufficient advice and assistance from their wholesale salesmen. The merchants needed help on store management, especially with reference to advertising, display, buying, stock control, and sales promotions.[11]

Manufacturing

Small manufacturers may sell direct to final consumers, to dealers, or to both types of customers. In either case the following suggestions for the factory owner, selected from Small Business Aids, No. 81, will be helpful:

1. Are telephone calls answered promptly and courteously?
2. Are telephone inquiries brushed off with the old "I'll call you back" excuse, only to have the call never returned?
3. Is it possible to obtain price information by telephone without long waits and some impatience on the part of the employee who answers? (It might be well to make a test.)
4. Are letters answered promptly?
5. Are letters answered fully? (Send your own company a letter asking two questions. When the answer comes, see if it ignored one question.)
6. Is it possible to obtain accurate information of deliveries to cus-

[10] Small Business Aids, No. 350, U. S. Department of Commerce, "Retailers' Preferences and Practices in the Distribution of Dry Goods." Adapted from "Retailers' Preferences and Practices in the Distribution of Dry Goods." *Survey of Dry Goods Distribution,* prepared by Marketing and Research Service, Dun & Bradstreet, Inc., for The Wholesale Dry Goods Institute, Inc., New York.

[11] Small Business Aids, No. 409, U. S. Department of Commerce, "How the Candy Wholesaler Can Increase Retail Sales." Condensed from "Balanced Selling—A Guide to Master Salesmanship for Wholesale Candy Distributors." Unit Eight—*Creative Retail Selling.* Published by The National Confectioners' Association, Chicago 2, Ill., in coöperation with the Business Education Service, U. S. Office of Education, Washington, D. C.

tomers, shipping dates, or similar information from your employees?

7. Do your salesmen answer inquiries promptly and intelligently?

8. How do your truck drivers and deliverymen act toward customers? If you don't check this point, your customers may be leaving you for one of your competitors.

9. Does it make your credit department angry, and do they show it, when a customer slips slightly behind in his payments?

10. Is it common talk among the trade you serve that you favor the bigger buyers and neglect the little fellows? [12]

The small manufacturer can make especially good use of informative labels, if they are appropriate to his products, in building both dealer and consumer good will as well as in supplying salesmen with selling facts. The big concern may accomplish these objectives through extensive publicity and training programs not available to the small operator. The large firm may have a tremendous investment in past advertising featuring the brand name or particular selling points that would not be well suited to the use of informative labels, but the small manufacturer "on the way up" has no such restrictions.

One feature of the informative label that recommends its use to the small manufacturer struggling to establish a favorable reputation for his product is that salespeople do not always tell the customer how to use and care for a product and the customer sometimes forgets even when told. Extensive experience with the use of informative labels shows that they increase the proportion of customers who buy better-quality products. This helps the small producer with a superior-quality product to overcome some of the effects of extensive advertising by large competitors.[13]

[12] Adapted from Small Business Aids, No. 81, U. S. Department of Commerce, "Customer Relations Checklist." Condensed from "Customer Relations Checklist." *American Business,* October, 1946, Chicago, Dartnell Publications, Inc.

[13] Small Business Aids, No. 232, U. S. Department of Commerce, "Informative Labels Do a Job." Condensed from "Informative Labels for Extra Sales Allure." *Modern Industry,* March 15, 1947, New York, Magazines of Industry, Inc.

The small manufacturer should make the most of the fact that he is more dependent than the big producer upon the effectiveness of his personal selling force and close relations with his customers. The large company can do more of the selling job by means of extensive advertising.

Even small manufacturers will have customer complaints, suggestions, advice from employees and outsiders, and other records or sources of information from which ideas for sales promotion may be secured. In the very small factory the owner may be close enough to his business to keep informed about all complaints. The problem then is to be willing to accept the complaint as an opportunity for improvement and to take appropriate action. For example, if a customer remarks that a $2.00 kitchen gadget is unattractive, the manufacturer, who probably designed it himself, may resent the comment and react by saying, to himself at least, "What does she expect for $2.00, the Academy Design Award?" Possibly further inquiry and a little experimenting with a more attractive finish or styling would meet the objection and greatly increase sales.

In the average plant or other small business many valid complaints may not come to the attention of the owner unless provisions are made to insure that they do. Experience shows that a systematic procedure in handling complaints is desirable.

Good complaint handling by any company entails three steps: (1) making rapid and reasonable adjustments; (2) gathering facts about the complaints; and (3) using the facts to improve production and operational methods. One food company, merchandising a product of low unit cost, adjusts all complaints directly and quickly by multiple replacement (sometimes double the original quantity, often more) of the product.

A single complaint may not be significant, but a concentration of complaints on a single subject is almost certainly so. Various methods are used to ferret out concentration, such as encouraging dealers and salesmen to pass on product complaints to the manufacturer. Forms for easy forwarding of

complaint information may be supplied to them and to customers.

Repeated experience shows that unless a company obtains, analyzes, and acts upon the facts about its products and service that a good complaint system turns up, a significant opportunity for good sales promotion is being missed.[14]

Service Business

Selling intangibles like services has long been recognized as more difficult than selling physical goods. Often it is difficult to convince customers of their need for the service and to prove to them that it has actually been performed. Many small automobile repair shops have a worn parts panel. Customers can actually see how bearings, breaker points, and other parts of their car look after considerable wear. It is then easier to "sell" prospects on the need for installing new parts, as well as on the importance of preventive maintenance. Radio repair shop operators often keep the replaced parts to show the owner why it was necessary to replace them and as partial proof that new parts were actually installed.

Since services are performed upon the person or property of the customer, the qualifications of the operator are important to patrons. When life or health may be endangered, state laws usually restrict practice to those of proved competence. Signs displayed in the shop assure customers that all operators are certified to be competent. Even in fields where laws do not require such certification many service operators employ this device for promoting sales. Examples that might be cited include AAA approval signs in hotels, tourist courts and restaurants; United Motor Service signs in auto repair shops; and Master Barber certificates in tonsorial establishments.

The Brant Radio Company handled radio sales and repairs

[14] Small Business Aids, No. 49, U. S. Department of Commerce, "Making the Most of Complaints." Condensed from "How to Turn Minuses Into Pluses." *Modern Industry,* September 15, 1946, New York, Magazines of Industry, Inc.

and succeeded in an intensely competitive community by offering specialized services under the direction of a "Graduate Radio Engineer." Customers were handled more like patients in a medical clinic than like visitors to a radio repair shop. When the customer brought in his radio, an invoice slip was made out showing the usual information concerning the customer's name and address, type of set, and so forth, but in addition general tests, special tests, and services that the company provides were listed. The customer was then interviewed and asked questions about how the set behaved. This information was placed right on the slip as an aid in determining the trouble. If the customer had time, preliminary tests were made in his presence. This approach impressed the customer with the company's scientific methods.

When customers return to the store to pick up their repaired sets, they don't like to wait while the set is located. To speed up this process, the Brants used a simple but effective method. When a set was repaired, it was placed in a numbered bin ready for pickup and the bin number was marked on the working copy of the invoice form. When the customer presented his copy of the invoice form, it was checked with the one on which the bin number was shown. The attendant then went to the bin immediately and got the set. The customer's waiting time was cut down considerably.

Because these special services had been emphasized throughout the several years of the company's existence, sales volume increased steadily. Despite the fact that the Brant Company handled only radios and radio repairs, the competition of businesses that sold other electrical products as well as radios did not detract from its sales. By emphasizing laboratory techniques and knowledge of radios, the Brants capitalized on their specialization in this field.[15]

[15] Adapted from Small Business Aids, No. 18, U. S. Department of Commerce, "Stimulating Sales in a Business Limited to Radio Sales and Repair in a Highly Competitive Area" (Case Study). Washington: U. S. Government Printing Office, 1946.

Another aspect of promoting the sale of services is the importance many customers attach to little "extras." Hotels often find that a flower for lady guests or a free newspaper for the men pays big dividends in greater spending and repeat business.

Goss Brothers Frozen Food Lockers is a proprietorship operated by Mr. John Goss with five employees. The plant is centrally located on one of the busiest thoroughfares in Portland, Oregon, within one block of the city's buying center. Its customers are principally homeowners living in the neighborhood. As a means of retaining customers the company has added such promotional specials as rent-free space to residents while repairs are being made to home equipment, meat curing facilities, and emphasis on cleanliness and appearance; and attention is called to savings on quantity purchases.[16]

Harry James, head of Roswell Laundry and Dry Cleaning Company, builds good will while he helps motorists extend their parking time. Sometimes a driver returns to his car and finds added time on the meter. He also finds a card stating: "In passing, our representative noticed that time had expired on your parking meter. He inserted a nickel, saving you a one-dollar fine, and the disagreeable task of paying it. This is a courtesy of: Roswell Laundry & Dry Cleaning Co." [17]

In other places in this text the great importance of the *quality* of service rendered has been mentioned. In promoting sales this fact should be stressed at every opportunity. A recent survey by the Drycleaners Institute of Detroit found that better quality of work was ranked first in order of importance by 51 out of 100 customers, lower prices by 29, and faster service by 10.[18]

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[16] Adapted from Small Business Aids, No. 316, U. S. Department of Commerce, "Promoting the Rental of Food Locker Space in an Urban Center" (Case Study). Washington: U. S. Government Printing Office, 1947.

[17] "Selling Points." *American Drycleaner,* June, 1947, Vol. 14, No. 3, page 99.

[18] "What Customers Want." *American Drycleaner,* June, 1947, Vol. 14, No. 3, page 92.

Quality is important in the work performed by the service establishment, but the business must not stop at quality service: it must have quality salesmanship state honestly that the business desires to please the customer.

Salesmanship for the service establishment as well as for the retail store requires that the salespeople understand the working of the business. Even the stenographer who answers the telephone in a plumbing firm should be able to give the approximate time necessary to complete a repair job and should be instructed in the use of an appointment book. The salesman, whether in the office or doing delivery work, should be able to give a good sales talk. Any changes in prices or any "special" for the week should be immediately relayed to all employees.

Special Aspects of Sales Promotion

Without increasing his expenses a small businessman can promote sales through free publicity, timeliness, displays, special sales, and other means.

An alert businessman will use publicity to impress his public with the fact that he is continually seeking ways to give them better service. Dry cleaners in towns all over the country who attend the national convention to learn about new methods have their home town newspapers carry news items to this effect.[19] An apparel store in a southwestern town of 13,000 is operated by a man and his wife who make several trips to market each year. News items in the daily paper always report these trips with comments regarding the fashion showings to be attended. When the store became affiliated with a Los Angeles buying office a few years ago and the wife attended showings of California designers, the local newspaper publicized this step forward. Later, when their display director received high honors in a southwestern display convention in

[19] "Selling Points." *American Drycleaner*, June, 1947, Vol. 14, No. 3, page 99.

Dallas, the award was given ample free publicity to impress the "home folks" with the progressiveness of the store personnel. When the owner-manager of a small retail-wholesale jewelry business in the same town took several weeks away from his business to attend a school for advanced training in watchmaking and repair work, the paper carried an account of this fact and all employees in the store found ways to comment favorably on it to customers. Many local broadcasting stations have home town news periods on which the activities of small businessmen and their employees are reported. A company picnic for employees, the promotion of John J. Jones, Jr., from salesman to buyer for the store, a new machine for testing radio sets installed in the local repair shop—these and similar items should be reported by the small businessman to his local paper or radio station. But they must be items of real news value even though the reason for giving them publicity is to keep the name of the business before the public in a favorable light.

An interesting example of the power of publicity may be seen in the case of a woman who had been making artificial flowers in her home two miles out of town on a main U. S. highway. A news release written about her by a reporter for the local newspaper was picked up by A.P. and reprinted in hundreds of newspapers throughout the country. Letters and orders began pouring in, and within a few weeks it was necessary to buy land across the road to construct a new "factory," secure a business manager, start training employees to do the actual production, have form letters printed to answer the avalanche of inquiries and orders, start the process of taking out domestic and foreign patents on the production process, adopt a brand or trade name, and begin seeking advice on the methods used by big business. All this was accomplished without the expenditure of one penny for advertising.

One aspect of successful promotions is their timeliness, either when planned in advance for certain days or seasons or when opportunistic in capitalizing on some unexpected development.

Merchants have available to them calendars of promotional events prepared usually by the trade association in the field several months or more in advance, giving all important dates likely to be useful in staging promotions. Most of these are published in trade journals and in dealer material released by wholesalers' Merchants Service Bureaus. The National Retail Dry Goods Association Sales Promotion Calendar is published in the fall for the entire coming year and may be purchased from the Association.

Sometimes the kind of business provides seasonal merchandise for timely promotions regularly throughout the year. Feed dealers time their promotions with the planting, cultivation, or marketing of customers' (farmers') products; auto accessory stores time their promotions to the weather and the popular use of the family car.[20]

Games and contests primarily of local interest afford opportunities for timely tie-ins, often through displays in the small business. High school or local college football and basketball games are of this type. A score board displayed in the store may keep customers informed on the progress of the game. Some merchants place a radio in the store for customers to hear reports of important games that are broadcast. Local elections and other political campaigns often arouse intense interest. Many small stores, shops, and newspapers attract customers by reporting election returns or other events likely to have a bearing on the outcome of such contests.

Another group of promotional ideas, such as anniversary sales, relate to the company itself. The established business should keep records of each promotion and consult them in

[20] Small Business Aids, No. 97, U. S. Department of Commerce, "Suggestions for Seasonal Sales." Condensed from "For Alert Feed Dealers—Suggestions for Seasonal Sales," by Edward Case. *Feedstuffs*, August 24, 1946, Minneapolis, Miller Publishing Company; Small Business Aids, No. 53, U. S. Department of Commerce, "Market Analysis and Sales Planning by the Automotive Dealer." Condensed from "Plan Your Profit—Profit by Your Plan," by Ray W. Booth. *Automotive Retailer*, May, 1946, Morristown, N. J., H. F. Ohmeis.

planning future events. Contrary to popular belief, previously successful promotions of a seasonal or recurring nature are more likely to be effective when repeated than are entirely new ones. Each new promotion is an experiment that may or may not prove successful. Since the customers of one store do not change greatly from year to year, an event that has proved its appeal to the customers once is very likely to succeed several times more. Of course details may be changed, but the basic idea of the promotion will remain the same. This should not discourage careful experimentation, but it should be a warning against seeking change merely to be different.

The range of themes or ideas useful in building sales promotions is unlimited. Each issue of the trade journals contains suggestions. *3033 Retailing Ideas,* a compilation of successful events compiled and published in 1946 by Emanuel Lyons, Pittstown, New Jersey, is a regular encyclopedia of stimulating ideas from nearly every field of retailing.

A useful approach to planning sales promotions is to follow a check list of steps to be taken to provide for all details and proper timing. Important points, even the obvious ones, should be included:

1. Opening and closing dates.
2. Name of promotion and any explanations needed.
3. Merchandise to be featured.
4. Complete plans for advertising and window and interior displays, seeking coördination of media and use of all appropriate devices—signs, price cards, window streamers, banners, special layout, and display.
5. Organization plans—staff meetings, employee incentives, and provisions for extra help or special training.[21]

[21] Small Business Aids, No. 271, U. S. Department of Commerce, "Check List for Planning a Store-wide Promotion." Condensed from "Appendix 1.—Check List for Planning a Store-wide Promotion," by Roscoe R. Rau and Walter F. Shaw. *Selling Home Furnishings,* Vocational Division Bulletin No. 216, Federal Security Agency. Washington: U. S. Office of Education, 1941.

Often ideas developed by large city stores can be used to advantage by the small store, such as having customer juries select 100 perfect gifts for Christmas from the store's offerings.[22]

Every store will at times have some slow-selling items that can be sold through proper promotions before they result in a loss. The following methods are useful in the order stated: (1) showmanship, (2) bargain atmosphere, (3) reduced prices. Several methods in each group selected from Small Business Aids, No. 298, are presented to suggest the possibilities in this approach.

1. Mass-display the product at the best traffic spot, even if it means separation from other brands of like classification.

2. Give a premium with large quantity purchases of specified "cats and dogs." One retailer offered a scarce aluminum cooking utensil at cost with each $5.00 purchase.

3. Use hanging banners and pennants, strung from wall to wall, to promote shelf-warmers.

4. Place arm bands, bearing red question marks on all clerks. Clerks then tell inquiring customers about special offerings.

5. Emphasize slow movers on the shelves with differently colored price tags.

6. Focus colored spotlights on special mass displays.

7. Advertise that customers get a package of the featured item free if a clerk forgets to tell her about it. This makes both consumers and employees conscious of the product.

8. Offer free movie matinee tickets with every quantity purchase of shelf-warmers. These tickets usually can be bought by the roll at reduced prices from the neighborhood movie.

9. Pile "cats and dogs" in bushel baskets placed at traffic spots. Change baskets daily.

10. Mass-display full cases, offered at discounts of 5 per cent or 10 per cent on case lots.

11. Sell a "pig-in-a-poke" bag of slow movers for 49¢.

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[22] Small Business Aids, No. 267, U. S. Department of Commerce, "Store Jury Selects 100 Perfect Christmas Gifts." Condensed from "Selects 100 Perfect Gifts to Simplify Shopping." *Printers' Ink*, November 15, 1946, New York, Printers' Ink Publishing Co.

12. Tell the truth in advertising or display material. Say "I want to get rid of this stuff, so here's a bargain"; "We made a mistake and bought too much. Take some away and we'll give you a bargain"; "The quality is good, but we no longer can get this brand. Clean out what's left."

13. Advertise "certified bargains." Produce the original bills showing what you paid for goods now offered as bargains. Also show what you charged for them previously.

14. Gather all items that can be offered at a uniform price. Emphasize: "Look what 19¢ will buy," or "Look what 10¢ will buy."

15. Hold a penny sale like "One can for 18¢—two for 19¢."

16. Put slow movers alongside of fast movers. Contrast the two by sharply cutting prices of the merchandise you are trying to move.

17. Advertise "Surprise Sales." Whenever a crowd gathers in the store announce that, "For the next ten minutes, the such-and-such shelf-warmer will be sold at half-price."

18. Set up an automatic price system. Keep reducing prices by a fixed percentage every week until the merchandise is sold.[23]

Conclusions

The broad field of stimulating increased sales may be divided into three areas: customer relations, special sales promotional ideas, and advertising.

Any effort to increase sales is more effective when relations between the business and its customers are favorable. Very often sales promotion or advertising ideas that have been successful in one business are failures in another because the "environment" is different. A news release that Mr. Jones is attending the district convention of a big oil company will interest many people who will later come in and discuss the trip with him while having their car serviced. A similar item reporting Mr. Smith's trip to the laundry convention may arouse such comments as, "Well, it's about time Smith snapped out of it—I hope he learns something at the meetings."

[23] Small Business Aids, No. 298, U. S. Department of Commerce, "Some Ways to Sell Shelf-warming Food Items." Condensed from "40 Ways to Get Rid of Cats and Dogs." *Food Topics*, April 7, 1947, New York, Topics Publishing Co., Inc.

In most small businesses the sales personnel, including the owners, are very important in determining how favorable relations with customers will be. Most of the effectiveness of advertising or other special promotions that may be undertaken can be destroyed by poor quality of salesmanship. Consequently, our approach has been to emphasize first conditions that influence the customers' attitude toward the store, including quality of salesmanship. Next, a few ideas to illustrate various special aspects of sales promotion have been considered. The important sales promotional tool, advertising, as it can be used by the small businessman, is discussed in greater detail in the next chapter.

Review and Discussion Questions

1. Why are good customer relations of greater importance in sales promotion than in other activities?

2. How do you account for the fact that the trade press gives so much attention to sales promotion?

3. Is sales promotion, including advertising, of greater importance to the merchant, the manufacturer, or the service operator? Explain.

4. How, if at all, does sales promotion differ for each of the three major fields of small business?

5. State frankly your own opinion as to the importance of good customer relations in determining the effectiveness of sales promotional efforts.

6. Why is it no longer possible for any business to succeed without sales promotion?

7. Select several types of services and analyze each for sales promotion themes, using the major marketing instruments as a guide.

8. Examine recent editions of your local newspaper for publicity releases concerning small businessmen. How were they presented? What impression would they have on the reader's attitude toward the business? How could they have been improved?

9. Listen for similar news items broadcast over your local radio

station. Compare them with the newspaper releases as to probable effects on the public and as to opportunities for improvement.

10. For some kind of small business of particular interest to you, name four or five unusual ideas that could be used for effective sales promotion.

11. Do the same as in question 11 for topics suitable for local publicity.

12. In view of the fact that most producers who have adopted informative labels up to the present time are large concerns, evaluate the statements made in the chapter that the small business is in a better position than the large firm to make maximum use of informative labels.

13. Select some product suited to manufacture by a small firm and write out an informative label for this product.

14. What are the special problems and needs of the small wholesaler that might be at least partially solved by sales promotion, including better customer relations? Discuss.

15. Do you think the average small businessman can make effective use of survey results obtained by the trade association in his field? Explain.

16. Is personal selling or advertising more important to the small business? Discuss and give concrete examples.

Chapter XIV

ADVERTISING FOR PROFIT

Profit-minded businessmen use advertising because it is a cheaper, quicker, and more convincing way to increase sales than alternate methods. Advertising deals with the presentation of a message to particular groups impersonally or through mass media. Although advertising has been referred to as an area in which big business has many advantages, it can be a powerful tool for the small businessman too. Because the same message is presented to the entire membership of certain groups, each detail of an advertisement is magnified in importance. One basic rule of effective advertising is to recognize the importance of details.

Since advertising is a message to a group of people, a second principle is to aim your shots. Careful selection of the logical prospects for a particular advertisement should be one of the first steps in planning. The message or theme and its form of presentation in copy, illustration, and layout, as well as the appropriate media to use, all depend primarily upon the particular group to be reached by each advertisement.

Before buying a new car, refrigerator, radio, or any other article involving a considerable investment, the average businessman makes some effort to be certain the article is the best obtainable for the price. A great deal of advertising would be much more effective if the same businessman exerted equal effort to make certain the object of his advertisement is right before promoting it. The third principle is to make it right *before* advertising.

Probably the greatest single waste in modern advertising re-

sults from the careless preparation of many advertisements and campaigns. Much current advertising is ineffective. Recognition of this fact has led an increasing number of businessmen to take steps toward testing and measuring the effectiveness of their advertising. Keeping adequate records of all advertisements, including weather and other relevant conditions at the time each is released, and of traceable results is important. Some beauty shop operators make a practice of asking each new customer how she happened to come to the shop. An analysis of these results as a basis for planning future advertising increases the number of successes and reduces errors.

In certain cases it is possible for the small businessman to pretest advertisements before they are released on a large scale. This may be done by using a less expensive, more easily controlled medium like display, handbills, or direct mail circulars to improve the effectiveness of different elements of the advertisement before completing it in final form for use in such media as newspapers. Another plan is an adaptation of split run testing as used by national advertisers. If the element to be tested is the headline, one half of a sample mailing will receive the circular with one headline and the other half with another. On the next mailing the "heads" will be reversed. Results of each mailing will be carefully recorded either by inquiries received or by calls in the store if a retailer is working the test. Comparison will show which headline is the more effective. Copy, illustration, or the theme to use may be tested in a similar manner.[1]

Two types of advertising are recognized, according to primary purpose or objective, as institutional (selling the business) and direct action (selling the merchandise, product, or service the business has to offer). Both are necessary, although the small businessman will usually devote most of his limited advertising funds to the promotional or direct action type.

[1] Bieru, Helen Guild, "Copy-Testing Technique for Small Rural Store." *Journal of Retailing*, April, 1947, Vol. 23, No. 2, pages 38–42.

Selling the business and selling the goods are in many respects similar. Some businesses will wish to sell all the many things there are about a business to be sold; others will emphasize only one or a few. Many successful firms have been built with the latter method. Some of the business attributes that advertising sells are:

Services	Courtesy	Prestige	Price
Integrity	Long record	Location	Quality
Brands carried	Credit terms	Size	Fashion policies

Some businesses seek to set themselves up in the public mind as possessing all virtues. As this is difficult to do, the wise business operator stresses one or two at a time. Likewise, in presenting merchandise it is easier to convince the prospective buyer that it has the one or two outstanding things he really wants than that it is the paragon of all virtues. This is an application of the principle, "Aim your shots."

Basic factors to consider

There are several basic factors a small businessman in particular should bear in mind about advertising:

1. Advertising is much more than simply laying out an effective advertisement or writing a clever sales talk.
2. The kind of advertising that is best for some types of businesses may not be right for others.
3. Money can be wasted in advertising by failing to have adequate information about potential customers, by lack of experience or judgment, by spending too high a proportion of gross income, by lack of adequate planning, and in other ways.
4. Finally, the purpose of advertising is to sell or help to sell. Advertising that doesn't do this, directly or indirectly, should be avoided.

Although an advertisement should be regarded as the end result of considerable research and planning rather than the starting point of advertising, it is advisable to know in advance

what each advertisement is expected to accomplish. The following list is a test to use in checking each advertisement before it is released that will enable the advertiser to preview such requirements.

An Advertising Check List [2]

(To appraise effectiveness of retail advertising)

This advertising check list was worked out for appraising the effectiveness of retail advertising. Copy which gets 70 points or better has proved to be satisfactory. Sample checking of your advertisements against this table occasionally is suggested.

		Rating
1.	Does the headline contain news value?	15
2.	Is there a promise to the reader's self-interest?	15
3.	Is there an appeal for direct action?	10
4.	Is the advertisement of proper size for the importance of the offer and for its most favorable presentation?	10
5.	Is the advertiser's signature clearly displayed?	5
6.	Is the merchandise or service mentioned in the headline?	3
7.	Does the headline include the name of the firm?	2
8.	Does the illustration show the merchandise or service in use?	5
9.	Does the illustration invite the reader to project himself into it pleasantly, profitably, or favorably?	3
10.	Does the lay-out locate elements logically and eye-invitingly?	5
11.	Is the lay-out exciting or attention compelling?	3
12.	Does the copy tell what is new, different, or better about the merchandise or service, especially from the style angle?	3
13.	Does the copy inspire enthusiasm for the merchandise or service?	3
14.	Does the copy have a definite ring of truth and sincerity?	5
15.	Does the copy tell the merchandise or service is priced to save money?	2
16.	Does the copy tell that the product is guaranteed, lasting, and gives good service?	3

[2] Small Business Aids, No. 278, U. S. Department of Commerce. Condensed from "Appendix F—An Advertising Check List," by Roscoe R. Rau and Walter F. Shaw. *Selling Home Furnishings*, Vocational Division Bulletin No. 216, Federal Security Agency. Washington: U. S. Office of Education, 1941.

17. Does the copy develop and appeal to price? 2
18. Does the copy or illustration imply the merchandise increases sex appeal? 3
19. Does the copy tell why the merchandise is so priced? 1
20. Does the copy tell of the seasonal appeal of the merchandise? 1
21. Does the copy describe the merchandise or service with reasonable completeness? 2
22. Does the copy indicate a personal loss for not buying or using the product? 1
23. Are all negative thoughts connected with the product eliminated from the copy? 2
24. Does the copy indicate enthusiasm of users, such as testimonials? 2
25. Does the copy bring out superiorities of the merchandise or service over competitive products? 1
26. Is the urge to action repeated three times—in the heading, in first paragraph, and in closing? 5
27. Is the price displayed so it will command sufficient attention? 3
28. Is there a free deal, free offer, free trial, or something free included? 3
29. Have all details to facilitate action been included? (Phone number, order blank, store hours, mention of air conditioning, parking, etc.) 2

The groundwork for advertising

The first step in advertising, as in anything else, is to do the groundwork. A businessman can begin by asking himself these questions:

1. Who are my potential customers?
2. How many are there?
3. Where do they live?
4. Can they get to me conveniently?
5. Should I plan to deliver to them?
6. Are they the kind of people who want charge accounts and delivery service?
7. Where do they now buy the things or services I want to sell them?
8. Can I offer them anything they are not getting now? What? How?
9. How can I convince them they should do business with me?

A businessman should never cease to "survey" or study his customers. Neighborhoods and customers' habits change. If a customer drifts away, he should try at once to find out why.

Consumers may not realize a need for certain products until "educated" by advertising. This is generally true of new products, for which extensive pioneering advertising may be required. It is sometimes true for any new business unit, and this explains in part why advertising expense is higher during the first few years. But if consumers do not want a product or service, advertising alone cannot *make* them buy.

Advertising has a cumulative effect. Response is slow at first but increases with time. Sporadic splurges rarely pay. It is much better to advertise regularly and continuously on a small scale than to use even large advertisements infrequently. Advertising is like a freight train, slow in getting started but gathering momentum as it goes.

Most firms "merchandise" or sell their advertising to their own personnel as a steady diet. Road salesmen, for instance, should be convinced that the firm's advertising helps them make more sales more easily.

How much to advertise

Determining the right amount to spend for advertising is important because this expense often ranks among the highest. For the small business it is especially important that limited funds be used to the best possible advantage. Once the amount available for advertising is decided upon, a more intelligent campaign can be planned covering such factors as items to promote, prospects to seek, media to use, and frequency of releases.

For a business in an established field, operating ratios are valuable guides in determining how much to spend. Table 11 gives the percentage of net sales spent for advertising by nearly 50 lines of retail business. However, these are guides, not absolute standards. Many profitable stores and shops spend more than the standard for their fields. The correct amount of

TABLE 11 [8]

PERCENTAGE OF NET SALES SPENT FOR ADVERTISING (PRE-WAR)

KIND OF BUSINESS	PERCENTAGE OF NET SALES
Auto accessories and parts	1.1
Bakery shops	0.7
Beauty shops	1.65
Book stores	1.0
Cigar stores and stands	0.3
Coal and other fuel	0.6
Confectionery	0.5
Dairy and poultry products	0.9
Department stores:	
Sales under $150,000	1.9
Sales $150,000 to $300,000	2.6
Drug stores	0.8
Filling stations	0.4
Floor coverings	1.0
Florists and nurseries	1.4
Food stores:	
Combination (handle fresh meats and groceries):	
Sales under $100,000	0.6
Sales over $100,000	0.8
Groceries (do not handle fresh meats):	
Cash stores	0.5
Credit stores	0.5
Super markets	1.3
Fur stores	2.5
Furniture stores	1.6
General stores	0.7
Gifts, novelties, and souvenirs	0.9
Haberdashery	1.2
Hardware	0.98
Household appliances	1.5
House furnishings	1.7
Jewelry stores	2.1
Limited price variety	0.8
Lingerie, hosiery, millinery, etc.	1.0

[8] Small Business Aids, No. 309, U. S. Department of Commerce, "Advertising for More Sales." Condensed from "Advertising for More Sales." One of 17 booklets making up the handbook *Better Retailing*, 1941, Dayton, Ohio, National Cash Register Company.

Kind of Business	Percentage of Net Sales
Lumber and building materials	0.5
Meat markets	0.8
Men's apparel	2.47
Musical instruments	2.2
Paint, wallpaper, and glass	1.3
Radios, with repairing	2.4
Restaurants, eating places	0.6
Service stations	0.8
Shoe stores	2.0
Sporting goods	1.3
Stationery and office equipment	1.3
Specialty stores:	
Sales under $150,000	2.9
Sales $150,000 to $300,000	3.0
Taverns and bars	0.4

money to budget for advertising will depend upon the job to be done and the funds available. A compromise is the usual result. The following nine factors for a retail store, which can be modified for other small businesses, should be considered in most cases:

1. Age of the store (or shop).
2. Merchandising and service policies.
3. Size of business.
4. Location.
5. Size of trading area.
6. Competition.
7. Media.
8. Business conditions.
9. Past experience.[4]

Although manufacturers use a variety of methods to determine their advertising appropriation, the final standard will be some relationship to sales. A prewar study by the Association of National Advertisers found total consumer advertising expenditures in relation to net sales volume by industries to be as presented in Table 12.

[4] Small Business Aids, No. 64, U. S. Department of Commerce, "The Advertising Appropriation for a Retail Store." Condensed from "The Advertising Appropriation." *Department Store Economist*, May, 1946, Philadelphia, Chilton Company, Inc.

TABLE 12[5]

AVERAGE PERCENTAGE OF TOTAL CONSUMER ADVERTISING EXPENDITURES IN RELATION TO NET SALES VOLUME

Industry	*Per Cent*
Proprietary medicines	33.78
Drugs and toilet articles	27.65
Beverages (soft and carbonated)	15.23
Silverware, clocks, etc.	9.31
Paints, varnishes, etc.	7.40
Drug sundries	6.00
Auto accessories	5.90
Heating, air conditioning, etc.	5.73
Petroleum products	5.68
Sporting goods, etc.	5.67
Confections and ice cream	5.35
Food and grocery products	5.07
Service organizations	5.00
Beer	4.67
Clothing and accessories	4.50
House furnishings	4.50
Household electrical equipment	4.47
Knit goods, hosiery, etc.	4.20
Travel and transportation	4.05
Footwear	3.97
Agricultural equipment	3.78
Hardware	2.67
Office equipment	2.60
Textiles	1.82
Auto trucks	1.27

It will be noted that the small manufacturer of food products would appropriate for advertising only about one-sixth as much of his sales as the producer of drug products.

Operators of small service establishments use the same method with modifications. Most of the following data were presented in the U. S. Department of Commerce's "Establishing and Operating" series. For restaurants the standard ratio

[5] Small Business Aids, No. 404, U. S. Department of Commerce, "Determining How Much of a Product's Sales Should be Spent on Advertising." Condensed from "How Much of a Product's Sales Should be Spent in Advertising?" by Herbert B. West. *Advertising and Selling*, July, 1947, New York, Moore-Robbins Publishing Co., Inc.

is 0.6 per cent, with a range for profitable concerns of from 0.3 to 1.1 per cent. Larger firms often spend a higher percentage. Automobile repair shop operators spend from 0.5 per cent to over 5 per cent; beauty shops average 1.65 per cent, but many spend over 5 per cent. Electrical appliance and radio shops spend from 0.7 per cent to over 2.3 per cent. One study covering a small sample of 24 stores showed with the following data how constant the advertising percentage for electrical appliance dealers can be: 2.6 per cent in 1939, 2.7 per cent in 1924.[6]

Outside staff assistance

Since advertising is one of the most highly developed fields of business, there are specialists in every division of the work. Many sources of assistance are available even to the very small business. These services are referred to in this text as the "outside staff." An understanding of the field's organization is necessary to make the most effective use of modern advertising.

A large part of national and some local advertising is handled by approximately two thousand advertising agencies in this country. An agency is composed of specialists in each division of advertising: market research, campaign planning, copywriting, layout and art work, media selection, production, and follow-up. Revenue is secured in most cases from media—newspapers and other periodicals and broadcasting stations—rather than from the advertiser. A "recognized" agency that receives the customary 15 per cent commission in the form of a discount from the medium performs many skilled services for the advertiser free of charge. However, the advertising budgets of most small businessmen are too small to be attractive to the commission type of agency. In many cities there are local agencies who serve retail and other local advertisers primarily and who usually find it necessary to charge the

[6] Parris, Donald S., and Associates, *Establishing and Operating an Electrical Appliance and Radio Shop,* page 83. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 28, 1946.

advertiser for their services. Even so, this is a good investment in most cases.

Free lance specialists or independent small businessmen specializing in copywriting, layout, commercial art or illustration, photography, research, and display work will be found in many cities. Their services may be secured for a fee as needed. This group forms an important segment of the outside staff for small businessmen, providing services similar to those of public accountants, bookkeeping firms, and others. For certain types of advertising, such as signs, handbills, and circulars and other direct mail pieces, additional agencies stand ready to help the advertiser.

One of the most valuable aids in many cases consists of the various mat services. A mat is a heavy-paper impression of an advertisement or of some such element as illustration, headline, or copy from which the local printer can make the stereotype or metal plate from which the advertisement is printed.

Mats are prepared by two types of concerns, manufacturers and commercial mat services. Producers often help dealers who handle their products by furnishing them with mats to use in local advertising. These may be distributed direct to the retailer or through the wholesaler, trade association, or resident buying office. Usually they are available to the local merchant free of charge. Since they are prepared centrally for nation-wide distribution, advertising specialists may be employed and information about the product and its selling features incorporated in the advertisement much more effectively than the local advertiser could do it. Mats are flexible, permitting the local advertiser to make such changes as he needs or desires. Even when little or none of the actual mat is used, valuable suggestions for advertising themes, copy, illustrations, and layout may be obtained from it. Trade journals and the publications of Merchants Service Bureaus often present suggested advertisements based on centrally prepared mats that may be obtained by the retailer on request.

Commercial mat services are available to the small advertiser

either by direct subscription or through the advertising department of his local paper. Most lines of retailing and service businesses may find adequate the mats furnished at no extra cost by services subscribed to by the newspaper. These mat services are very comprehensive in covering the lines of business that do local newspaper advertising. Each month the subscribing paper receives a large book illustrating all the accompanying mats and making it very easy for the small advertiser to select material appropriate to his needs.

In addition to a score of mat services of broad business coverage, there are many more that serve particular lines of business, such as fashion apparel, furniture, foods, and some service fields. Subscription to one of these services by the small businessman may be a good investment when similar material is not available through his local paper, trade association, or other organization.

In the food field and possibly in others, commercial agencies take over almost the entire job of advertising, especially that in newspapers, for the local merchant. The following description of one of these agencies illustrates this:

> In the Ad Building Service, you have a suggested list of items that have been prepared after hours of research, so as to be sure of featuring the right items at the right time. Manufacturers of nationally advertised products keep the Ad Building Service posted on advertising campaigns.
>
> You are on the beam when you feature the items recommended in the Ad Builders Service. There are no more questions, "What shall I advertise this week?" Just check the items on the planning sheet and give it to the newspaper with the mat. It's all very simple.[7]

Advertising Media

Newspaper and radio advertising, the chief forms referred to so far, are considered "mass" media. Often they are not suited

[7] Sample excerpts from publicity that appeared frequently in *Retail Food Merchandiser* during 1947.

to the advertising needs of the small businessman, primarily because of the high cost of waste coverage. Although this is true in many cases, even very small-scale businesses may find limited amounts of advertising in both media useful. On the radio this may involve "station break" commercials or announcements. In the newspaper an especially valuable but often neglected form is advertising in the classified columns.

Newspaper advertising

With a given amount to spend for advertising, the following are some of the many things that can be done to make it "pay off":

Buy space at the best rates. Often advertising will cost less if more space is purchased. For example, if the campaign calls for 985 lines at a rate of 10 cents, the cost will be $98.50. A study of the publication's rate card might reveal that 1,000 lines can be run at a rate of 8 cents or a total cost of $80.00, making possible a saving of $18.50 and 15 additional lines of copy.

Do not scatter advertising. Skipping around from one publication to another seldom gets results. It destroys the effectiveness of consecutive advertising and, most important, such irregular space purchases secure no special handling or consideration with the medium like that enjoyed by the normally consistent advertiser. This makes a great deal of difference when it is desirable to secure a favorable position for the advertisement on a typical newspaper page.

Check circulation figures closely. The smaller the newspaper, the more chance of padded circulation. It is good business practice to demand certified statements as to how the total circulation figure is broken down. Run checks to see which of the local media pays best. It never pays to guess about which publication is bringing the best returns.

Tie-in a local angle if possible.

Study other merchants' advertising.[8]

[8] Adapted from Small Business Aids, No. 252, U. S. Department of

The classified sections of most local newspapers list for sale a remarkable array of merchandise and services. The classified pages of a single paper sometimes contain as many as 55 sections, including automobiles for sale, electricians' services, electrical supplies, mattresses remade, boats and equipment, awnings and shades, and the like.

Because this form of advertising is not used by the large, integrated store operator, we may conclude that the "little fellow" has obtained his money's worth from it, for if the medium had failed to produce results, its use would have been discontinued.

Over 90 per cent of the advertisers who paid the 90 million dollars for newspaper classified listings in 1945 were repeat-order clients. Little if anything can be expected from single-insertion advertising. Most of the failures come when the advertiser expects too much from a single insertion.

A reader is easily attracted by bold type, borders, and an illustration. Heavy type, a substantial border, and a well-selected cut give the appearance of dependability that standard classified type and layout cannot suggest.

The newspaper representative will assist the inexperienced advertiser in his selection of space, copy, and layout at no extra cost. These salesmen are usually highly skilled in planning classified advertisements.

Telephone-book classified advertising

Most telephone directories have a special section in which the local businessman may advertise his goods and services. Such advertisements are little different from those in newspapers except that they are more likely to be illustrated and to depart in other ways from a straight, agate line appearance. It is a reference advertisement.

One insertion in a telephone book continues to function as

Commerce, "Make Your Ads Pay Off." Condensed from "Make Your Ads Pay Off," by Ernest W. Fair. *The Jewelers' Circular-Keystone,* January, 1947, Philadelphia, Chilton Company, Inc.

an active advertisement until the next issue appears, usually six months later. The telephone book stays in the home or office, ready to serve as a source of information on where to buy anything. Every business that has a telephone receives without charge a one-line insertion in the classified section of the book. Any further advertising must be paid for.[9]

Radio advertising

One form of advertising that is often neglected by the small businessman is radio; yet it can be one of the most effective and far-reaching of all media.

It can and does sell goods for the small retail merchant. What many little fellows do not know is that "spot" announcements cost as little as $2.65 each on some of the small local stations that reach a large proportion of the local market. These, which make up about 65 per cent of all the commercial stations in the United States, have a power of less than 1,000 watts and are therefore unable to reach beyond a limited geographical area. This limitation is an advantage to the small retailer, because when he buys time on such a station he has little waste circulation. The programs of the local station are directed to the market in his area. The only way to get the complete story of radio costs is to visit the radio broadcasting office, examine the station's rate card, and have a talk with an authorized representative of the station. However, *Standard Rate and Data Service,* which is published monthly in Chicago and found in many libraries, will furnish the prospective radio advertiser with some cost information.

One authority furnishes the following illustration of how radio can be tested for the small enterpriser. A small town dealer in furniture and general household goods was persuaded

[9] Adapted from Small Business Aids, No. 334, U. S. Department of Commerce, "Classified Advertising." Condensed from "Classified Advertising." From Doremus, William L., *Advertising for Profit—A Guide for Small Business.* New York: Pitman Publishing Corporation, 1947.

to try a few "spot" announcements. Being doubtful of the results, he offered an inexpensive wicker footstool to each customer who made a purchase in his store and said he had heard the offer on the air. At the end of the first week, during which three suppertime announcements had been made, the dealer had run out of premiums. His sales totaled $780 on a combined cost of $96 for advertising and premiums. The dealer immediately signed a contract for a five-minute local newscast program to go on the air at 5:55 p.m. Friday, the day before his big shopping day. This time no premium was offered, but each week a "special" was played up. The results were as good as before, each program paying its $27 cost many times over.[10]

The advertiser must give attention to the type of person he wishes to reach—age, sex, and profession—before selecting the kind of program he wants and the time to put it on the air. For example, a farm implement company that wants to appeal to farmers will favor an early morning news broadcast that includes the market report, weather forecast, and latest news. Time immediately following the market quotations would also be good.

In numerous surveys made throughout the nation it has been proved that "soap operas" (that is, dramatized stories) continued from day to day have the highest rating among women for daytime listening; at night comedy and musical shows attract the largest audiences. An ideal time for a "station break" commercial advertising a beauty shop or laundry would be between the women's shows. A men's sporting goods shop, filling station, repair shop, or men's clothing shop commercial would reach many male listeners near a news or sports broadcast in the evening.

The age of the listener might be important to a candy store, theater, teen-age dress shop, or snack shop advertiser. The

[10] Adapted from Small Business Aids, No. 369, U. S. Department of Commerce, "Radio Advertising." Condensed from "Radio Advertising." From Doremus, William L., *Advertising for Profit—A Guide for Small Business.* New York: Pitman Publishing Corporation, 1947.

best time to appeal to children is in the late afternoon or on Saturday morning, and a commercial near a children's show would be ideal for a "spot" or "station break" commercial. Record shows in the afternoon or night appeal to teen-agers and college students, providing the record or snack shop with a chance to benefit from "spot" commercials.

There are certain hours that are recognized as the best broadcast time, higher in price than others. For example, Class A radio time on some stations is from six until ten at night; this means that, according to surveys, more people listen at that time than at any other time. These are the so-called "family hours."

Another factor determining the price of an announcement, "spot" commercial, or entire program is the power of the station. This is very important for the small businessman, because if his products are sold in one city or to nearby customers, a small 250-watt station will reach prospective customers easily; but if he covers the state or a larger area with his service or product, a 5,000-watt or larger station would be more effective. The question will be whether the less expensive station will meet the advertiser's needs as well as the larger station. Also, the population of the area covered by a certain station will influence the price of commercials; a station in a large town will reach more people and be more expensive than another station of the same power in a less heavily populated area. In addition, the price will be affected by the number of times a week and the number of weeks a "spot" commercial or a program is put on the air. The longer the commercial and the more often it is on the air, the cheaper it will be per unit of time.[11]

Use of public service features is an excellent way to promote good will for an advertiser. Such an announcement as, "Through the courtesy of Blank's Department Store we bring

[11] Current advertising rates and related information for every newspaper and broadcasting station may be obtained from the latest issues of *Standard Rate and Data Service*. Chicago: Standard Rate and Data Service, 333 N. Michigan Ave., monthly.

you a report on the activities of the Red Cross," is a "plug" for Blank. The department store has no commercials on this type of program other than the statement in so many words that the store is paying for the time to bring listeners some important civic information.

Manufacturers often send suggested commercials for the retailer to use in promoting both their product and the store. National producers sometimes send transcription disks of commercials which may be used by the small business. For example, motion picture studios arrange dramatized advertisements for local theater owners, including even "interviews" with stars to be carried on by the local announcer. The disks allow time for the announcer to ask prepared questions before the star answers.

Unless the advertiser uses an agency, usually all he need do as far as writing the commercials is concerned is to tell the radio station time salesman that he would like to publicize a certain sale or a product that day or week. The station man gathers the details and writes the commercials without any extra cost to the advertiser.

If the businessman wants an entire program, the radio station will suggest popular types that may be sponsored, or the advertiser may suggest a program himself. The national networks have "coöp" shows that are originated by the networks themselves but these may be sponsored locally. Commercials are inserted by the local announcer when the network gives the cue.

It is not advisable to accept a show to sponsor unless one has seen some national radio ratings of the type of program under consideration. Also, it may be well to ask relatives, friends, and acquaintances of different ages and professions, especially those representative of the audience desired, what their favorite type of radio entertainment is. An advertiser may also decide upon the most effective place for a commercial by using this method. He should listen to his commercials or programs on

the radio and try to judge them as he would an advertisement in a newspaper.

Sign advertising

Signs used to identify the place and kind of business represent one of the oldest advertising media. Sign advertising is well suited to reaching the buyer while he is traveling about the neighborhood on foot, by bus, or by automobile.

Some authorities consider the ideal outdoor advertising medium for the small retailer to be the hand-painted sign on a board located as near his store as possible, preferably on the side of his building. Such a sign has the advantage of relative permanence, but it also has the disadvantages of fixed copy, since it is more difficult to change a hand-painted sign than a poster panel.

The outdoor poster is made in two sizes, the 24-sheet poster and the 3-sheet poster. The 24-sheet poster, when assembled, measures 8 feet 10 inches by 19 feet 8 inches. These are the familiar large signs that may be seen along any highway, mounted on a substantial steel or heavy wooden poster-panel structure 11 feet high and 25 feet long.

The 3-sheet poster can be effectively displayed on the side of a building. It is well suited to use by the small retailer. A space 4 feet 10 inches by 8 feet 7 inches is required for the whole display including the frame. Such a poster makes a good point-of-purchase reminder or a colorful supplement to mail, newspaper, and handbill advertising. There are approximately 12,000 poster plants set up to handle such work in this country.

At one time or another nearly every member of the family uses the bus and reads the bus cards for lack of something more interesting to do. Certainly the small enterpriser whose business is located near a bus terminal should be able to use the bus card as an advertising medium.

Convenience services, such as shoeshine parlors and while-you-wait repair shops, located on busy streets or near bus ter-

minals or railroad stations can often use the sandwich sign effectively. Other small business establishments that may use this medium are novelty restaurants (gypsy tearooms, for example), mail-order snapshot development services, and special service shops, such as tailors who match men's suit jackets and vests with trousers or who do expert fabric repairing of holes made by cigarette burns or moths.

Storefront signs are often provided by some manufacturer whose product or equipment is carried or used by the small establishment. Such signs naturally contain the name of the manufacturer as well as that of the local businessman. Many small retail and service establishments and most factories prefer to erect their own building sign featuring the name of the firm or its business exclusively.

Other forms of sign advertising frequently used by the retailer in window and interior displays are lithographed cutouts, oversized package reproductions, show cards, hangers, and electric flashing and mechanical-action displays.[12]

Point-of-purchase signs may easily be used to excess, especially when the small businessman is too lenient in permitting every salesman to put up his own signs. The cluttered appearance of many small shops is testimony to this danger. Useful guides to follow are: make each sign justify its space in terms of sales volume or profit to the business; require that it harmonize with the "atmosphere" and over-all appearance of the establishment; and reserve all spaces needed for the firm's own signs or other business uses.

Handbill advertising

Handbills can be a very effective and inexpensive form of advertising for most small businessmen. They are especially useful for announcing the opening of a new neighborhood

[12] Adapted from Small Business Aids, No. 282, U. S. Department of Commerce, "Sign Advertising." Condensed from "Sign Advertising." From Doremus, William L., *Advertising for Profit—A Guide for Small Business*. New York: Pitman Publishing Corporation, 1947.

business, for periodic reminders of the merchandise or services offered, and for advertising special sales. Handbills should be planned carefully as to layout, message or appeal, headline, and appearance. A good printer can give advice on the quality of paper to use, overall appearance, size, cost and similar factors, but should not be depended on for the sales message or copy of the advertisement. The printer can, however, render many valuable services to the beginning advertiser, and it is advisable to select and work closely with the best printer available.

Since the use of handbills is likely to be undertaken partly because of low cost, there is a real danger that efficient distribution may be neglected. It is advisable to select reliable distributors and pay adequately for the work. Either the owner or some other competent adult should supervise distribution. In many cities organized handbill distributors may be employed who will guarantee effective circulation.[13]

Direct advertising

Direct advertising includes all forms produced and distributed under the direct control of the advertiser. Thus, handbills, circulars, package stuffers that contain advertising, and certain novelties as well as *direct mail* pieces belong in this group. Direct mail advertising is probably the most important and widely used. It is also the most selective type of advertising. Generous postal laws in this country provide businessmen with extensive opportunities for using this highly effective medium.

Most people like to receive a friendly, interesting letter. The small businessman can capitalize on this human tendency and should make his direct mail advertising as personal, informal, and selective as possible. Careful study of charge account and

[13] For further study see Small Business Aids, No. 313, U. S. Department of Commerce, "Handbill Advertising." Condensed from "Handbill Advertising." From Doremus, William L., *Advertising for Profit—A Guide for Small Business.* New York: Pitman Publishing Corporation, 1947.

delivery records, as well as the owner's personal knowledge of his customers, should make it possible to classify most of his clientele into several groups based on their common buying interests. Direct mail pieces can be thoughtfully worded in such a way as to have a strong appeal to each customer and create the impression of individualized attention.

Although as many as ten different forms of direct mail advertising are recognized, the most important for the average small businessman are envelope enclosures, mailing cards, and post cards. Envelope enclosures include the direct sales letter, self-addressed return card or envelope, and folders or booklets to supplement the letter. The last mentioned, or "stuffers," are frequently enclosed with monthly statements to charge account customers.

A mailing card can be used to advantage for making an announcement in a dignified manner. It may be printed either with or without illustration on stock of good quality. Appropriate uses include announcing the addition of a new line of goods, the arrival of new models, or a change of business address. A mailing card of superior quality should be enclosed in an appropriate envelope and first class postage should be used.

Many small-scale advertisers have made effective use of the lowly post card. It is an ideal direct mail form for the retailer with a good prospect list and a limited budget. A good layout that combines well-selected type with a line-cut illustration presents a concise sales story on a post card and can carry on an excellent and economical sales campaign. A series of such messages mailed on a systematic follow-up basis is likely to produce a telling effect. The penny postal card (government printed) has been used successfully by many small enterprisers. During the beginning days of a business each postal card may have the selling story typed out by the owner or a part-time typist. Later more economical quantity production methods will be used.

Within each merchandise or service group appropriate

themes should be chosen to appeal to strong human desires, such as health, comfort, security, and advancement, or to any of the consumer wants the advertised good is especially intended to satisfy. In the presentation of the message, consumer benefits should be stressed in a friendly person-to-person manner. Each letter should contain all the essential information necessary to make the prospect want the offering. Descriptive folders or small booklets may be enclosed to supplement the letter. Such descriptive material is frequently available from manufacturers.

Nearly two dozen shapes and sizes of enclosures are used in direct mail work. Each variety has its advantages and special uses. For example, the "broadside" (a large sheet of paper, usually 25 by 38 inches) is very effective for creating "impact" or dramatic effect. The large size of broadsides makes it possible to use showmanship methods effectively. When the nature of the advertisement makes a reply by the prospect desirable, make it easy for the recipient to act by enclosing a return post card or envelope. Whether to use a stamped, self-addressed card or envelope or to take advantage of postal provisions permitting "postage guaranteed" returns should be studied. The former is cheaper per letter, but the latter often costs less in the end, since usually not all the cards or envelopes are returned.

Direct mail is more expensive per message delivered than publication advertising, but when used properly it can be an inexpensive method of reaching selected groups. The mailing list is of the utmost importance. If it is necessary to economize, most authorities recommend using a less expensive mailing piece and the best possible mailing list. Each name on the list should represent a live prospect for the goods advertised. It is important to keep the mailing list current and to make every effort to have titles and first names correct.

Repetition will ultimately drive home the message. One piece of direct mail advertising may bring results, but it is a

proved fact that regularly repeated mailings will do a better selling job.

Arrival time should be considered. It is better to have direct mail advertising arrive on pay day than on the day the rent is due. Tests on direct mail advertising have proved that the first mail to arrive in the morning is read hastily or consigned to the wastebasket without being read at all. If it arrives later in the day, it has a 50 per cent better chance of being read. It is smart of the direct mail advertiser to consult his postmaster on the timing of deliveries. The banker can furnish information regarding important pay days in the community.[14]

Advertising for the Small Retailer

For the retailer, timeliness, selection of the right merchandise to advertise, the best theme to use, and window and interior displays are important points to consider in addition to those already discussed.

Timing the release of advertising should be related to the store's position in the merchandise acceptance curve or fashion cycle. Fashion leaders in the community will advertise heavily at the very beginning of the selling season; those catering to the middle class, just before the peak of the selling period; and stores in the "economy" group, just after the selling crest has been passed. For staple merchandise and special sale events, advertising should be timed to fit in with pay days and shopping habits of customers for stores in the lower and average income groups; those catering to the upper income brackets will be more concerned with tax dates and special customer preferences.

Selecting the right merchandise to advertise is of great importance to the retailer because only about 15 to 20 per cent of all goods carried are suitable for the purposes of external ad-

[14] Small Business Aids, No. 343, U. S. Department of Commerce, "Direct-Mail Advertising." Condensed from "Direct-Mail Advertising." From Doremus, William L., *Advertising for Profit—A Guide for Small* Business. New York: Pitman Publishing Corporation, 1947.

vertising. Not only should goods selected produce enough sales of the advertised articles to cover the direct cost of advertising, but they should also attract to the store customers who will buy quantities of unadvertised merchandise. In other words, advertising should attract shopping traffic of regular customers rather than bargain hunters or specific item buyers exclusively.

Customers can be encouraged to buy additional merchandise by attractive displays, informative signs, point-of-purchase advertising, and circulars, handouts, or lists of unadvertised items placed in convenient traffic locations throughout the store. Interior displays and advertising material should be representative of the store and its merchandise in appearance and merchandise selections. These should represent articles of real value (not "bargains") selected from various departments in order to encourage customers to visit all parts of the store. Appealing displays of impulse items adjacent to each listed item, as well as to merchandise advertised externally, will give real meaning to the axiom, "It pays to advertise."

Selecting items to advertise may be done in many ways. Preference should be given to goods representative of the store's character and of proved clientele appeal. The store's records of past sales, advertising, want slips, customer complaints, and adjustments may be used for goods similar to those previously carried. For new items customer response to display is considered the best guide. Merchandise that sells best without advertising should be advertised most. "Play the winners" is the rule to follow. Opinions of buyers and salespeople are useful guides if time will not permit test displays before advertising.

After checking the circulation of *Esquire* in his trading area, the proprietor of a small men's apparel store in a town of 40,000 began to mention frequently in his advertisements items in stock that were currently advertised in that magazine. Results were very satisfactory.

To help in deciding upon the theme or appeal to be used in

advertising, buyers should state the features about each article that caused them to buy it for the store. Current practice is to require each buyer at the time he purchases new merchandise to secure from the vendor the "sizzle" or selling story for each article. Salespeople should also be able to give valuable suggestions as to what features of the merchandise would be most attractive and interesting to customers. Unless an article has some outstanding point of superiority, it is well to look for hidden values less obvious to the average customer and to stress the benefits customers will derive from purchasing it.

As a further guide, the list of human motives and buying habits presented in Chapter V may be used. Naturally, certain merchandise suggests its own theme, such as fashion rightness, authenticity, or economy. Experience has shown, however, that such "obvious" points of appeal as durability, strength, economy, or assumed use of the article may differ widely from the *real* reasons why customers buy particular merchandise. Careful and continuous investigation is the safest course to follow.

Most authorities agree that windows are the only indispensable advertising medium and that they are also the average small retailer's *best* medium. External advertising presents a message about the merchandise; displays present the merchandise itself. "Atmosphere" can be used with equal effectiveness in both. Showing the merchandise in three dimensions, in all its true color and beauty, is a strong point. Most interior displays can be arranged to allow the customer to feel or handle as well as see the goods. Since they are at the point-of-sale, displays serve as reminder advertising in addition to stimulating impulse buying.

Window displays should be changed once a week in large cities and more frequently in smaller places. Usually it is desirable to have a regular schedule based on local buying habits. Not only the glass but all merchandise and props in the display as well should be clean and neat.

If any merchandise in the window fails to result in the vol-

ume of sales expected, it should be replaced at once—even in the middle of a busy selling day—by items that will produce the desired results. Not only is window display space the most valuable space in the store, but goods on display help to make up the "face" of the store that impresses traffic.

Displays should be tied in with national advertising whenever possible. This may be accomplished in many ways, such as by timing displays to appear during national campaigns and by including pages from the national media or placards stating "As advertised in *Vogue*" and the like. Seasonal displays are usually effective, offer many opportunities for originality and related item selling, and help to build the store's reputation for merchandising alertness. Important promotions in the community, such as National Cotton Week, Mardi Gras, or Days of the Forty-Niners, should always be capitalized.

Interior displays should always have price cards and usually informative signs. For impulse and convenience goods, mass displays are very effective, especially the jumbled type with nothing for the customer to knock down when selecting articles from the display. Grocers have found that the effectiveness of mass displays is noticeably increased by the addition of advertising placards calling attention to featured goods and giving the price. If the offering is a special-price feature and there is a time or quantity-per-customer limit, this information should also be given.

As a rule, the display cards and other dealer helps offered by manufacturers and distributors should be utilized, because they provide authentic sales information about the goods and provide space for pricing. Such dealer helps represent extensive and often expensive study to discover the appeal that will be most effective in presenting a product to the public, and they contain tested catch-lines that are bound to help sell the goods.

Advertising for the Small Wholesaler

Small wholesalers do relatively little advertising. For most lines of wholesaling, considering large and small firms to-

gether, the expense of personal selling is from ten to twenty times as much as the amount spent for advertising.

For our present purpose, small wholesalers may be divided into two classes, those who do "floor selling" and those who do not. Buyers often visit those in the former group to inspect merchandise displayed in the sample rooms or on the selling floor. Since these buyers are mostly small retailers, the wholesaler can use appealing displays both to increase immediate sales and to show the retailers how to present the merchandise effectively in their own stores.

The following recommendations illustrate principles that apply equally well to other wholesalers who do "floor selling":

> An electrical wholesaler who does not have a first-class display of industrial fluorescent lighting equipment is losing an opportunity to show his manufacturer's lines advantageously to prospective dealers, contractors, and industrial accounts. On the other hand, a wholesaler who has a well-designed lighting display can expect excellent coöperation from utility lighting engineers, architects, lighting contractors and lighting equipment specialists. An analysis of a number of wholesale establishments shows that the average lighting fixture display falls short in many ways.
>
> If there are three electrical wholesalers in any given trading area, and one displays fixtures in a well-planned display room, he will be the one who does the major lighting volume. The utility lighting man, the wide awake contractor, the architect, and the store lighting manager will want to see the latest lighting display in town before buying.[15]

Whether display rooms are operated or not, some small wholesalers do a limited amount of external advertising. Practically all of them use signs over the store front and on the side of the warehouse if possible. Most other advertising is

[15] Small Business Aids, No. 210, U. S. Department of Commerce, "Improving Wholesaler's Displays of Fluorescent Lighting." Condensed from "Making Your 'Show Room' a 'Buy Room,'" by Daniel Dunne. *Lighting and Lamps,* August, 1946, New York, Krieger Publications, Inc.

directed to the trade rather than to consumers. Only when a wholesaler has an exclusive franchise line or is trying to promote his own brand does he use consumer advertising.

Catalogs, price lists, sales letters, and some dealer aid material that is usually furnished by the manufacturer constitute the principal forms of advertising used. The objective is to pave the way for personal selling or to economize the salesmen's time. Almost no direct merchandise advertising is undertaken by the wholesaler himself. This is understandable, because in most cases the wholesaler carries a large number of parallel or competing lines. The exception, of course, would be exclusively franchised lines.[16]

Advertising for the Small Factory

The small factory will usually direct its advertising either to consumers or to dealers or business users (other manufacturers) of its product. Manufacturers of consumer goods selling only in the local market, whether through local dealers or direct, may often use newspaper, radio, outdoor sign, and direct mail advertising effectively. Not all these media are likely to be used by one small factory, but they might be.

In some small factories the nature of the business permits advertising through the appearance of the building as well as through use of the windows. Candymaking, bottling, and some processing plants are of this type. A small candy factory that was recently opened in a town of 13,000 illustrates these ideas. Merchandise displays as well as several candymaking processes are visible from the sidewalk through the glass store front. The interior is done in bright red and white "candy stripes" on the walls and ceiling, with varicolored glass blocks in one partition transmitting bright colors from a hidden source of illumination.

Sometimes a small factory located near a highway can make

[16] For further study see Beckman, Theodore N., and Engle, Nathanael H., *Wholesaling*, pages 377–381. New York: Copyright 1937 by The Ronald Press Company.

good use of highway displays. A small artificial flower plant displays orchids and gardenias in transparent individual packages ready for sale to customers. The plant itself is not visible from the highway but is close enough to service the highway displays. When the product made is attractive, has impulse appeal, and may be sold profitably direct to consumers, such a plan should be useful for other small manufacturers.

Small factories selling through dealers or to other businesses will select as their media principally direct mail and trade publications read by their prospects. When the area covered or sought to be covered is regional or national in scope, trade journal advertising will probably be the best. Space rates are relatively low and the circulation is selective. Small advertisements inserted frequently may be most effective. The purpose will be to solicit inquiries or secure leads to be followed up by direct mail, samples, or personal selling.

In either situation direct mail is the suggested medium when prospects are relatively few in number and form a highly selective group or when the advertising message requires a great deal of description and explanation.

Lists for direct mail advertising should usually include: present active customers, former or inactive customers, and prospective customers. Regarding the last named, the small businessman should make certain that the person whose name is used is the one who makes the buying decisions. A common experience in attempting to sell to certain department stores is to address the buyer of the department concerned when in reality practically all the buying for this department is done through the store's resident buying office, probably in New York City.

Mailing lists should be checked frequently to keep them up to date. Many small manufacturers have found the following methods useful: periodic checking with Dun & Bradstreet reference books; retaining on the mailing list only those retailers who maintain their ratings; frequent checking of lists by salesmen in their territories; and checking by the Post Office

Department as provided for under postal regulations. A local postmaster can furnish information about the last method.

Although radio is used by small manufacturers less frequently than direct mail, "spot" announcements may be an effective way to get a new product off to a good start, to draw attention to other advertising media used, and to gain dealer acceptance and distribution for the product because it is being supported by consumer advertising.[17]

Advertising themes will usually be found in one of the major marketing instruments. Such themes might be: the product itself if it is new or superior to competing products; the package; the price, which may be favorable to the small producer either because of low costs or because he is entering a field of well-advertised brands where his competitors have already incurred the expense of demand creation; or availability in terms of prompt deliveries and nearness to customers. Other themes may of course be used if certain unusual services are offered, the product is better for certain special uses than those now on the market, or other particular circumstances prevail.

Advertising for the Service Business

The service establishment's calling card has long been "quality service." With competition in service businesses growing rapidly, the owner must not only build up a reputation for quality but must also put his imagination to work setting up new plans for promotion.

Too many small service establishment operators are in doubt as to just how they can improve their advertisements. What

[17] For further study see: Small Business Aids, No. 415, U. S. Department of Commerce, "How Small Manufacturers Can Maintain Lists for Direct Mail Advertising." Condensed from "Mailing List." Section Forty-Four, *The Sales Manager's Handbook*. Chicago: The Dartnell Corporation; Small Business Aids, No. 383, U. S. Department of Commerce, "Using Spot Radio Ads to Increase Sales." Condensed from "16 Ways to Back Sales with Spot Radio in Selected Markets," by Thomas Cox, Jr. *Sales Management*, Dec. 15, 1946, New York: Sales Management, Inc.

can a laundry do? A laundry is just a laundry; if the customers like the service, they will come back. This is true to a certain degree, but it shows a rather short-sighted outlook. How can new customers be won in the face of so much competition? Other laundries may have quality service too. How can the housewife be persuaded that it pays to send her clothes to the laundry rather than do them herself? How can a reputation for quality service be built? Why do people desire the particular service offered? Why do customers prefer to trade with one shop rather than another? These questions must be kept in mind while the promotional campaign is being planned by the proprietor if his plans are to be effective.

To answer them he must take the customer's view in advertising. He must tell in a truthful manner what the customer wants and needs to know about the service. Both emotional and rational motives of the consumer play an important part in service organization patronage.

Experience has shown that small laundries and cleaning establishments can make effective use of one or more of the following forms of advertising: signs on trucks, strikingly clean appearance of trucks and store front, distinctive bags and wrapping paper that carry a short advertising message, and inserts that tie in the firm name with trade association or other general advertising. If a window trimming service operates in the city, dry cleaners especially may use this service effectively. These methods are in addition to the use of common media like newspapers, radio, and directories.

Automobile repair shops cater to motorists and therefore should have two outside signs, one visible to traffic from each direction. Service stations should use signs that identify the brand of products carried. Both of these types of small business can usually make good use of attractive road signs.

Restaurants find interior signs especially effective because of the impulse nature of customer buying. In addition to promoting the sale of particular dishes, signs can build confidence in the quality of food served. One small restaurant has two

such signs. The first, which carries the slogan "Good Food For Good Health," states that the firm is a member of the National Restaurant Association; the other reads, "Member—American Restaurant Association—An Approved Restaurant." The same restaurant has two "Ultra Violet Purifyers" and a Salad Bar with identifying signs, all visible to customers. The result is to convince patrons that the owner is doing everything possible to protect their health and best interests.

Many service industries, such as laundries, maid services, or dry cleaning establishments, base their claim for customer patronage on freeing the customer from laborious tasks, because the goal of most people is to obtain more leisure time for their own personal interests.

Pride in the appearance of person or property, distinctiveness in taste, health, and cleanliness are all emotional buying motives used by various service establishments. Rational buying motives include quality, dependability, durability, enhancement of earnings, and economy.

Professional services, although they do not "advertise," feature the qualifications of the practitioner by his degree, title, or badge of approval of the certifying agency. Examples are such designations as C.P.A., M.D., A.I.A., and Realtor. A list of professional association memberships and past or present offices held is also used to support the title. There is a trend to expand this practice to other service fields.

Window displays may be one of the best and yet the most undeveloped promotional media in service industries. Ideas used for display in laundries and dry cleaning businesses might show a new garment and one like it that had been washed or cleaned one hundred times by the establishment; a shoe repair shop could show the steps in manufacturing or repairing a shoe. In San Diego, California, a fur storage plant displayed a piece of valuable fur being eaten by moths.

Open displays of machinery showing the service actually being performed give customers confidence in its quality. Examples can be seen at Coca Cola Bottling Companies through-

out the country, where one can stand on the sidewalk and watch, through a large window, the bottles being inspected, filled, and capped. In Little Rock, Arkansas, a laundry used this idea by installing a plate glass window that enabled passers-by to watch employees iron the various garments. In Akron, Ohio, a bank spent $6,000 to build a large showcase in the lobby for displays of its customers' wares, with the idea of keeping its clients "sold" by helping them to sell.[18]

The owner should reaffirm the appeal to buying motives in planning his advertising schedule. Too many think that word-of-mouth publicity and past performance should be the main promotional efforts of the service shop. Both newspaper and radio will help at the time of the grand opening, when prospective customers are informed of the presence of the shop and some free offers are made to help get it off to a good start.

A good idea to follow in newspaper advertisements is to establish a firm name or logotype that is distinctive and characteristic of the shop. "The sign of the flying red horse" is one example. Footprints of mother, father, and baby for "The Family Cobbler" could be carried out in the store front, in newspaper advertising, and on stationery and wrapping paper.

In using radio advertising it is good to have a definite type of program with which to be associated. The Valley National Bank in Arizona blankets the state daily with spot announcements and news broadcasts, and startled the state with such "coups" as sending a radio commentator to cover the San Francisco conference.[19]

Visualization may be used in advertising either verbally or by illustration, although the latter is much more common and usually more effective. It is also very appropriate for displays

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[18] Small Business Aids, No. 88, U. S. Department of Commerce, "Banks Profit Through Glamour, New Services." Condensed from "Banks Make Glamour Pay," by Keith Monroe. *Nation's Business*, May, 1946, Washington, Chamber of Commerce of the United States.

[19] *Ibid.*

either at the plant or for those at the customer contact office.[20]

Conclusions

Advertising is one of the most important "mass production" tools of big business available to the little fellow. However, like dynamite and other powerful forces, its effective use requires understanding and skill in handling. Heeding the following admonitions should make your advertising more effective:

Do:

Plan your advertising well in advance and follow your plan.

Advertise consistently no matter how small each advertisement must be.

Develop a style and a personality for your advertising.

Have an objective; know why you are advertising.

Know your best prospects, goods, selling points, and the cost of advertising.

Keep records of all advertising, analyze results, and strive for improvement.

Don't:

Advertise just to see your name in print.

Release hastily prepared advertising.

Advertise goods or services unless you know they are right.

Scatter your advertising efforts.

Be misled by the statement "It pays to advertise." *Only effective advertising pays!*

Review and Discussion Questions

1. If the standard expense for advertising in your chosen field were 4 per cent, would you be justified in spending during your first year in business 6 per cent? 10 per cent? 25 per cent? Explain.
2. How does the professional man advertise?
3. Which is the more expensive form of advertising for the small business, newspaper or radio? Explain.

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[20] For a discussion of visualization see Kleppner, Otto, *Advertising Procedure*, 4th ed., chapter 9. New York: Prentice-Hall, Inc., 1950.

4. What "sizzle" or advertising theme would be best for each of the following: A new record changer, a child's picture story book, an electric-clock-operated radio, a launderette with adjoining-beauty parlor, a home study high school course?

5. If a retail store has to dispose quickly of a limited quantity of some item of outer wearing apparel representing good value, what medium or media would be best to use? Why?

6. What advantage, if any, does the characteristic of privacy give direct mail? Discuss.

7. Upon what bases may the costs of different media like the newspaper, radio, and direct mail be compared? Discuss each.

8. If the budget for direct mail advertising is limited, is it better to economize on the mailing list or on the mailing piece? Explain.

9. One limitation on retail advertising is that it cannot succeed without the backing of the entire organization. Explain fully why this is true.

10. List a number of ways in which a firm's policies will influence or limit its advertising. Give examples of each.

11. Consult a standard retail advertising text, such as *Retail Advertising and Sales Promotion*, Revised ed., page 438 (Edwards, Charles M., Jr., and Howard, William H. New York: Prentice-Hall, Inc., 1943), for recommended uses of direct mail advertising. Which of these would be appropriate for a wholesaler? for a small factory? for a service establishment?

12. Mention additional uses for direct mail advertising in each of these fields of small business.

13. Compare the post card with the postal card for advertising use by the small businessman.

Chapter XV

PRICING FOR TURNOVER AND PROFIT

That price, turnover, and profit are related seems reasonable to most businessmen, but the specific relationships among these three are not always clearly understood. Profit does not depend upon either price or rate of turnover alone nor only on both together. It is the result of the combined effects of price volume, and expenses. Since the usual tendency is for expense to decrease percentagewise as turnover increases, many small businessmen think that increasing turnover is a sure road to greater profits. In general this is true only when increased turnover can be achieved without loss of sales volume and without either a proportionally greater increase in total expenses or higher purchase prices as a result of buying in smaller quantities.

Furthermore, the usual tendency for sales volume, and consequently turnover, to increase as price is lowered does not always hold true in specific cases. Correct pricing of the product or service of a particular business depends upon many factors, such as company policy, nature of the product or service, location, costs and expenses, competition, market strategy, business conditions and trends, and distribution.

Company price policy will normally be influenced by casual factors like location, size or position in the field, nature of the product, customer services rendered, and the owner's preference for a particular market or reputation. Certain businessmen seek a particular class of trade and consequently follow a price policy intended to appeal to this group. For the small business this may be either a matter of owner preference or of

business experience and ability. It is well known that certain individuals can cater successfully, especially in the retail and service fields, only to one of the three major income groups.

An individual may set out to establish a reputation for having either the lowest or the highest prices in his field. In such cases the level of prices set is the starting point; expenses, location, organization, and policies other than pricing must be adjusted to conform. For most beginners, however, a policy of price strategy is best. This involves selecting prices that appeal to markets not already served by existing firms.

The casual factors are dominant in the majority of small businesses. A merchant whose location characteristics change will adjust his prices to the current demand. Likewise, competition will influence his prices. A manufacturer will normally change his prices to correspond to changes in costs. Any intelligent businessman will price each product or service according to customer reaction, using a low price when demand is highly elastic, a "class price" for luxury items, and so forth.

It is important to understand how certain characteristics of marketing costs and even the method of distribution used may influence appropriate pricing, especially for the manufacturer and in some cases the service business. Distribution or marketing costs, relative to production costs, are "sticky" and do not change quickly with small changes in price. Since marketing costs for most consumer goods make up almost half of the price paid by the final consumer, this rigidity tends to lessen the benefits received by the producer who reduces his prices when costs of production are lowered. Another important consideration for the small business is that distribution costs may increase per unit with increased sales, at least up to the point where large-scale methods, such as extensive advertising, can be used. Some examples will clarify these points.

Two situations will be examined, examples of indirect and direct marketing. First, assume the existence of a factory producing 10,000 units per month of an article sold through several dealers to consumers; manufacturing cost is $0.50 per unit,

net profit $0.10, factory selling price $0.60, and retail price $1.00. Thus, marketing cost is $0.40 per unit. A way is found to reduce production costs 10 per cent or $0.05. If factory price is lowered by this amount from $0.60 to $0.55 and dealers pass along the full amount of this reduction, retail selling price will be reduced by only 5 per cent. If this increased retail sales in units by only 5 per cent, sales will now be 10,500 units with a retail value of $9,975 and factory value at selling price of $5,775. The manufacturer would thus be selling 10,500 units for $225 less than he formerly received for 10,000 units and his net profit would be increased by only $50. The retailer would receive $25 less in total sales for 10,500 units than he formerly received for 10,000. Even an increase in retail sales of 6 per cent to 10,600 units would mean sales at retail of $10,070, or only $70.00 more than when the price was $1.00. To the manufacturer this would be only $5,830 in sales, a decline of $170, and $1,060 profit, an increase of only $60. Had price not been reduced, profit to the manufacturer would have been increased by 50 per cent, or from $1,000 to $1,500, with no change in sales volume. However, such a static condition is usually undesirable and likely to be unstable.

Assume, as a second example, that the $500 gained by lower cost plus an additional $500—a total of $1,000—is used for effective sales promotion. If an additional 10,000 units were sold, advertising cost would be only 16⅔ per cent of the increased sales or 8⅓ per cent of total sales (both figured at the factory price of $0.60). This would double profits to the manufacturer, over and above his advertising expense. It would probably increase dealers' profits sevenfold by reducing expense per unit. Probably the dealers would begin to lower prices, thereby further stimulating sales. Larger volume would very likely lead to still lower production costs, and the cycle of expansion typical of most manufactured consumer goods would be under way.

The foregoing example may be presented in tabular form as in Table 13.

TABLE 13

EFFECT OF ADVERTISING ON PROFITS

	BEFORE COST REDUCTION		AFTER COST REDUCTION AND EXPENDITURE OF $1,000 FOR ADVERTISING	
Manufacturer:				
Units sold		10,000		20,000
Total sales		$ 6,000		$12,000
Cost of production.		5,000		9,000
Advertising expense				1,000
Net profit		$ 1,000		$ 2,000
Retailer:				
Units sold		10,000		20,000
Total sales		$10,000		$20,000
Cost of goods sold.		6,000		12,000
Gross margin ..		$ 4,000		$ 8,000
Expenses (estimated):				
Fixed or overhead	$2,500		$2,500	
Variable or selling	1,000		2,000	
Total		3,500		4,500
Net profit....		$ 500		$ 3,500

Another situation likely to be present for the small factory is direct sale to consumer or user. The principal difference in this case is the ability of the manufacturer or service operator to set the final price. Otherwise, the following three factors are important in determining price and promotion policies, whether distribution is through dealers or direct to consumers, namely: elasticity of demand, expansibility, and distribution costs. Elasticity of demand refers to the change in dollar value of sales that accompanies price changes. If a lower price alone increases total revenue, demand is elastic; if it decreases total revenue (even though the number of units sold increases), it

is inelastic; if price changes do not change total revenue, the elasticity is unitary. Different products and services vary greatly in the amount advertising increases sales. This property is known as expansibility or advertisability. An article that sells only slightly better when well advertised has a low coefficient of expansibility; one that sells much better has a high coefficient. The latter is often called a "natural" for advertising. In most cases both price reductions and advertising will be used simultaneously but in amounts proportionate to the product's relative elasticity and expansibility.

Distribution cost is more complicated than either elasticity or expansibility alone. One of three situations is likely to prevail. First, distribution costs per unit sold may remain constant within fairly wide ranges of amounts. This was illustrated in our first example, in which marketing costs remained at $0.40 per unit when both factory and retail prices were reduced and the quantity sold increased. Such a condition is probably characteristic of most situations. Second, distribution often takes place under conditions of increasing unit costs. This is especially true after a certain volume point is passed. It explains why department store expenses usually become a larger percentage of sales as volume increases and also why selling costs to final consumers remain fairly constant while production costs are decreased.

A small manufacturer may sell his initial production at a profitable price to local customers with relatively little expense. If he seeks to expand his market, all distribution costs tend to rise until it reaches a volume sufficient to justify mass distribution methods, especially extensive advertising. This was illustrated in our second example, in which advertising by the manufacturer helped to reduce the retailer's total expense from 35 per cent to 22½ per cent of sales of the advertised article.

The third situation is that in which distribution operates under conditions of decreasing unit costs. This occurs less often than might be expected. The best example is a staple product

that can be sold and distributed to one or a few buyers in ever increasing quantities. The belief that such a concentration of buyers is a dangerous marketing policy to follow, plus the fact that such situations occur very infrequently, has made this type of cost condition relatively unimportant. However, opportunities in this direction should be cultivated. Small business, as the characteristic present-day pioneer in other fields, might experiment and find a solution to this extremely important problem.

A firm's price policy under direct marketing conditions will be strongly influenced by the representative situations just discussed. With constant costs, a policy of lowering prices requires a fairly high degree of elasticity of demand. With constant or only slightly increasing costs, sales promotion should be used with greater vigor in proportion to the expansibility of demand. For example, imagine two products, A and B, each selling for $1.00 per unit above production costs and having a constant total distribution cost of $0.90 per unit. Assume further that 10,000 units are being sold and that A has a very slightly elastic demand, whereas that of B is highly elastic. Experiments with different prices might yield results as follows:

Price		*A*	*B*
$1.00	Number of units sold	10,000	10,000
	Total sales	$10,000	$10,000
	Total expenses	9,000	9,000
	Net profit	$ 1,000	$ 1,000
$0.97	Number of units sold	11,000	20,000
	Total sales	$10,670	$19,400
	Total expenses	9,900	18,000
	Net profit	$ 770	$ 1,400

Under the conditions assumed, it would be profitable to in-

crease sales by lowering price for product B but not for A. If A has a high expansibility, the procedure indicated for it would be to use extensive advertising while keeping the price constant.

When both production and distribution take place on a decreasing cost basis, an ideal combination of conditions exists for the small business that plans on expanding rapidly. In the short run, when distribution operates on a decreasing cost basis, the small businessman may well lower his price and push sales promotion to the maximum limit of his capacity to produce. His attention in this case should be directed primarily toward reducing production costs and expanding facilities, and next toward devising plans to continue this most fortunate condition.

Turnover will receive more particular attention later in discussions relating to each major field. What should be reemphasized at this point is that turnover is merely one of the factors that can lead to an increase in profit. Its importance varies by type of business and by commodities handled, as well as by the most important consideration of how an increase in it is achieved and at what cost.

Today pricing is closely related to certain federal and state laws, to social control within most business fields, and to custom. Each of these will be considered in their applications to the three major fields of small business.

Price is one of five or six devices so often used in various combinations by businessmen to expand their market that these relationships should be understood. These major marketing instruments are: price, advertising, personal selling, availability, the product itself, and the package or container if one is used. Experience has demonstrated that the same result —greater volume—may be achieved by using any one or several of these devices, but the most effective and profitable combination will vary for different situations and will require careful study and forecasting. As a means of expanding sales, pricing should always be considered as an alternate for other

methods, and attention should be paid to its most effective use in a proper combination of all major marketing instruments.[1]

Pricing in Merchandising

Merchants handle a wide variety of goods under varying conditions of location, clientele, competition, and operating expenses. Legal regulation of some retail pricing, first appearing in the middle thirties, often affects individual prices that may be charged. Fair Trade, or resale price maintenance, laws exist in nearly every state. These permit the maker of a branded or identifiable article sold in commerce to enter into agreements with dealers governing the price at which it can be resold. One resale price agreement may apply to all dealers in the state. Some states have anti-loss leader laws intended to prevent selling at a price lower than landed cost plus six per cent.

Next to legal limitations on pricing, certain store policies are of greatest importance. Among these are policies regarding the store's reputation, clientele desired, competitors, and market strategy. Most independent retailers try to sell at current market prices, recognizing differences in services, location, and quality of goods handled. For staple merchandise this is probably the best policy. Retailers handling luxury or specialty items with no direct local competition often sell at "market plus" or "class" price. Many small retailers attempt to sell at less than current market prices, but few if any succeed with this policy. Whenever the local situation permits, it is better for the small retailer to select merchandise lines that can be priced to avoid direct competition.

Retail pricing is complicated by several factors. An important one is the fact that the cost of handling each item out of thousands carried is impossible to determine with sufficient

[1] Reiley, W. J., "Advertising." *Handbook of Business Administration*, Chapter II, pages 44–47. New York: McGraw-Hill Book Company, Inc., 1931.

accuracy and speed to be valuable. Demand and competitors' prices therefore become dominant factors.

For pricing purposes most merchandise can be divided into seven major classes: Fair Trade items, items with prices suggested by the manufacturer or nationally advertised, staple convenience goods, shopping goods, fashion and seasonal merchandise, novelties or specialties, and leaders. Correct pricing will be somewhat different for each class. Pricing of items under Fair Trade laws is done for the retailer by the manufacturer, usually through the local wholesale distributor. Each item has either a fixed price or a minimum price that usually becomes the market price whenever competition is active. When vendors suggest retail prices or quote prices in national advertising, small retailers usually conform to them unless the store policy is to cut prices. For staple convenience goods, which are fairly well-standardized items available in a large number of stores, either customary prices or the going market price is used. These are usually the lowest prices at which such merchandise can be handled profitably. A serious danger in cutting prices on such items is that all competitors will quickly reduce their prices and no permanent increase in volume or traffic will result.

Shopping goods are unstandardized items that change frequently in both quality and style. Before retailers adopted price lining, prices also changed frequently. Customers formerly compared the offerings of two or three stores before purchasing goods in this class, although this practice has been declining for several decades. Retail districts, however, vary in the extent to which customers actually shop and each merchant should understand his trading area. Some branded lines of shopping goods, especially in the wearing apparel fields, are sold through exclusive or selected agency agreements according to which prices are set or suggested by vendors. In most cases, however, the retailer has a certain amount of freedom in setting prices. It is here that price lining, or the reverse demand

curve, and elasticity of demand are especially important to the individual merchant.

This is also the principal area in which price strategy, or selecting both merchandise lines and prices that dovetail rather than compete directly with those of other dealers, is most important.

Before 1920, merchants often carried a bewildering array of prices and brands with little analysis of the rate at which each sold. Since Filene popularized price lining in his book *The Model Stock Plan,*[2] extensive studies have proved that customers of any store handling shopping goods prefer a small number of prices within each merchandise classification. Often 65 to 85 per cent of all purchases will be made at three prices even if six, ten, or more prices are offered. This is the reverse demand curve in action. Since food is not usually considered a shopping good subject to price lining, the following quotation was selected to show both the basic nature and widespread application of this concept:

> Briefly, price-lining is nothing more than having quality merchandise at prices customers want to pay. Experience shows that when a grocer carries 7 to 9 different lines of the same quality item with prices ranging from 15¢ to 27¢, the bulk of his sales will be concentrated in 2 or 3 prices. Let us assume that these prices are 17¢, 19¢, and 21¢. The grocer should make sure that these items always are available—and give serious consideration to eliminating some or all of the items in other price classifications. Knowing the prices that sell, the grocer can deduct his margin and know what prices he can pay for such items.
>
> Take coffee, for example. Coffee is available in a certain store at the following every-day prices.

Type	*Price per Lb.*	*Per Cent of Sales*
A	$.36	2
B	.37	1
C	.37	14
D	.39	6

[2] Filene, Edward A., *The Model Stock Plan.* New York: McGraw-Hill Book Company, Inc., 1930.

E	.42	28
F	.43	24
G	.45	12
H	.46	12
I	.49	1
J	.52	1

Nine prices are listed, yet analysis shows that 14 per cent of sales are at 37¢; 28 per cent at 42¢; 24 per cent at 43¢; and 12 per cent at 46¢. The 36¢, 49¢, and 52¢ coffee account for only 10 per cent of total sales.

Examination showed that stocks of these slow-selling items were much too large in proportion to sales, that considerable sales effort had been put to selling these items, and that three of the four items had been purchased by the grocer because they were a good buy. The grocer had made the cost price to him the first step in his buying process instead of the last step—for there is no such thing as a good buy until there is a good sale.

By price-lining, the grocer shifted the price range of coffee from 36¢–52¢ to 37¢–46¢, with a corresponding decrease in stock (investment) and an increase in coffee display space. The net result was greater sales and more profit.

Along with price-lining, the grocer must consider brand-lining, in order that both price and brand desired be available. This is especially true in grocery items where the price differential is negligible.

In one store where the retailer aimed to stock a complete variety, by brand, it was found that canned milk sales broke down in the following manner:

Brand	*Percentage of Total Sales*	*Amount of Display Space (Per Cent)*
A	34	20
B	30	20
C	17	20
D	9	10
E	4	10
F	3	7
G	2	7
H	1	6

Obviously, by cutting down the number of brands and utilizing total available display space in a manner best suited for merchandising properly those brands which consumers desired, total sales were increased, faster turnover was achieved, and higher profits resulted. There was no noticeable consumer dissatisfaction over the elimination of the slow sellers.

The most effective way of breaking down consumer indifference is not by offering leaders and bargains in items that the consumer does not want, but by offering reasonable values on merchandise she needs daily. If the housewife can walk into a clean, friendly store and find bright, fresh displays of items she needs—at the right price and in the brand she likes—that is the store that will get her business.[3]

Although most fashion goods and seasonal items are subject to price lining, they show the additional influence of the time factor in relation to pricing. Store policy will determine whether fashion merchandise is first offered at the very beginning of the season or somewhat later after the risk element and retail prices have been reduced. Initial fashion offerings should be priced high enough to allow for the great amount of risk and the very large subsequent markdowns involved. As the fashion cycle develops, prices become more competitive and therefore lower.

A store catering to the middle or upper middle class but not to the fashion leaders in a community would price merchandise relatively high early in the season expecting to take markdowns as the fashion cycle progresses and just before the more popular-priced stores enter into competition. Initial prices would be somewhat higher than those in volume or "promotional" stores but substantially lower than prices in fashion leadership stores. Markdowns to be considered in the initial

[3] Small Business Aids, No. 330, U. S. Department of Commerce, "Keeping a Balanced Grocery Inventory." Condensed from "Clear Your Decks for Action." *National Grocers Bulletin*, May, 1947, Chicago, The National Association of Retail Grocers of the United States, Inc.

price would be normal for fashion (not high fashion) goods and would be similar for different styles, because the fashion acceptance of all styles carried would be assured before this type of store begins promotions. By contrast, the high fashion store will offer many styles that do not receive public acceptance. These may be difficult to sell at any price, often even well below cost. Consequently, the few fashionable lines must bear the loss of less successful numbers. Also, predicting even what percentage of styles offered at the very beginning of the fashion cycle will become fashionable is far more difficult than estimating markdowns for the more conservative store.

Two methods are used to arrive at the initial retail price when retail reductions are a major item. One is the simple, non-competitive, or approximate method whereby the initial price is the sum of cost of goods plus total expenses plus profit desired plus markdowns and discounts to employees plus estimated stock shortage. The last three are called "retail reductions." The formula to use for this method is:

Initial retail price (\$) = landed cost of goods + expenses + profits + shortages + markdowns + discounts to employees

Markon (or the amount added to the cost of goods to arrive at the initial price) thus calculated may be used either in dollar amount or as a percentage. This method will always give a higher initial price than the second method, which is used only when percentages rather than value figures are employed. Most small retailers will find the simple formula adequate for their needs.

In standard retail accounting, markon (sometimes called initial markup) is figured as a percentage of the initial retail price, but markdowns, shortages, employee discounts, expenses, and profits are figured as percentages of net sales. Adjusting for this shift in the basis of percentages, we have the formula:[4]

[4] For further study see Wingate, John W., and Brisco, Norris A., *Elements of Retail Merchandising*, pages 40–41. New York: Prentice-Hall, Inc., 1938.

$$\text{Markon } (\%) = \frac{\text{Expenses} + \text{profits} + \text{markdowns} + \text{shortages} + \text{employee discounts}}{\text{Net sales} + \text{markdowns} + \text{shortages} + \text{employee discounts}}$$

Regardless of which formula is used, the final price set is the nearest or most appropriate price line. For example, if use of either formula gives an initial retail price of $1.66 and the store has price lines for such goods of $0.98, $1.39, and $1.79, the article would probably be priced at $1.79.

Novelties or specialties usually carry a relatively high markup. Also, they may often be selected with price strategy, or dovetailing, in mind. Since novelties are likely to have a short selling season, prices may be high at first but often must be lowered as the novelty demand wears off. As with seasonal or fashion items, drastic markdowns may be needed to close out stocks as the demand drops toward zero. Careful daily watching of prices is important with goods of this type.

Leaders are items priced low enough to attract price-conscious customers. If properly selected, they may attract shoppers who will buy regular merchandise in addition. Small retailers affiliated with voluntary groups often use leaders furnished by their sponsoring vendors, especially in the grocery and drug fields. In general, the trend has been to use fewer leaders than formerly. Price regulating laws, especially state anti-loss leader or unfair practice laws, restrict their use. Unfair practice laws resemble the anti-loss leader laws discussed previously except that they require a vague "cost of doing business" instead of some small percentage to be added to landed cost in determining retail price. However, economic conditions that make customers extremely price conscious may cause an increase in the importance of the loss leader price policy.

Although the retailer is not ordinarily able to price each item to cover its landed cost, expenses, retail reductions, and a fair margin of profit exactly, he should always consider these factors and aim to average the results of a line or class of goods,

or at least a department, to achieve this goal. In the case of unstandardized goods, the small retailer's intimate knowledge of his customers will often enable him to select different styles for two or more retail prices from a lot of goods that all cost the same, or he may find it possible and necessary to sell for the same price lots of goods having different landed costs. These are both cases of averaging to achieve the desired gross margin.

The size of the town in which a store is located often has a bearing on price policies. Contrary to uninformed popular belief, prices on most items sold in retail stores are lower in large cities than they are in small towns. Even when chain stores have outlets in cities and nearby small towns, their prices in the small town stores tend to be higher than in their city stores. High fashion goods, which are not ordinarily handled by retailers in the smaller towns, are an exception to this generalization. However, merchants in small towns have two serious dangers to contend with that are all too frequently ignored—out-of-town shopping and mail order competition.

Shopping out of town is a more serious and extensive problem than the vast majority of retailers in small towns of 10,000 or less realize. Numerous important studies have proved this fact, but few of the retailers affected will face the facts. Because the larger-margin, more expensive items are usually purchased out of town, the local merchants lose most of their business on the more profitable items.

Pricing by Wholesalers

Wholesale pricing in many lines is still influenced by the traditional trade discount system, as illustrated by the manufacturer's use of chain discounts from list prices. This practice was originally based on the relatively constant margins required for dealers in each stage of distribution. Thus in the farm equipment line the wholesaler may expect to receive a discount of "less 25 less 20." His price to retail dealers is list price less 25 per cent. The 25 per cent is considered adequate to enable retailers to pay all expenses and have a satisfactory

margin. When the list price used is actually the retail price at which the article is sold to the consumer, when each discount in the chain represents the gross margin actually needed currently for dealers in the respective stages of distribution (retailor, wholesaler, or broker), and when the discounts are large enough or changed frequently enough to keep them in line with gross margin changes, the chain discount system is usually satisfactory to the dealers. When conditions and prices are subject to great changes, the small wholesaler who has any choice in his pricing will do well to investigate the relative merits of this fairly rigid type of pricing as compared to alternate methods.

In general, wholesale as well as retail prices are based on the markup or gross margin necessary to handle each line of goods profitably. Competition tends to keep margins small on staples, but larger margins are needed on lines affected by fashion or other influences resulting in large markdowns. Wholesale prices are much more sensitive than retail or factory prices. In many fields they change frequently, sometimes daily. This happens less often under the chain discount system and very seldom for goods in regard to which the producer follows an administered price policy.

Sometimes the wholesaler wants to suggest a list or retail price, either at the request of the manufacturer or as management counsel to the retailer. An extreme example of this practice is merchandise sold under Fair Trade agreements. When Fair Trade pricing is used, margins for both wholesaler and retailer are usually adequate. With other goods the wholesaler has the problem of pricing to the retailer in such a way that the latter will have sufficient margin and still be able to keep his prices competitive. This is probably the major pricing problem for most small wholesalers today.

In setting his prices low enough to enable retailers to handle each item profitably, the wholesaler must consider the effects on his margins and business methods. This is one reason for

the great interest in cost accounting and expense control among wholesalers in recent years.

Another decision the wholesaler must make is what basis to use for determining the cost of goods. Three methods of arriving at this cost are used: (1) landed cost for each shipment—the "first in, first out" method, (2) last purchase, and (3) replacement cost. Since even small wholesalers purchase in large lots and prices may fluctuate greatly before the wholesaler has sold all of any one shipment, selection of the best methods to arrive at cost is a matter of considerable importance. There is no one best way that would apply to all fields under the various conditions that may exist at a given time.

Even small wholesalers are likely to follow the varying price policy—that is, quoting different prices on the same merchandise to different buyers depending upon bargaining ability, size of order, and similar factors. Even under the one-price policy, actual prices may vary according to the services extended, such as credit and delivery. This condition is not so troublesome, because usually a uniform discount schedule can be used or a price schedule prepared for each grouping of services.

Under the varying price policy it is desirable for the wholesaler's salesmen to have maximum and minimum prices for each good and some incentive to sell at or near the maximum price whenever justifiable.[5]

Pricing for the Small Factory

In manufacturing in general the price of each product is closely related to its cost of production. When only one product is made, unit cost is easily calculated by dividing total expenses plus total costs of materials and parts for a given period by the number of units of products made during the same period. To this must be added distribution or selling costs per unit plus a fair margin of profit for a minimum price to be

[5] Beckman, Theodore N., and Engle, Nathanael H., "Wholesale Prices and Pricing Policies." *Wholesaling*, Chapter 22. New York: Copyright 1937 by The Ronald Press Company.

determined. Sometimes whether a higher price than the minimum should be charged will be determined by other conditions, such as lack of competition, a demand greater than the company is able at present to supply, or the desire to create a prestige reputation. In setting a price above the calculated minimum there is always the danger of inviting competition. Usually it is better for the small business to figure a fair profit in the minimum calculation and price at that point.

When two or more products are manufactured, cost accounting becomes necessary to arrive at the approximately correct minimum price for each product. Expenses are divided into two groups, fixed or overhead and variable or direct. As volume increases, fixed or overhead expenses remain approximately the same in total amount but decrease per unit. Variable or direct expenses increase in almost direct proportion to increased volume but remain fairly constant per unit of output. Total unit cost is the sum of these two. Consequently the cost of production can be decreased, per unit, in proportion to the relative importance of overhead or fixed costs. When additional products of a different nature can absorb some of this overhead, the effect is similar to that of manufacturing one product in greater volume. When certain variable costs, such as that of raw materials, are small or even decrease with increased volume, as they may in the utilization of waste or by-products, actual additional costs of production for the by-product may be relatively very low. And finally, when several products are made in the same factory, the determination of unit costs becomes somewhat arbitrary and standards for pricing should be shifted from so-called "cost of production" to other factors like competition, nature of demand for the product, and company pricing policy.

In pricing to meet competition the first question to decide is what competition the firm plans to meet. This may be viewed in two ways, either as to other manufacturers' products or as to temporary price reductions or cut-price wars. In general, it is inadvisable for the small manufacturer to attempt to meet

all such price cuts as special promotions and those resulting from competitors' price wars. Selection of the manufacturers' products for competitive pricing should recognize the extent to which the firm's product differs from those of other companies. If a company has successfully differentiated its product, the pressure to meet direct price competition is greatly reduced. Probably the two best guides are, first, those products that most nearly meet the same need as the company's product and, second, from this group those that are most popular in the marketing area.

Another factor especially important for the small businessman to consider is the way competitors are likely to respond to price changes. If pricing is keenly competitive and price changes take place frequently, it may be risky for the small business to take the lead in offering lower prices. This leads logically to a consideration of the general nature of pricing accepted in the field. At one extreme is a policy of administered prices, by which the leaders set their prices and stay with them for considerable periods of time. At the other extreme is the policy of meeting all price reductions and keeping prices at the lowest possible point. Between these extremes will be found the policies followed by the majority of companies.

Within the more important limits on pricing set by competition the effects of two important factors should be considered: nature of demand for the product and cost of production. Products vary widely in customer response to small changes in price. This property is commonly known as elasticity of demand for the product. The importance of lower price as a method of market expansion naturally varies directly with the degree of elasticity or the price alertness of customers. It is well to remember that price is only one of the six major marketing instruments and should be emphasized only when it is more effective in expanding sales than one or more of the others. Frequently experimentation with customer response to different possible prices may be necessary to determine the relative importance of the price factor. In this experimentation

competitors' actions should be noticed and care taken to avoid starting a price war.

Very often some pricing must be done before actual production takes place. This involves the necessity of estimating costs fairly accurately, because the price set will influence volume of sales. This in turn will react upon unit cost of production and is important in making cost and sales estimates as well as for a continuous review of current prices. Thus it is desirable to determine for each product the breakeven point, beyond which further price reductions should not be made under existing conditions. It means that point at which the extra revenue obtained from increased volume just equals additional production plus marketing costs.

Another condition likely to be encountered by the small business is that involving differential pricing, which may be desirable when the company's products are sold through two different types of outlets. For example, a small factory may contract to sell approximately half of its output to one large distributing organization, such as a mail order house, chain store, or department store. Since these large firms perform the wholesaling functions and selling to them usually involves a low selling cost per unit of product, a low price can be quoted on this part of the plant's output. Pricing the rest of the product will follow the principles already discussed, except that in calculating costs of production allowance must be made for the fact that a large share of indirect or overhead expenses has already been absorbed by the sale of the large order. It is considered a violation of the Robinson-Patman Act to price the product to the large buyer so low that it does not include a proportionate share of overhead costs. A second consideration in such cases will be the effect of this dual distribution on the price necessary to induce individual dealers to handle the product. For the small manufacturer this may not be serious, because the large distributor will probably resell the product under its own private brand name. It is only when the product

is offered by the large distributor in easily identifiable form in direct competition with individual outlets that pricing to the latter becomes a serious problem for the small businessman.

Another consideration in pricing by the manufacturer relates to the use of list prices from which discounts are granted, as compared to quoting direct net prices each time a sale is under consideration. The use of list prices has at least three advantages: first, it suggests the retail price to the dealer; second, it is often useful to the dealer in selling to the final consumer; and third, it permits more flexibility in making price changes and quoting different prices to different buyers. A closely related question is the extent to which individual salesmen are to be given authority to determine prices at which the company's product will be sold. This is mainly a matter of price and organization policy. The company price policy should further provide for any recurring decisions not already discussed in this section.

A small dress manufacturer in a town of 13,000 sells through two agents who also handle other lines and sets his prices as follows: A card file is maintained with the approximate cost of each different type of garment. To the cost of materials and labor is added a 40 per cent markup as well as 10 per cent for selling costs and .093 per cent for overhead. One card is maintained for each dress made, and the price calculated as just described is used in quoting prices.

The factory referred to in the preceding paragraph is not located in a market center. Small factories located in market centers for their type of product often find it desirable to use wholesale price lines. When the goods produced are sold through retail stores that use price lines, as is the case with many articles of popular women's wear, this method of pricing is used. Wholesale price lining is also desirable when the products are sold through fixed price or even price concerns like variety stores. In either case the manufacturer has his prices determined for him, within narrow limits, and his prob-

lem is the profitable manufacture of goods to sell at these price lines.

Pricing by the Service Business

The variety of businesses classified as services is enormous and pricing will be quite different in some fields from what it is in others. In professional and many semi-professional lines like insurance, real estate, and advertising agencies prices are usually based on a customary fee or percentage of the value of the transaction handled. Splitting commissions with clients and similar price-cutting tactics should not ordinarily be considered in these fields. It is always unethical and frequently contrary to law.

Another broad class of services may be represented by personal service establishments like beauty parlors and barber shops, and common repair or reconditioning plants like appliance repair shops, laundries, and dry cleaning plants. In most communities there will be several establishments of each kind with currently accepted prices for the basic or more standardized services. Pricing in these fields is usually based on a fairly stable price for a few of these services in each kind of business. For example, in dry cleaning plants a lady's plain dress and a man's three-piece business suit are commonly used. Appliance and other repair services may take the typical cleaning and tuning-up job for a popular model of car, refrigerator, or radio, as the case may be, for the basic price. In barber shops a haircut is the same price whether it is an easy or complicated job. From these basic service prices a price schedule should be set up for other important and fairly standard services. Special jobs are frequently priced at some standard rate according to the amount of labor required. In all cases adequate allowance must be made for wide variations in the amount of materials and supplies needed.

Many small repair shops in the automobile, radio, appliance, and similar fields find that customers like flat rate pricing. It can be used on 80 to 90 per cent of the jobs that come to the

average shop. Company agencies will ordinarily use the list prices suggested by the manufacturers they represent. Others may use published lists or subscribe to a price reporting service like those used by plumbing and heating contractors. When published lists are used, an average wage rate is the basis. Flat rate prices are calculated by applying to the average hourly wage rate some multiplier, such as two or two and a half, for overhead and expenses other than direct labor.

The tendency with many small operators is to use hourly rates that are too low. For example, a list may give the standard time for a particular job as four and a half hours, the multiplier as two, and the average hourly rate as two dollars. Thus the standard flat rate price would be eighteen dollars plus cost of materials used. A small operator may figure his price as follows: $4\frac{1}{2} \times 2 \times 1.50$ (his hourly rate in dollars) = a flat price of $13.50. If his labor at $1.50 per hour is fully as efficient as the average $2.00 per hour worker, he will be in the clear. However, the standard time is usually based on efficient labor skilled in the particular kind of work being priced.

Another method of arriving at costs for the purpose of setting prices is the following: Assume that you are a beauty parlor operator (although the procedure might be used in other personal service shops). In the table shown below are 3 typical shops. The total costs of Shop 1, exclusive of supplies, amount to $8,600. Assuming that this shop has 3 booths and allowing 1 additional booth for the open space used, cost per booth equals $8,600 divided by 4, or $2,150.

On the basis of a 48-hour week, allowing for ⅓ "idle time," there remains productive working time of 32 hours a week, or 1,664 hours in a working year. If each booth has a total cost of $2,150 for 1,664 hours, cost per booth per productive working hour is $1.29.

Following the same process, we find that the cost per booth per productive working hour in Shop 2 is $1.20 and in Shop 3, $1.12.

In order to determine a selling price for each service you

render, you will need to know the time involved in each operation. If doing a shampoo requires 20 minutes, the basic cost in Shop 1 will be ⅓ of $1.29, or $0.43. The charge for a shampoo will be this figure plus the cost of supplies plus profit. In the case of Shop 2, the selling price would be $0.40 plus the cost of supplies plus profit; in the case of Shop 3, $0.37 plus the cost of supplies plus profit. Should the time element be 30 minutes, you would take ½ of the cost per booth per productive working hour instead of ⅓. Should the time be 1 hour, you would take the full cost per booth per productive working hour.[6]

ANALYSIS OF COST PER BOOTH PER PRODUCTIVE WORKING HOUR

	Shop 1	*Shop 2*	*Shop 3*
Rent	$1,200	$ 1,600	$ 2,800
Salaries and commissions	5,000	7,000	11,000
Overhead	2,400	3,400	4,000
Total (exclusive of supplies)	$8,600	$12,000	$18,600
3 booths plus 1 for open space	4 booths		
5 booths plus 1 for open space	6 booths		
8 booths plus 2 for open space	10 booths		
Cost per booth per annum	$2,150	$ 2,000	$ 1,860
Productive working hours per annum based on 48-hour week and ⅓ idle time	1664 hrs.	1664 hrs.	1664 hrs.
Cost per booth per productive working hour (exclusive of special supplies)	$ 1.29	$ 1.20	$ 1.12

One more illustration of relating price to cost is the two-price system used by some dry cleaners. Under this plan, price is based on the cost of labor and materials used rather than on the value of material worked on. For example, cleaning a pair of $10 drapes with hooks would cost more than a $20 pair without hooks, and a man's suit that was badly stained would

[6] Adapted from Small Business Aids, No. 8, Department of Commerce, "What Price Service." Condensed from "What Price Service," by Murray M. Sumner. *The American Hairdresser,* July, 1946, Chicago, MacLean-Hunter Publishing Corporation.

cost more than a similar suit requiring a minimum amount of labor and materials.[7]

Although prices should be set high enough to cover processing and marketing costs, the relationship is not so simple as total cost plus a fair profit. In fact it is more likely in these fields for the small operator to accept prevailing prices and try to keep his costs low enough to make a profit. Custom and competition tend to set the basic price. The small firm will have difficulty in charging more and usually finds it unwise to charge less. To attempt to cut prices for services of comparable quality is likely to start a dangerous price war. Often the larger units in some of those fields in which machinery is used will have lower costs than the small operator.

Even when the small businessman would be able to sell at reduced prices, it is not certain that it would be desirable to do so. Assuming that competition merely meets his prices, the lower level may or may not increase total use enough to make it profitable. It is usually better for the small business to stress quality of service, being careful to maintain an above-average quality at all times. In addition, any advantages possessed by the smaller firm should be capitalized and featured as a reason for patronage. The very small concern may personalize many of its services and offer other conveniences appreciated by patrons, such as quicker delivery of the finished job, friendly advice regarding the service, special inducements on less frequently used services, and the offering of unusual but related new variations of the service.

Although prices for services of the type under discussion here tend to be customary and competitive in each town, they vary considerably in different towns and parts of the country. Also, costs vary widely among different concerns even in the same town and kind of business. Labor costs and the general level of incomes in a given town account largely for the former

[7] For further study see "A Two-price System Based on Costs." *American Drycleaner*, October, 1945, Vol. 12, No. 7, page 37.

condition, whereas the latter depends mainly on volume of business and relative efficiency of management.

The remaining group of service industries are those in which direct quality competition is absent. Many forms of personal service are of this type. Services entirely new to the community would also lack direct price competition, at least at the beginning. In such cases important factors to consider in setting prices are: the willingness and ability of customers to pay; the extent to which users are unable to judge the quality of the service directly and consequently tend to use price as a guide to quality or desirability; nature of the service itself; whether larger volume lowers unit cost or does not affect it; whether expansion is definitely limited by the time of key men; and the danger of inviting competition to enter the area. Most of these are self-explanatory. In general, prices for services of this type will tend to be high—well above nominal "costs of production"—but tempered by opportunities to expand at decreasing costs or by the threat of competition.

For the service field as a whole, costs tend to be less powerful in determining price than in either merchandising or manufacturing. If costs are not much lower than prices that can be successfully charged, they must be reduced to meet customary or competitive prices. In all cases the quality of the service is of fundamental importance. A real danger in meeting competitive prices is that quality will be reduced enough to jeopardize the future of the business.

Conclusions

Inasmuch as modern business operates through a price structure or system, correct pricing is of great importance in maximizing profits. Incorrect pricing can quickly put any small concern out of business. Price is one of a few major marketing instruments commonly used by most firms to expand their markets or volume; its importance relative to the others varies widely under different circumstances. At one extreme lower prices may result in no appreciable increase in sales or may

even cause sales to decline. At the other extreme even small decreases in price result in large increases in sales. However, even in this case it is not always wise for the small business to take the lead in cutting prices. At least two additional factors must be considered: total unit costs at the new price and probable action of competitors. *Pricing for profit is important but not simple.*

Many factors in addition to costs and competition need to be considered in successful pricing. Two important factors are company policy regarding the reputation and class of trade desired and the customers' attitude toward price. In a surprisingly large number of cases customers—especially household consumers—tend to judge quality primarily by price. When quality determination or comparison is difficult or troublesome, as it is for some consumer goods and many services, this situation is likely to be present.

For the manufacturer who distributes his products through dealers the additional factor of marketing costs is often important in correct pricing. Sometimes a policy of maintaining prices at the factory and putting any available funds into increasing sales promotional efforts, improving packaging, or restyling the produce is much more desirable than lowering prices to dealers.

In general, price is the most dangerous of the major marketing instruments for the small businessman to use aggressively. This should not discourage carefully directed experimentation in pricing, but it should emphasize the need for careful study and understanding before changing prices or price policies.

Review and Discussion Questions

1. How do the most important factors in pricing differ for each of our three main fields, merchandising, manufacturing, and service? How do you explain these differences?

2. For each main field compare the discussion of price policies in Chapter IX with the corresponding discussion of pricing con-

tained in this chapter and explain why certain topics considered in this chapter were not discussed in Chapter IX.

3. In which of the main fields is successful pricing by the small businessman likely to be most difficult? Why?

4. Are the prices charged for similar merchandise sold in retail stores in different towns and cities likely to vary more or less widely than the prices of comparable services under the same circumstances? Explain.

5. What are the advantages and dangers to the small businessman of experimenting with his prices? Are these the same for each main field? Explain.

6. For each main field, briefly trace the relationships between price, turnover, and profit.

7. Select some kind of business not discussed in the chapter and list: (1) the important factors to consider in pricing and their approximate relative importance; and (2) precautions to take or the most likely dangers to avoid in connection with pricing.

8. Which is more likely to lead to business failure, selling at too high or too low a price? Discuss.

9. How important is forecasting the trend of future prices as an aid in correct pricing by the small businessman? Explain and illustrate.

10. Name as many products and services as you can think of in regard to which consumers rely chiefly on price as a guide to quality. Suggest probable reasons in each case.

11. Is the business selling at a "class" price (well above total costs or intrinsic value) or one selling at market price on firmer ground? Explain and support your conclusion.

12. If you were starting an entirely new kind of business, explain how you would endeavor to determine the most profitable prices to charge.

13. What attitudes among businessmen are likely to influence pricing by the small businessman? Discuss.

14. Describe the conditions under which it might be advisable for a small business to initiate price cutting.

15. Give several examples of the pricing tactic of "dovetailing" in a competitive market.

16. Examine the prices in several stores from the viewpoint of price lining. If you find examples of more than four price lines, find out the proportionate sales of each.

17. Do the same as in 16 for brand lining.

Problems

1. A general merchandise store in a town of 50,000 has always followed the practice of pricing reserve stocks at the latest prices quoted. Prices on forward stocks, or merchandise actually on the selling floor, are not changed. For several years the trend of prices had been upward and the company had frequently remarked reserve stocks once or several times before moving them to the selling floor. Competitors had apparently been doing likewise. Recently, however, several competitors seemed to revert to the practice formerly followed of using actual costs.

The owner had just about decided to change back to the original cost method when the question became an issue over a particular lot of fairly staple merchandise that had recently been received. About two-thirds of this shipment was still in reserve stock. The buyer had just received a new price quotation 20 per cent higher and had already instructed the marker to change the price by this amount. The owner and the buyer found that about half of the other merchants were repricing reserve stocks. The others planned to keep the original price.

Analyze the problem and decide what you would do. Give your reasons.

2. A small artificial flower shop makes a high-grade, realistic product and has acquired a good reputation for orchids and gardenias. The flowers have often been mistaken for live ones, even by florists. With reasonable care they will last indefinitely. The shop is small but is in the process of expanding. It is owned by the lady who originated the process and her partner, a young college graduate with about five years of successful business experience. Four girls make the flowers by hand. The work requires an artistic type of individual. However, there is a possibility of subdividing operations somewhat along the usual factory assembly line principle.

The principal raw material is obtained from Japan through an importer. Other materials and supplies are purchased from American manufacturers and wholesalers. At present the average total cost per orchid of materials and supplies is about $0.90, direct labor $1.00, and overhead $0.20, making an average total cost per orchid of $2.10. All sales are made direct to consumers with no advertising or selling expense. At the current price of ten dollars each the firm is behind on filling orders actually on hand. With the new organization of production it will just about be able to supply present demand, and production costs will probably be lowered to about $1.80 per unit. Further cost reductions are possible with increased volume, although it is doubtful if real mass production would ever be possible.

The buyer for a large group of department stores has offered to take the entire output of the plant or any part of it up to an expanded output of twenty times its present capacity on a five-year contract basis at a factory price of $2.30 per unit, all packing and delivery expense to be paid by the buyers. He contemplates that the individual department stores would sell the orchids at prices between $3.75 and $5.00. If his offer is accepted, output would have to be increased fourfold and he would prefer an increase of from ten to twenty times present capacity. At such a volume unit production costs could probably be reduced to about $1.60.

The owners believe that most of the department stores would find a better market for the orchids at prices of $7.50 or $10.00 each, or even more, than at prices under $5.00. This belief is based on previous experience with department store selling. There is also some question as to the effect upon their mail order sales to consumers at $10.00 if department stores were to offer the same flower at prices under $5.00. A buyer from California suggested that the price be raised to $15.00.

There are no serious questions concerning financing expansion or securing raw materials and an adequate supply of workers who could be trained to turn out a quality product. The only questions are those relating to pricing and price policies with reference to the future and profits of the business.

Analyze this problem carefully and decide what you think the

management should do. If you decide they should sell to the department store group, at what price should the orchids be sold? Should a minimum resale price be part of the contract? Why or why not? Justify all your decisions.

Chapter XVI

EXPENSE CONTROL

Profit in business is the difference between net sales or receipts and cost of goods plus total expenses. In Chapter III we noted as one essential requirement for business success the ability to control expenses. For the small business, expenses are of two broad types: actual and imputed. Examples of actual expenses are payments actually made for utility services, labor, interest on loans, and, if the building is not owned by the proprietor, rent. Imputed expenses are those that would be charged for property or services of the proprietor if secured from someone else; they include interest on his own capital invested in the business, rent for the premises he owns that are used for business purposes, and a fair salary for his own services as manager of the business. Too many small businessmen fail to include in their expenses charges of the three types just mentioned. Other beginning entrepreneurs assign themselves a "salary" in excess of the true value of their services. Both extremes should be avoided.

Many small businessmen fail to appreciate the importance of the difference between gross margin and net profit. The common practice of referring to the former as "gross profit" is in part responsible for this careless attitude. In addition, failure to keep adequate records showing *all* expenses that must be deducted from gross margin to ascertain net profit has caused much vague and optimistic thinking on this subject. With a margin of 30 per cent too many operators think of their net profit as being almost that much, after allowing for a few of the more obvious expenses like rent, utilities, and so forth. In

manufacturing a common weakness is to focus attention on the cost of raw materials and the expense of direct labor without giving much thought to other expenses.

The profit and loss statement is the basic accounting record that brings sales, material costs, expenses, and profit (or loss) into their logical relationships. The following examples prepared by Professor P. D. Converse will make this clear.

To illustrate the variety of expenses and their relative size, two operating statements are presented here—one of a men's clothing store of moderate size and the other of a small factory.

The first statement reveals that John Doe, Clothier, paid 68½ cents of each dollar of sales for the goods he sold. This left him a gross margin of 31½ cents. Out of this margin he had to pay the salaries and commissions of his salesmen; the salary of a bookkeeper, if one was employed; his rent; the wages of his deliverymen and the expenses of his delivery truck; his own salary; his advertising; his heat, light, water, and telephone; interest on borrowed money; taxes; insurance; stationery and postage; contributions; and various miscellaneous expenses such as travel, auditing, and legal. He also had to reserve a small amount to provide for depreciation of furniture and fixtures and to meet losses from bad debts.

The problem of the store manager is to meet all these expenses and have some profit left. John Doe, Clothier, succeeded in meeting all his expenses and having $1,029, or 2.6 per cent, left as a profit. If we assume that the item "general salaries, $1,575" represents John Doe's salary, he earned $2,604 for his work and for his capital invested in the business. This is slightly below the average return of retail clothing stores but is typical of the profits made by thousands of retail stores of moderate size.

The second statement covers the operations of the X Manufacturing Company. From each sales dollar, this company paid 36.6 cents for raw materials. This left 63.4 cents to pay labor and other operating expenses, selling expenses, and to provide a profit. Twenty and nine-tenths cents went for labor, and 13.6 cents for salaries. This left 28.9 cents to cover freight, insurance, taxes, repairs, fuel, reserve for amortization of patents, reserve for depreciation of equipment, general factory overhead expenses, office expenses,

contributions, advertising, commissions and traveling expenses of salesmen, royalties, bad debt losses, and interest on borrowed money. These expenses amounted to 38.7 cents, resulting in a loss of 9.8 cents on each dollar of goods sold.

TABLE 14

PROFIT AND LOSS STATEMENT OF JOHN DOE, CLOTHIER

		Per Cent of Sales
Sales	$38,693.26	100.0
Cost of merchandise sold	26,493.70	68.5
Gross margin	$12,199.56	31.5
Expenses		
Salesmen's salaries	3,344.71	8.6
Salesmen's commissions	1,025.63	2.6
Traveling expenses	183.20	.5
Advertising	322.10	.8
Auto expenses	525.79	1.4
Wages of deliverymen	1,040.00	2.7
General salaries	1,575.00	4.1
Stationery and postage	271.69	.7
Telegraph and telephone	42.00	.1
Rent	1,800.00	4.7
Heat, light, and water	527.72	1.4
Insurance	55.50	.1
Taxes, exclusive of income taxes	190.40	.5
Bad debts	43.96	.1
Auditing and legal expenses	75.00	.2
Miscellaneous administrative expenses	110.08	.3
Interest	37.70	.1
Total	$11,170.48	28.9
Net profit for the year	$ 1,029.08	2.6
		31.5

This manufacturer was unable to pay all of his expenses out of his receipts from sales and suffered a loss of $7,798. A company

TABLE 15

PROFIT AND LOSS STATEMENT OF X MANUFACTURING COMPANY

		Per Cent of Sales
Sales ..... (1)	$79,196.09	100.0
Expenses		
Materials used	29,104.05	36.6
Labor	16,634.10	20.9
Freight	1,480.64	1.9
Insurance	696.62	.9
Taxes, exclusive of income taxes	1,103.21	1.4
Factory repairs	1,430.76	1.8
Fuel	543.00	.7
Amortization of patents	307.32	.4
Depreciation of machinery and tools	5,110.44	6.5
General factory expense	5,151.61	6.5
Salaries	10,840.00	13.6
Office expense	4,502.94	5.7
Contributions	121.00	.2
Advertising	474.12	.6
Commissions	1,256.62	1.6
Traveling expenses	676.49	.9
Royalties	4,049.86	5.1
Bad debts	1,192.09	1.6
Interest expense	2,319.00	2.9
Total ..... (2)	$86,993.87	109.8
Loss for the year (1) minus (2)	$ 7,797.78	9.8

cannot operate indefinitely without making a profit. In the year the X Manufacturing Company lost approximately $7,800 of its capital. If such losses continue over a period of years, the capital will be used up and the company will fail. Many concerns incur losses in some years but make profits in others. If a company is to continue in business, losses in some years must be offset by profits in others. Losses are a challenge to a businessman to find the reasons and correct them. The plant may be inefficiently operated; sales may be too small to carry the overhead expenses of the plant; the wrong selling methods may be in use; or the company may be

paying too much for its raw materials. Poor quality of the product may limit sales; perhaps a new or improved product is needed. Whatever the reasons, the head of the business must discover them and correct the conditions at fault. If he does not, the business will eventually fail.[1]

The foregoing examples show what can happen in the absence of proper expense control. Our job is to see how modern management deals with this problem.

Modern business is forward-looking. Sales, expenses, and profits are planned in advance and strenuous efforts made to achieve or go beyond the goal set. This means expense control, but not necessarily reduction of expenses. Expense control is normally used to reduce expenses, especially those tending to get out of line, but it may well be used to increase some or all expenses to achieve certain desired objectives, such as greater total profit or the pioneering of some new product, service, or idea. In either case the same fundamentals will apply. Several techniques have been developed to improve the effectiveness of expense control, especially: budgets, expense classification, standard accounting (including use of operating ratios), and method studies.

Expense budget

An expense budget is a control device used by management to predetermine what each major class of expenses should be for the period of time covered, and to aid executives in conducting the business in line with these expenses as planned. It is a valuable management aid.

In modern business, control is always exercised in relation to some goal. There must be a desired objective, certain standards set or predetermined, current reports or records for comparison with these standards, and prompt executive action to keep in line with planned figures. This applies to every

[1] Converse, P. D., *Should I Start My Own Business?* Special Bulletin No. 5, *University of Illinois Bulletin,* April 10, 1945, Vol. 42, No. 34, pages 18–20.

division of the business, including sales, production, raw materials or merchandise purchases, personnel, and financing; but our attention here will be confined to business expenses. To repeat for emphasis, control requires: predetermined standards, current comparable reports, and prompt, intelligent executive action.

As applied to the expense budget, the objective may be to achieve a certain volume of business at minimum cost or to expand volume rapidly even though the cost of doing so will be high temporarily. In either case standards will be set in terms of anticipated expenses appropriate to the objective planned; operating reports that show at frequent intervals what expenses have been actually incurred will permit comparison with planned figures. Appropriate action taken in time will prevent an unsatisfactory condition from continuing. In some cases it is possible to require authorization before certain expenses are incurred and thus to increase the degree of expense control exercised. One example is to require prior authorization before a department head can add an additional employee.

An expense budget is a "must" for every business. In launching a new enterprise, it is the basis for deciding whether the venture should be undertaken or for satisfying the banker that the enterpriser has a good proposition for a loan. To the established business it means the difference between success and failure. It should be made in terms of an accepted expense classification for the particular business field and in line with available data from other successful firms. If a businessman aspires to higher goals, he should provide for improving on industry standards by reducing his expense percentages through better management.

Expense classification

Each major, established field has developed a classification of expenses best suited to itself. Usually for the very small establishment a simple breakdown of expenses into a few major divisions is suggested, with progressively detailed subdivisions

recommended as the size or volume of the business increases. This topic will be discussed in more detail later for each of the three major fields.

If the firm is well established, the standard expense classification accepted for that particular line of business should be set up in the firm's accounting records. In so doing one will inherit the benefit of previous experience in the field. He will also be able to use current operating ratios and expense data published by the trade association, Department of Commerce, Dun & Bradstreet, and other reporting agencies as a continuing guide to the success of his operations. If he selects his own expense accounts, definitions, or classifications, he will have no assurance that they are comparable to published data. For example, does the expense for advertising include only payment to newspapers and other media, or also payroll, "donations," and other such items? Are the same items included in the delivery, credit, or other expenses for customer services that other businessmen in the field include? Discrepancies in expense classifications such as the few suggested here will render comparison with average data for the field worthless.

With an accurate, complete record of the expense items which make up the totals in standard expense accounts, an operator can immediately tell whether one item that is too high can be cut down in future operations. Suppose one of the accounts is lower than standard. Ordinarily he would experience a certain amount of satisfaction over this, but he should examine it anyway. Perhaps something is wrong. If this was his advertising account, he might have brought in a larger sales volume and a correspondingly higher profit if he had spent more for advertising. In studying expense control it is well to know how much can wisely be spent to increase profitable sales volume and where adjustments, up or down, can be made to increase net profit in the long run.

There are two major classes of expenditures in operating expense: fixed (such as licenses, franchises, taxes, and usually

rent) and variable (such as payroll, utilities, supplies, and advertising).

Fixed expenses are those that cannot be changed a great deal, although, of course, minor reductions can usually be made. These expenses often represent only a small part of the total operating expense.

Most of the important expense items are variable expenses, which can be controlled to meet the needs of the business. Even rent, for example, may be reduced in a number of ways. There is always a possibility of getting the landlord to make a reduction if he is convinced that the firm cannot possibly operate profitably because of excessive rent. If the rental rate is not excessive compared with that of similar buildings, the sales volume may be too low for the amount of space or the location occupied. If this be the case, sales may be increased by more aggressive promotion. If more space is occupied than is actually needed, possibly the rent can be reduced by subleasing to other persons.

The cost of utilities can be reduced by turning out unneeded lights in storerooms and by making a periodic check of heating equipment and any possible changes that would result in a lower fuel cost over a period of years. It might be more profitable over a long period of time to substitute a new, more economical heating plant.

Salaries and wages may be reduced either by employing fewer workers or, preferably, by increasing productivity per worker. Incentive wage plans and method studies are both used to accomplish this.

Advertising expense can be reduced in proportion to sales by making the advertising result in more business. This can be done by a better description of merchandise offered and by convincing the reader that he is getting his money's worth when he buys the advertised articles.

Bad debts can be reduced by keeping accurate, up-to-date records on all charge sales and following them up immediately when they become delinquent. Credit applicants should be

interviewed and their past credit records should be checked. The terms to be granted should be carefully explained to the customer to prevent any misunderstanding.

Delivery costs can be reduced by a periodic inspection of delivery equipment. "An ounce of prevention is worth a pound of cure" means just that in connection with the upkeep of delivery equipment. An inexpensive grease job on the pickup truck could very well save the much greater repair cost of having a universal joint replaced. Sometimes one can save on delivery costs by hiring delivery services instead of maintaining his own equipment.

The miscellaneous expense account is usually a catchall in which are gathered all expenditures that cannot be classified under any of the other expense accounts. Many times one will find small expenditures in this account which should never have been made and charged to business operations. These can often be cut down to some extent.

Method studies

Method studies are careful analyses of the way some activity is being performed, usually for the purpose of reducing the expense involved or making other improvements in the way the work is done. For repetitive operations that take a short time to perform, time studies may be used to assist the analyst in selecting more efficient methods. For most situations in the small business, however, critical observation and good judgment in making changes will usually be sufficient.

The good manager is alert to notice any unsatisfactory condition in the business and is anxious to do something about it. If some activity is not satisfactory at present, the manager may either eliminate or improve it. Method studies should be used to help decide what action to take and how to improve any division of the business that it is desirable to retain. Operating ratios and other expense data from the firm's records show what is the current condition regarding major activities performed, but they do not set standards as to what is possible.

Furthermore, although an expense in some particular classification may be out of line at present, there is no satisfactory excuse for not bringing it into line or doing even better. All the techniques of scientific management and human knowledge are available for this purpose, and those that will help should be used. To repeat, expense control means *control;* if any item is too expensive, something should be done about it. This is the primary purpose of method studies.

If a retailer cannot make a profit selling cereals with clerk service, he should put them on a self-service basis. If a product costs too much to manufacture, production expenses must be reduced or the business turned over to competitors. If a store is unable to operate a needed millinery department at a profit, it can lease it to one of the millinery syndicates.

Labor is the largest item of expense in most businesses. Good employee relations will help to reduce this expense, as will good personnel management and careful selection, placement, training, and incentive remuneration of all employees. Formal method studies and written job descriptions are always used to advantage by the small businessman.

To illustrate applications of the fundamentals of expense control further we shall now examine the major fields of small business. It must be remembered that within each major field there will be variations in application, different standard methods of expense classification, and similar adaptations to be made for each particular line of business.

Expense Control in Merchandising

To the retailer certain items of expense are of major importance. They are: labor, rent, advertising, and those items relating to inventory or investment in merchandise. In some lines customer services also account for large expenditures. Store policies regarding the class of customers desired and services to be rendered may affect expenses greatly.

A merchant can keep his payroll under control by employing the amount and kind of help needed. More use should be

made of part-time employees and a contingent group of workers than is made at present. A little investigation in most communities will disclose many individuals willing and able to work on a part-time basis during normally busy periods in the store. It may also show a few persons, such as former employees who resigned to get married, who would be willing to work occasionally when needed but who would not accept regular employment. Although the small retailer is not usually able to employ workers specially trained and skilled for each kind of task to be performed, he can try to secure more reliable and better qualified employees than those frequently hired. To do so will involve paying higher wages but may actually reduce labor costs because of the greater productivity secured. Once qualified workers are employed, it is a good policy to assign duties to each worker to take full advantage of special skills and abilities. Proper supervision and use of the other techniques of good labor management will help to keep this largest item of expense under control.

In some cases retailers can reduce expenses by employing outside agencies to do work that would not justify investment in equipment and payroll. For example, deliveries can be made through a mutual or consolidated delivery system. For infrequent small deliveries Western Union messengers may be used. Sometimes delivery trucks may be rented, maintenance and depreciation costs being borne by the renting firm. Purchasing such services as bookkeeping or window display may be good business when they are performed by experts for a modest charge.

Store policy determines how rent, which is usually the second largest item of expense, can be controlled. Continuously adjusting policies to capitalize fully on all changes in the characteristics of the store's location will help to keep this expense in line.

Studying location trends in the region closely and planning future adjustments to them will provide for the long-run needs of the business. Usually a fundamental decision is involved,

whether to remain on a particular site and adjust to changes in shopping traffic or to keep changing sites to follow the original class of customer.

Advertising is an example of an expense that can often be controlled more effectively by increasing than by decreasing the amount spent. The intimate relationships between rent and advertising were discussed in Chapter VII and need not be repeated here. The important point is that a merchant whose advertising expense ratio is below the standard could probably increase his sales and profits by spending more money for effective advertising.

In other areas the retailer may find that certain expenses should be increased to secure greater profits. Others might be decreased by better maintenance or more careful supervision without impairing results.

Electricity is an item in regard to which expense reduction may be accompanied by better service. Frequent cleaning of all light fixtures and replacement of bulbs when necessary should be standard practice. Walls and ceilings should be painted white or a very light color and kept clean if maximum returns are to be secured from the lighting bill. In the use of electrically operated equipment, such as refrigerators, deep-freeze units, or fans, conservation should be studied and practiced. Frequent inspection to keep motors at peak efficiency may be needed.

Other opportunities for economy can be found in the use of supplies, as well as in most divisions of the business. Although a "penny pinching" attitude is unwise, continual alertness to ways of making major expense reductions is often one of the surest roads to profits. A good example of this is the case of fire hazards, especially during busy months like December.[2]

The merchant's problem of expense control is unique because he carries a large number of articles of merchandise, many of

[2] For further study see "Insurance to Value." *Men's Wear*, September 13, 1946, Vol. 114, No. 3, page 107.

his employees do several kinds of work, and he must continually defer to customer wishes or demands. In place of using cost accounting for particular products, as is done in manufacturing, the merchant "costs" entire lines or classes of goods. Since the functions performed by various retailers remain basically the same regardless of location, class of customers, kinds of merchandise handled, or other variables, and since many of the expenses incurred, such as those for labor, rent, and equipment, serve two or more functions, a dual system of expense classification and control has been developed, especially for the department store and general merchandise fields.

Expense classification

Retail expenses, under this dual system, are classified as either natural or functional. The natural groups include all expenses, such as payroll, utility bills, rent, and travel, as they are actually incurred and recorded, regardless of what functions are served. The functional classification assigns to each function the proportion of these natural expenses it accounted for. To illustrate, the National Retail Dry Goods Association recommends for small stores fourteen natural classes of expense as follows: payroll, rentals, advertising, supplies, services purchased, travel, communication, repairs, taxes, interest, insurance, depreciation, professional services, and unclassified. These are then distributed among five major functional classifications: administration, occupancy, buying, selling, and publicity. Further breakdowns are used in both types of classification. Operating data assembled and published by the Controllers' Congress, National Retail Dry Goods Association, and the Harvard Bureau of Business Research use these standard expense classifications. Merchandising departments are also standardized and numbers are assigned to each so that a given number always refers to the same department in every store anywhere in the country. Such departmental operating data as turnover, stock-sales ratio, and total expenses can then be compared accurately with national averages.

Closely resembling these expense classifications for department and general merchandise stores is an effort by the Department of Commerce to develop a system of cost accounting for retail stores, especially those handling such convenience goods as groceries, drugs, and hardware. Although somewhat complicated for the average small retailer, this system is recommended for study and use as the problem of expenses grows more pressing.[3]

Operating ratios

Ratios constitute an important device for comparing data when two factors vary, such as sales and rent, payroll and size of city in which the business is located, or manufacturing expense and type of order (stock, special, rush, or preseason). Operating ratios serve as the yardstick or measuring device for many business activities. They are averages of the results achieved by thousands or hundreds of thousands of businessmen striving to do the same thing—namely, make a profit. Some fail and show very poor ratios. Many achieve moderate success and give us the average ratios. A few excel and provide ratios for the most ambitious to use as guides or bases for comparison. Many published operating ratios are presented in these three groups: those for unprofitable, for average, and for very profitable concerns. Operating ratios are usually compiled annually and published by the trade association in each field. In recent years, retail operating ratios by store and town sizes have been published by the U. S. Department of Commerce in the *Inquiry Reference Service.* Since operating ratios are more highly developed in the retail than in other fields, they are considered in this section, although their use is recommended for small businessmen in other fields whenever they are available.

Comparison, analysis, and intelligent, timely action is the proved formula for expense control. Operating ratios help in

[3] Bromell, John R., "Cost Accounting in Retail Grocery Stores." *Domestic Commerce,* February, 1947, Vol. 35, No. 2, page 23.

this respect just as does the budget for the individual store.

At the end of the year the retailer may find out whether he has made as much profit as he should have or if he has operated efficiently by comparing his business with others in his line of trade. If he finds that his expenses are too high, a comparison of his figures, item by item, with the expenses of profitable firms will enable him to ferret out those that are guilty of eating up the profits. Also, he may find that he is losing business by not spending enough along some lines or is raising other expenses by more than the amount he is saving on the low items.

To use standard operating ratios, the retailer should first list the different items in his profit and loss statement under the headings used in tables available for his line of trade. He should then work out the ratios by dividing the total of all the items shown under each heading by his net sales.

It is the total of all expenses that affects net profit; should one item be too high, some other must be decreased to keep profits at the average ratio. For example, a high delivery cost ratio may be balanced by a low rent ratio. Also, increasing one expense item may cause a reduction in another that was formerly too high.

To illustrate the use of operating ratios Table 16, which shows typical operating and merchandising ratios for limited-price variety stores, may be analyzed. An individual retailer in this field would, of course, compare *his* ratios with those given in the table.

As the table shows, profitable concerns had a combined salary and wage expense of 16.2 per cent, whereas unprofitable concerns had a ratio of 19.7 per cent, or 3.5 per cent higher. Occupancy expenses were 4.9 per cent and 5.8 per cent respectively, or 0.9 per cent more for unprofitable concerns. Thus, of the difference in total expenses (5.6 per cent) between the profitable and unprofitable groups, about two-thirds consisted of higher payroll and three-quarters of payroll and occupancy expenses combined.

TABLE 16

TYPICAL OPERATING AND MERCHANDISING RATIOS—1939
LIMITED-PRICE VARIETY STORES [4]

	All Concerns	Profitable Concerns	Unprofitable Concerns	Range of Usual Profitable Experience: Lower Limit	Range of Usual Profitable Experience: Upper Limit
PROFIT AND LOSS STATEMENT: (in percentages of net sales)					
1. Net sales	100.0	100.0	100.0	....	....
2. Cost of goods sold	68.5	67.4	73.2	....	....
3. Total expense	26.5	25.8	31.4	22.0	28.1
a. Salaries, owners and officers	9.4	9.2	9.9	6.5	11.8
b. Wages, all other employees	7.2	7.0	9.8	4.0	8.5
c. Occupancy expense (89% of concerns renting)	5.1	4.9	5.8	3.6	6.6
d. Advertising	0.8	0.8	0.7	0.4	1.3
e. Bad debt losses	0.2	0.2	0.1	0.1	3.3
f. All other expense	3.8	3.7	5.1	1.5	6.0
4. Profit or loss [(L): loss]	5.0	6.8	4.6(L)	3.4	10.6
MERCHANDISE RATIOS:					
5. Gross margin (% of sales)	31.5	32.6	26.8	29.5	35.8
6. Realized markup (% of cost)	46.0	48.4	36.7	41.9	55.8
7. Inventory turnover (times per year)	2.8	2.8	2.7	2.1	3.7

[4] Mitchell, Walter L., Jr., *Standard Ratios for Retailing*, p. 49. New York: Research and Statistical Division, Dun & Bradstreet, Inc., 1940.

It will also be noted in the merchandising ratios that the gross margin was 5.8 per cent larger for profitable than for unprofitable stores. This suggests the possibility of poor buying accompanied by heavy markdowns. Although inventory turnover was lower for unprofitable concerns, it was so nearly the same for both groups that it does not appear to be an important factor in this case.

Failure to control payroll (especially employee wages), higher occupancy expense, and lower gross margin are indicated as the chief reasons for failure to make a profit. However, attention should be called to the figures for bad debt losses. Unprofitable stores had losses of only 0.1 per cent, or just one-half the average for profitable concerns. The figures would ordinarily suggest that the unprofitable firms were losing business because of their unwillingness to grant enough credit. Before concluding that a strict credit policy played a major role in the failure of these stores to show a profit, we should need to know how important credit extension was in influencing sales. In general, it is less important to variety stores than in most fields of retailing. Actually, of the stores included in the survey only 10 per cent sold on credit (that is, made 10 per cent or more of their sales on open account).

As this analysis shows, expense ratios do not show how a retailer may be failing to obtain an adequate return for some of the money he pays out. Even when the retailer's ratios compare favorably with the standard expense ratios, individual items may in reality be too high if he gets less for his outlay of money. For example, one retailer may deliver fewer packages than another who spends the same amount for this service. The remedy may be found in cost analysis based on the cost of doing a given piece of work, such as either cost per package, in the case of deliveries, or cost per average sale. This type of cost accounting requires that overhead costs be charged to lines of goods or to departments. How much of the rent bill for the store should be charged off to delivery expense, for example, might be figured out by estimating the percentage of total

floor space occupied by the quarters devoted to preparing packages for delivery and loading them on trucks.

The ratio of net profit to sales should be interpreted in the light of sales volume and capital invested. A low ratio on a large volume may mean a good profit. Likewise the same ratio is more satisfactory when volume is the same but investment less.[5]

The following comments of the Senate Special Committee to Study Problems of American Small Business are pertinent to the subject of using operating ratios effectively:

> Even though the standard ratios are based on the figures of a group of stores more or less like your own, there are sound reasons why the ratios for your store may vary considerably from the standard ratios. Some of the reasons why variations between your ratios and the standard ratios may be either favorable or unfavorable are discussed under the headings which follow.
>
> *Gross-Margin Ratio.* A high gross-margin ratio may indicate either purchases at low prices, or sales at high prices, or both. A low gross-margin ratio, on the other hand, may indicate either inadequate mark-ups, or high merchandise costs as a result of poor buying judgment. Or, it may be the result of a deliberate merchandising policy (or campaign) of selling at low prices in order to obtain a large sales volume. To be profitable, such a policy must result in large sales volume and be accompanied by low operating costs.
>
> *Total Operating-Expense Ratio.* A higher-than-average total operating-expense ratio does not necessarily reflect any unfavorable conditions in the store. If it is accompanied by a high gross-margin ratio, and a satisfactory net-profit ratio, it may reflect the character and policy of the store. For example, a better-than-average type of merchandise, or sales based on additional service to customers, may yield extra gross margin to cover the extra expense involved, and to provide a satisfactory net profit.
>
> Nevertheless, a store with a total expense ratio much higher than

[5] Cornish, N. H., "Retail Store Operating Results as Guides for Small Merchants." *Journal of Marketing*, July, 1946, Vol. 11, No. 1, pages 62–64.

that for similar stores is quite likely to be unprofitable. The typical unprofitable store has a high total expense ratio for its kind of business. This may be owing to small sales volume as compared with the profitable store, and not necessarily because it pays higher wage rates or higher rent rates. More frequently, however, a higher-than-average total operating expense ratio in an unprofitable store indicates low efficiency; that is, poor management in controlling expenses.

Net Profit or Loss Ratio. The profit or loss ratio reflects the net results of the operation of the store. This ratio indicates the effectiveness of the management of the store and measures the efficiency of its operation. The net profit or loss ratio is influenced by many factors. A profitable store is usually the result of efficient management which, on the one hand, succeeds in maintaining a satisfactory dollar gross margin—from purchases at low cost and from sales at prices that are neither too high nor too low—and, on the other hand, succeeds in keeping all expenses under control.

Proprietor's Wage Ratio. Since many retailers do not make a distinction between money withdrawn for their wages and that which is a withdrawal of profits, a proprietor's wage ratio which varies from the average may have no significance. A higher-than-average ratio may indicate either that the store earns large profits, or that excessive wages are being paid to the owner.

A low owner's wage ratio, accompanied by small withdrawals of profits and a satisfactory net profit ratio, indicates that the retailer is building up his capital by leaving his profits in the business. On the other hand, a low wage ratio, accompanied by a low net profit ratio, indicates that the owner is getting a small total return from the operation of his store.

Employees' Wage Ratio. A relatively high employees' wage ratio is ordinarily an unfavorable sign. A high wage ratio may be the result of inefficient use of help, a poor store arrangement, the employment of too many clerks for the sales volume being obtained, or it may be the result of other factors. Like a high gross-margin ratio, however, a high wage ratio may be the result of a carefully thought-out management policy. It may indicate the retailer's policy of obtaining sales by providing more or better clerk service instead of spending more on rent, fixtures, or advertising. The degree of

success of this policy can be determined by studying the sales volume, the gross-margin ratio, the rent and other expense ratios, and the net profit or loss ratio.

A low employees' wage ratio is usually evidence of efficient management, especially if it is accompanied by a low total operating-expense ratio and a satisfactory net-profit ratio. It may mean, however, that the store is not employing enough workers or not employing the right kind of clerks. An unsatisfactory sales volume may indicate that the latter is the case.

Rent (or Occupancy) Expense Ratio. A high rent ratio may be the result of the store being larger than necessary to handle the present sales volume. On the other hand, a high rent ratio may mean that a favorable location has been obtained which makes it possible to obtain sales without high expenditures for advertising which might otherwise be necessary.

A low rent (or occupancy) expense ratio may mean that the retailer has been able to secure the store building at a low rental or purchase price. Or it may mean that the building is too small for the volume of business.

Advertising-Expense Ratio. An advertising-expense ratio that is in line with a standard ratio may not necessarily be favorable. The advertising may have been successful in increasing dollar sales volume, so that the added dollar advertising expense represents no greater percentage of sales than normal. But, if the added sales volume consists mainly of staples or low-margin goods, the advertising may not be profitable. To be profitable, advertising must result in added dollar gross margin more than sufficient to cover the added dollar advertising and other expenses. That is, the advertising should sell goods carrying high gross-margin rates as well as staples.

On the other hand, a low advertising-expense ratio, which is accompanied by small sales and net profits, may possibly mean that one of the causes of the unfavorable results is insufficient advertising.

Delivery-Expense Ratio. Unless the proportions of delivered sales to total sales are known, no worthwhile comparisons of delivery-expense ratios can be made. A store with two-thirds of its sales delivered will almost necessarily have a higher delivery-expense ratio than a store with only one-third delivered sales, and any difference between the ratios of two such stores will be of no significance.

Only when a store has approximately the same proportion of delivered sales as that of the group with which it is being compared can significant comparisons be made. A high ratio will then indicate inefficiency in the delivery operation, and a low ratio the opposite.

Bad-Debt-Loss Ratio. One of the factors to be considered in analyzing the bad-debt-loss ratio is the proportion of credit sales to total sales. Just as in the case of the delivery-expense ratio, a more worthwhile comparison can be made if the proportion of a store's credit sales is approximately the same as that of the group of stores with which it is being compared.

A low bad-debt ratio is usually evidence of a credit and collection policy that has been carefully planned and strictly enforced. Or it may be an indication that too much caution is being used in the development of credit sales. A high ratio usually indicates laxness in extending credit and in making collections.

Other Expense Ratios. Higher-than-standard ratios for any of the other expense items on the profit and loss statement usually indicate an opportunity for expense reduction. Heat, light, power and water, store supplies, and miscellaneous expenses, may be higher than average because of a deliberate merchandising policy of rendering extensive service, but more often they are high because of a lack of expense control. Depreciation of store equipment, being a noncash expense, may be high because of the methods of computing depreciation. A cash-shortage ratio that is too high is almost always the result of improper methods of safeguarding cash. Taxes and licenses may not be subject to the control of the retailer, but a high miscellaneous-expense ratio probably arises from carelessness in expense control.

Inventory Turn-over Rate. The inventory turn-over rate is calculated by dividing the cost-of-goods-sold item on the profit and loss statement by the average of the beginning and ending inventories at cost. For example, assume the cost of goods sold was $17,595, the value of the inventory at cost on January 1 was $3,569 and the value of the inventory at cost on December 31 was $3,606. This means that the inventory was "turned" approximately five times during the year—$17,595, divided by $3,587.50 equals 4.9.

A high inventory turn-over rate is commonly considered to be

favorable, but its importance may be exaggerated. In fact, a turnover rate that is too high may be just as unfavorable as one that is too low. A high rate sometimes means that the retailer has concentrated his attention on carrying small stocks of "fast movers." This practice may result in the loss of potential sales because of the increased risk of being "out of stock" and because of the lack of a sufficient variety of goods to satisfy customers. Also, the practice of buying fast-moving merchandise in small quantities may merely deprive the retailer of the wholesaler's lowest prices for quantity purchases, and increase the time he spends in ordering and receiving goods.

On the other hand, an inventory that turns over too slowly is probably loaded with slow items, that may not only tie up needed working capital, but also may lead to loss of sales because of the lack of fresh stocks of merchandise.

The foregoing discussion indicates that the profit and loss statement of any store should be analyzed. As an aid in your analysis you may compare your operating results with those of similar stores, by means of standard ratios. This comparison must be made, however, with a knowledge of the ways in which the operating conditions of your store differ from those in the stores whose operating results are reflected in the standard ratios. Such critical analysis can point the way to larger profits.[6]

Expense Control in Wholesaling

In wholesaling materials-handling is a major target for expense reduction. Clerical expense can easily get out of line, since almost every transaction involves some paper work. Other common methods of expense reduction are: simplification of stock, reduction in selling costs through closer coöperation with retailers, manufacturers' coöperation in packaging small units to eliminate the wholesaler's "broken package" room expenses, and selective distribution.

Stated differently, the wholesaler must help his independent

[6] Welch, Charles H., and Sevin, Charles H., *Small Business Problems; Record Keeping for Small Stores.* Senate Committee Print No. 2, 79th Congress, 1st Session, Revised ed., pages 50–53. Washington: U. S. Government Printing Office, 1945.

retailer customers meet the growing competition of chains, mail order houses, manufacturer-controlled retail outlets, "supers," and new kinds of low cost retailers in a market where price competition will be an important factor. Many wholesalers are setting goals for expenses that will enable them to sell to independent retailers at prices low enough to permit the retailer to meet mail order competition or at chain store prices adjusted for the difference in customer services. The more important wholesaler's expenses can be reduced only if retailers coöperate. This is especially true with reference to selling expense. Also, unless wholesalers can aid many of their retail customers in reducing expenses the retail margin will offset most of the lower prices made possible by expense reduction.[7]

Wholesalers share the advantages of manufacturers and most service businesses in being able to control expenses on an impersonal basis. It is primarily the retailer who must accept many added expenses arising from personal contact with customers. Location, type layout, displays, and costly customer services account for most of these retail expenses that can be greatly reduced in the other major fields. Wholesalers should discover useful adaptations by studying cost reducing techniques and equipment as developed in manufacturing.

Distribution unit cost studies, a technical application of the method studies technique already discussed, have been used by wholesalers in connection with expense control. The following procedures in particular illustrate this approach: determine the cost of rendering service to individual customers, the cost of handling orders of various sizes, and the cost of selling per dollar of sales or for a certain number of orders received by each company salesman. The last is a common function of sales management. The first two deserve some special comment.

Experience shows that many retailers buy in such small

[7] "Operation Cost Survey." *Hardware World*, August, 1946, Vol. 43, No. 8, pages 80–82, 197.

quantities from any one wholesaler and often demand so much service that their accounts are found to be handled at a loss when all valid expenses are charged to the servicing of their accounts. If it takes a $10-a-day salesman one-half day twice a month to call on such an account and the wholesaler receives only $75 of business a month as a result, it would be difficult in most cases to pay even the salesman's salary from the margin available. If in addition credit and other services are extended to the customer, an account of this type would clearly be unprofitable.

When a wholesaler has determined the minimum he can handle at a profit, expense control can be used more effectively in dealing with small order buyers. Efforts are usually made to bring every order accepted up to the minimum, allowing for a few exceptions in the case of normally good customers whose annual volume would justify an occasional small order. Repeated small orders below the minimum may be refused. Usually the salesman can show the small buyer how he can plan his purchases to meet this standard. A few new customers who show promise of expanding may be carried at a loss temporarily. In general, however, it is better to refuse orders below the minimum and to reduce the expense of trying to serve "hopeless" customers.

Expense Control for the Small Factory

Although some of the best opportunities for small business in the field of manufacturing are in totally new or non-competitive lines, expense control is important in such cases for several reasons. No matter how new, different, or so-called "non-competitive" the product being made seems to be, it must compete on a price-usefulness basis with all other objects of consumer expenditures. Inter-industry competition exists regardless of the size of business units involved. In test factories and pilot plants or in pioneering the manufacture of a new product, the ultimate criterion of the commercial value of the item is the cost at which it can be made and sold. And finally,

a new article that clicks with the market will soon be copied by competitors making price competition based on production and selling costs inevitable.

During the first few years, while a new product is being perfected in design, expenses may be considered second to quality only if they are (1) in line with the owner's ability to pay and (2) capable of future reduction to meet the inevitable competition that will quickly develop once the product gains market acceptance.

Fortunately for the small manufacturer highly developed techniques for expense control have been perfected in this field. Cost accounting, method studies, and almost every other tool of modern management were inaugurated in the field of production and later adapted to other fields.

For example, standard costs as used in estimating, pricing, and budgetary control have been well developed for most kinds of manufacturing. Although specific standard, or average, costs are developed for each concern and consequently are not so useful to other firms as the standard operating ratios discussed for retailing, methods of arriving at standard costs and their appropriate uses may well be studied and applied to any kind of business.

No matter how small the factory, certain costs can be controlled from the first day of operations. One of these is plant maintenance. Maintenance should be systematized, planned, scheduled, and controlled as carefully, costwise, as production. The same principles of careful assignment of duties and responsibilities, good supervision, and budgetary control of expenses may be used to advantage. Providing maintenance workers with efficient tools and equipment is good economy. Work should be so scheduled that it does not interfere with productive operations.

Many other expenses are significant to the small producer, such as packing and shipping costs and selling expense. Several references are mentioned in this connection at the end of the book. The same basic techniques are used: careful selection of

the best materials, methods, and equipment; adequate records; simplification and standardization; and planning, supervision, and control.

Distribution or selling costs for the small manufacturer are subject to essentially the same types of expense control. It may seem strange to insert a caution against "volume-itis" for the small producer, but practical considerations make this advisable. All too often the beginning or small concern goes after volume by means of seeking additional orders regardless of their immediate profitableness, hoping for future repeat business at a profitable price. Granting that some pioneering must be done, it is still good business to watch expenses on all orders and follow up closely on those of questionable value. One of the popular methods of exploiting the small producer is to get him to accept orders at or below cost by making glowing promises (never contracts) for future business at highly profitable figures.

Expense control for the average small manufacturer involves good management in at least seven areas: (1) demand forecasting, (2) direct production costs, (3) indirect costs, (4) material and supply costs, (5) transportation costs, (6) costs of methods used for market promotion, and (7) miscellaneous costs such as financing.

Keeping in mind that expense control does not necessarily involve expense reduction, there are ways in which a small operator can improve the accuracy of demand forecasting. By subscribing to the trade journals in his field and possibly in certain cases to those in his customers' fields, he can keep better informed of future conditions likely to affect the demand for his product. There are numerous forecasting services available, one or more of which should be helpful. It is possible to cooperate with business neighbors in subscribing to some of these services and thus reduce their cost to each plant. Attending meetings of trade associations at which trends in the industry are frequently discussed by representatives of large companies that spend a great deal of money on their forecasting research should pay the little fellow. Monthly reports of the Federal

Reserve Banks for each district report major trends that can be used to forecast demand. Many state universities publish a monthly bulletin analyzing economic and business conditions within the state, often undertaking to forecast demand and supply conditions likely to have a bearing on the sales plans of local businessmen. The charge for these bulletins, when there is any, is seldom much more than the cost of printing and mailing. Every small operator should write to the college of business or bureau of business research of his state university to have his name placed on the mailing list for monthly bulletins and other useful publications. In many industrial fields the U. S. Department of Commerce, Washington 25, D. C., publishes monthly analyses and forecasts of conditions. This material too is either free or so inexpensive that no small businessman can afford to neglect using it.

What direct production costs involve is pretty evident in the small factory. Their control involves the determination of a fair day's output for men and machines or the man-hour and machine-hour amounts required to produce each article. These become output standards with which actual production is compared to secure control. Before adopting such a standard, the operator of even a small factory should study ways of improving productivity. Perhaps subdividing the work and letting each worker become more skilled in performing a smaller number of tasks would increase total productivity, or a new layout might accomplish the same result. The small artificial flower factory referred to in the preceding chapter is a case in point. While output was small and all flowers were made by the owner with one helper, no production standards were needed. With expansion it was necessary to increase the number of workers as well as to measure production costs more accurately. Work was subdivided, a modified production line was established, and studies were made to improve the efficiency of each worker before adopting standard times. A similar procedure is possible in any small factory and probably much easier to carry out than

for the artistic, individualized type of work required in the artificial flower plant.

Indirect costs, as the words are used here, include such overhead expenses as management salaries, utility bills, rent, and similar rather fixed costs that do not change directly with varying quantities of production, although such office items as management salaries and excessive utility bills may be partially controlled. In small factories the number of employees engaged in paper work, maintenance, and other activities involving indirect expense may be small relative to the number of direct production workers, and it is easy to be careless about efforts to control such costs.

There is one major difficulty that seems to hold back many plants from making a vigorous effort to raise the productivity of indirect employees. Their reasoning is: "Measuring output of indirect workers is impossible, or at least impractical. How then can you set standards as a basis for measuring productivity?"

In a Detroit bearing plant the measuring job is done this way: physical standards for indirect workers like toolcrib attendants are set up on a basis of the number of direct workers served: for janitors, the area covered; for shipping and receiving employees, the weight or units of material handled; for payroll clerks, the total employment. The same general approach is followed for all indirect worker tasks, from process engineering to accounting.[8]

Managers of larger plants are giving increasing attention to both the control and reduction of indirect costs and have developed methods to direct and check on such work. These guides should help the small plant operator do a better job of controlling indirect costs in his factory.[9]

[8] Small Business Aids, No. 180, U. S. Department of Commerce, "Reducing the Manufacturer's Indirect Labor Costs." Condensed from "Trimming the Fat from Indirect Labor Costs." *Modern Industry*, February 15, 1947. New York, Magazines of Industry, Inc.

[9] For further study see Small Business Aids, No. 180 (just cited), which includes a 16-point plan to control indirect labor costs.

Control over material and supply costs involves much more than shrewd buying. It starts in the factory with a careful study of production needs and processes. One small manufacturer found that a slight change in design enabled him to use an unfinished moulded metal part at less than half the price formerly paid for a similar part with finished surfaces. In another case investigation and the advice of a local technician showed one plant operator how he could use a slightly more expensive lubricant for his machines but actually reduce total supply expenses 20 per cent because the new lubricant was especially made for the type of work involved. Since new materials and supplies appear on the market frequently, many designed for special purposes and others less expensive than ones traditionally used for the same purpose, the small operator always has opportunities for expense reduction. Also, few small operators are so well informed that they know the properties of all materials and supplies already on the market that they might use.

The small factory is often strategically located in such a way that it can take advantage of economies in transportation. Even so it will usually have some transportation costs, with good opportunities for expense control. Careful study of the methods in use, alternate routes, comparative rates, "extra" charges, services required compared to those being used and paid for, auditing of invoices, packing procedures and materials used, damage claims, and use of more costly emergency methods or small order shipments will usually disclose ways of cost reduction and control.

In one case shop needs for minor parts and supplies are neglected until current stocks are nearly exhausted. An emergency order is telegraphed or phoned in for delivery to be made by air express, and transportation costs may exceed the price of the goods purchased.

In some cases an alternate method of transportation, such as trucks instead of railroads or leased instead of company-owned trucks, may result in reduced transportation costs and other

economies. By leasing trucks from private concerns instead of maintaining truck fleets many bottling companies today are operating more efficiently and more economically. The companies have freed themselves of the troublesome job of truck maintenance and are able to devote full time to their primary job—bottling and selling beverages. The following advantages are gained: (1) costs are known in advance, (2) capital is freed for other purposes, (3) valuable time of officials is saved, (4) better work is gained from salesmen, (5) smart, well-maintained equipment is obtained, (6) specialized trucks are used, and (7) extra company trucks are not needed.[10]

Market promotion offers many opportunities for expense control. At the start personal solicitation of orders may be necessary. Later the expense of personal selling may be lessened by using brokers or selling agents who operate on a very small margin, by selling through established middlemen like wholesalers or supply houses, or by using some of the many forms of advertising. Solicitation of repeat orders can often be done by mail or telephone. Although both methods are cheaper per unit than salesmen's calls, they may actually be more expensive per order received than the latter.

Miscellaneous expenses such as costs of financing in the small factory resemble those for market promotion in this respect: during the initial stages of the business, or while its operations are on a very small scale, only the most expensive methods are likely to be available. As the small manufacturer becomes better established and expands his operations, he may easily secure needed capital at four per cent or less. In one case a small factory was started with machinery purchased on long-term credit. An outstanding balance of $4,000 to be paid over a period of three more years was discounted during the second year at seven per cent, using surplus accumulated during the

[10] Small Business Aids, No. 319, U. S. Department of Commerce, "Bottlers Gain By Leasing Trucks." Condensed from "Truck Leasing Can 'Work' for You." *American Carbonator and Bottler*, January, 1947, Atlanta, Ga., Loyless Publishing Co., Inc.

two years of operation. Before discounting the debt, the owner obtained the assurance of the local banker that any unexpected financial needs up to the $4,000 "reserve" would be supplied at five per cent interest.

This discussion of expenses in manufacturing concludes with the advice to use all the regular methods of expense control already discussed, including working closely with the trade association in the field. In manufacturing, the opportunities for expense control are relatively greater than in other fields, because the producer is dealing mainly with materials and processes. He should learn all he can from the extensive writings on industrial management and adapt to his business every idea and technique possible.

Service Establishment Expenses

Well-established service fields have standard accounting systems and expense classifications useful to the small operator. For instance, in the laundry business the American Institute of Laundering (A.I.L.) has developed three systems for plants of each size group. For smaller plants the simplified system is used. There are eight expense accounts: (1) productive labor, (2) productive supplies, (3) power plant costs, (4) building overhead, (5) laundry machinery overhead, (6) indirect overhead, (7) collection, delivery, and sales promotion costs, and (8) office and administrative costs. For expense control purposes, however, each of these is further subdivided. For example, 1.1 is productive labor (laundering), 1.2 productive labor (dry cleaning), 4.2 is rent of laundry building, and 4.3 repairs and maintenance. For each size group operating ratios that may be used for comparison by individual plant operators are compiled each year.[11]

Cost analysis for the purpose of expense control has pulled more than one service business out of the red. It is not always

[11] Kramer, V. H., *Establishing and Operating a Laundry*, pages 100–101. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 37, 1946.

necessary to engage outside industrial engineers, although sometimes their objective approach and specialized knowledge may be needed, as the following cases illustrate.

A failing dry cleaning plant was taken over by a firm of management engineers. Investigation showed labor costs to be excessive and rigid. Whenever business increased additional workers were added, but when volume declined man-hours were not reduced. Lack of supervision and the absence of performance standards were apparent. Production was poorly scheduled and work centers were not properly balanced, so that work piled up at certain points while employees at other production centers were idle. The engineers devoted special attention to making method studies, establishing labor output standards, and promoting sales more effectively. Results were gratifying. Plant output per worker doubled, labor costs were greatly reduced, and both store cash-and-carry and route sales increased.[12]

Two case histories selected from many available for the hotel field will illustrate opposite methods used for expense control, namely, cutting down and increasing expense.

One hotel had two bell boys on duty during the period from 8 A.M. to 8 P.M. Because patrons demanded early morning delivery of mail, one boy was sent to the post office to pick it up. This trip and sundry other duties took the boy off the floor for an hour and a half at the most critical time of service. Instead of employing a third bell boy, management investigated the work loads of other employees and was able to assign a relief elevator operator to do the work formerly performed by the bell boy.

In another hotel the manager was payroll-conscious. Investigation showed, however, that the kitchen staff were overworked and unable to perform their duties efficiently.

[12] For further study see Small Business Aids, No. 131, U. S. Department of Commerce, "Cost Reduction Experts Bring Plant Out of the Red." Condensed from "The Van Gastel Story." *Cleaning and Laundry World*, January, 1947, New York, Cahir Publishing Company, Inc.

Overtime payments alone offset the economy of a small basic staff. By employing two more workers and improving the scheduling of work, an actual reduction in total payroll expense was made.[13]

Conclusions

Expenses must be incurred to operate any business. Activities relating to management of expenses involve accounting records, expense control, and usually expense reduction. Control operates through standards, comparable reports, and prompt executive action. It does not have expense reduction as a necessary objective. Expense control may involve: the use and operation of machines, equipment, and supplies, and method studies or similar research to discover less expensive ways of performing essential operations. *Since business costs are directly related to profits, efficient management of all expenses is essential to success.*

Review and Discussion Questions

1. How could some of the ways of reducing expenses in manufacturing and service industries be applied to retailing?

2. Summarize the points of similarity and of difference in expense management for each of the three major small business fields.

3. Explain and illustrate why expense control is not the same as expense reduction.

4. Compare the operating ratios for the following retail fields and explain any similarities and differences: grocery, hardware, drug, jewelry, wearing apparel.

5. What mechanical aids to expense control are used in the line of business you are interested in?

6. What machinery, equipment, or other mechanical aids could be used by a retailer who finds the expense of operating certain

[13] Maus, Sanford E., "Payroll Studies Eliminate Costly Labor Waste," *Southern Hotel Journal*, July, 1947, Vol. 27, No. 7, pages 26–32.

necessary divisions of the store to be too high? Be specific in your answer.

7. What would you classify as indirect labor in retailing? in wholesaling? How important are these expenses? Can output of such workers be measured and expense control applied to their activities? Discuss.

8. Suggest and discuss several ways expense control should involve deliberate efforts to increase certain expenses.

9. How could the topics discussed in this chapter be of use in appraising a business for possible purchase? in justifying a new business?

10. List in two columns the conditions under which expense control is of greatest and of least relative importance. Discuss.

11. Investigate the extent to which standard operating ratios are used in various fields of manufacturing as they are in merchandising and report your findings. Discuss.

12. Select some kind of business and prepare a budget for the first year of operation based on an assumed volume of business.

13. Locate two possible sites for some line of business for which operating data are available. Make a complete analysis of the relative value of each site as a desirable location, using methods suggested in this and preceding chapters.

14. The following list of suggestions for cost reduction in a certain kind of business illustrates a particular application of many of the points discussed in this chapter. Only a few words that might disclose the kind of business under discussion have been changed. Study it and see if you can determine the type of business for which it was prepared before you read the reference at the end. Which of these methods could be applied to the kind of business in which you are most interested? Discuss.

Ways to Reduce the Cost of Doing Business

1. Make a weekly or monthly survey of the office, store and storage area to locate and eliminate obvious wastes that can be seen at a glance.

2. Have a time study made of the work of employees in office and plan to locate and eliminate waste effort and time.

3. Have a chart made of the flow of work and materials in both office and plant. Study it to see if simplifications and short cuts can be effected.

4. Have complete job analyses made for each employee and type of work. See that each employee knows in detail what is expected of him.

5. Share money saved by reducing costs with the department heads. This is possible when each department has a definite expense budget set in advance. Prizes can be offered to department heads who can, without lowering efficiency, spend less than their budget allows.

6. Secure coöperation of employees by holding frequent meetings for study of wasted time and materials.

7. Reward employees who make suggestions that result in savings.

8. Hold friendly discussions of costs with employees. This will help prevent carelessness in matters of expense.

9. Check the use of every foot of space which you rent or own. By more efficient utilization of such space costs can be reduced or income increased.

10. Study modern mechanical equipment to determine if it will make materials-handling in your storage area more efficient and less costly.

11. Study modern office equipment that might improve efficiency.

12. Survey bulk storage warehouses to determine efficiency of storage arrangements.

13. Study delivery costs carefully. Keep drivers and equipment busy. Group orders for economical routing of deliveries.

14. Provide the switchboard operator with a typewriter, if she is not too busy, and give her routine duties such as addressing envelopes.

15. Have carbon copies of replies to correspondence typed on the back of the original letters. This simplifies filing and makes second sheets unnecessary.

16. Use letter file folders for the second and third time by placing gummed labels over former names.

17. Get employees to cooperate by turning off unnecessary lights. Explain to them how much is spent for lighting in a year.

18. Analyze records and reports compiled in the office. If they serve no real purpose eliminate them. In some companies useless work has been a routine matter for years.

19. To save printing and paper costs standardize the size of state-

ments, invoices, etc. Also avoid two-color printing where it is not needed or does not add effectiveness.

20. Have the clerks who open and distribute mail start work 30 minutes earlier than rest of staff. Mail will then be ready for workers' attention when they arrive.

21. Save on fire and accident insurance rates by having insurance experts explain ways to reduce hazards in your plant.

22. Use inexpensive storage files for old correspondence and accounts. This will eliminate need for additional expensive cabinets and free modern cabinets for current files.

23. Study efficiency of office layout once a year. Make indicated changes to minimize movement of personnel, records and equipment from one department to another.

24. Before ordering office supplies such as letterheads, envelopes, etc., check desks and private offices. Frequently this will reveal large quantities even though stock room supplies are low.

25. Avoid spotty and sporadic buying of office supplies. Plan for needs intelligently and take advantage of quantity discounts.

26. Encourage economy in use of stationery and supplies by means of a regular bulletin reminding employees of high cost of waste.

27. To avoid waste postage in direct mail advertising have each salesman make a quarterly check on mailing lists for his territory. Weed out certain names, keep addresses correct and up-to-date.

28. Club memberships which the company carries might be cancelled if officials or salesmen do not regularly attend meetings or participate in the club's activities.

29. Hold sales meetings and training sessions evenings or mornings when productive time will not be lost.

30. Be positive rather than negative. Praise employees for saving money in preference to criticizing them for spending it. You will enjoy the same—or better—results and have better morale within the company.

31. Don't build up a reputation as either a piker—or a careless spender. Be cheerful in okaying expenditures for worthwhile improvements. Be gracious in forgiving expenses incurred by employees in what they believe are best interests of company. But impress employees with importance of spending company money carefully. Moderation is a virtue, and a middle-of-the-road course will elicit cooperation from employees without destroying initiative.

32. Keep records to determine which of the various advertising

media you use are most effective. Concentrate your expenditures where they will do the most good.

33. Make a complete survey of all extra costs involved in selling packaged jobs. There are probably numerous points where procedure can be streamlined and costs lowered. Just for example, if your methods of handling financing, estimating, materials take-off, and so forth are thoroughly organized they can be executed quickly and accurately, thus saving time of employees and avoiding costly errors.[14]

[14] Small Business Aids, No. 238, U. S. Department of Commerce, "Some Ways of Reducing Lumber Yard Expenses." Condensed from "Effective Plans That Reduce Costs." *American Lumberman & Building Products Merchandiser,* March 15, 1947, Chicago, American Lumberman, Inc.

Chapter XVII

INVENTORY OR STORES CONTROL

Every business requires some inventory of goods. In most lines this inventory of merchandise, materials, parts, or supplies represents a sizable investment of the owner's capital. In general, the merchant invests a larger proportion of his capital in inventories than the small manufacturer, and the service businessman invests a smaller proportion than either. Extensive experience in all fields has shown that unless these inventories are controlled they tend to get out of balance and result in loss to the business. It is the primary purpose of inventory control to maintain the balance that permits most profitable operations.

Any inventory may be out of balance in either direction; that is, it may be too large or too small. This applies to the investment in total inventory carried as well as to investments in each subdivision or classification of inventories. It is especially important with reference to the lack of balance among different items of merchandise, materials, or parts. A $200 inventory of one class of goods composed of ten different items may be average for the field in value and yet be unbalanced when the need for each of these ten items is considered. A satisfactory inventory control will maintain both types of balance, in value and in units.

Under different economic conditions the relative importance of the value aspect—that is, the amount of capital invested in total inventories—varies in importance. An inventory may be well balanced in terms of number of units of each item within a total amount, but be dangerously out of balance with regard to the dollar value invested. This is true especially at the peak of

a rising price trend, just before a pronounced upward swing in prices, and when shortages with controlled prices are imminent. Each of these three important but unusual situations requires management policy decision and lies beyond the normal scope of inventory control, although each may influence management's concern regarding present conditions of the firm's inventory.

In addition to its use as a buying guide, inventory control may result in maintaining small stocks and thus reduce taxes, lessen interest and storage expenses, and secure other benefits.

Scope of inventory control

Five topics are usually included in the scope of inventory control: (1) information required, (2) system, (3) basic data, (4) storeskeeping, and (5) inventory taking. For our purpose the last two will be discussed principally in connection with each of the major fields of small business.

At this point we are concerned with a preview of the scope of inventory or stores control, as well as with some general comments that will apply to all fields and conditions. Variations by field and particular applications will be considered later.

Inventory control requires information. Whether records are used to secure this information depends upon the size of the business and particular internal conditions. Many very small businesses have good inventory or stores control without maintaining more than a few records, if any, for this purpose.

Effective inventory control requires accurate information from the using departments (sales in the case of merchandising, processing in the case of manufacturing or service businesses) concerning such requirements as kind or quality of goods and quantity of each variety, as well as when they are needed. It is not the function of inventory control to forecast needs, but it does help in making these forecasts more reliable. To keep stocks balanced it is necessary to know what a balanced stock is in each case.

Good inventory control will furnish information to the buyers whenever procurement is needed. It will also provide them useful information as to the rate of use, stock turnover, and changes in normal rate of use—"shorts" or overstocks.

Some system must be used if inventory control is to be even moderately efficient, but the small businessman must not mistake the system, which is merely a labor- or timesaving device, for the goal, which is balanced inventories. Any "system" requires intelligent human effort to be successful. Systems or methods used to secure the information essential for inventory control will usually operate through observation, physical checks, or a perpetual inventory record. Another basis for the classification of systems is whether value or quantity is the factor controlled. Thus, in merchandising especially, we observe both dollar control and unit control systems.

Any form of inventory or stores control works with the following basic data: quantities needed, amounts on hand, additions to stock (purchases), subtractions (sales or issues), goods on order, and critical points at which action is needed. The last are usually expressed as maximum and minimum amounts. Whenever the quantity on hand reaches either the maximum or the minimum, steps must be taken if the inventory is to be kept in balance. Two other elements frequently included among the basic data are quantities allocated to known needs and the quantity to order at any one time.

Storeskeeping, or the physical handling and storage of merchandise, materials, and parts, must be performed efficiently if good inventory control is to be achieved. This requires adequate facilities to store each item in such a way that it will be protected and can be located quickly as needed. If some items are carried on consignment, storeskeeping should provide for their special identification.

Finally, inventory taking, or the counting of articles on hand, must be carried out from time to time. When the physical count or frequent check system of inventory control is used for all items stocked and each count is recorded on the inventory

control card (or ledger), it may not be necessary to take additional inventories. However, if the perpetual inventory system is used, actual counts must be made from time to time to correct the book figures.

Inventory Control in Merchandising

The small retailer's biggest investment is his inventory of merchandise carried. When this can be kept at the optimum amount, profits are increased. When inventories are well balanced at all times, the investment in merchandise is working most effectively. Among the major advantages of inventory or merchandise control in retailing is the fact that it enables the retailer to do the following: (1) balance stocks as to value, size, color, style, and price line, in proportion to sales; (2) "play the winners" as well as move slow sellers; and (3) secure the best rate of stock turnover for each item. Expenses and markdowns are reduced. The store's reputation for always having new, fresh merchandise in wanted sizes and colors is one of the major long-run benefits of good merchandise control.

Information provided by a good system of merchandise control that will improve both buying and selling activities includes the following:

1. Price preferences of customers.
2. Right quantities to buy.
3. Amount of a given item sold.
4. Season or time a given item sells.
5. Time to stop buying seasonable goods.
6. Kind and style of goods customers want.
7. Items no longer popular.
8. Time to display and promote certain items.
9. Particular item for which demand is falling off.
10. Best buying sources.
11. Best buying prices.
12. Possibilities for new lines or kinds of goods.

A control system giving this information will eliminate guesswork and memory, both unreliable guides to prosperity.

Every store that has tried a stock control system for the first time

has found that the greatest number of items in stock are rarely asked for or sold. Difficult as this is to believe, it has been found that from 20 to 24 per cent of the items in a poorly-controlled store produce from 75 to 80 per cent of sales.

Efficient, profitable merchandise control need not be difficult, complex or expensive. Many agencies, organizations and associations can furnish good control systems to store owners in their respective fields. These system forms are economical, simple, and easy to operate. They are easy to install, can be brief or extended to fit the need and can be handled in a few minutes each day.[1]

To illustrate how stock control may aid in buying to meet customer demand, the following representation of unguided buying may be used.[2] Data furnished by inventory control could have reduced A and C in the table.

If AB represents what you buy	A	B	
And BC is what customers want		B	C
Then B is what you sell		B	
A are the "sleepers"	A		
C represents the "outs"			C

Since inventory control tends to increase the rate of stock turnover, it may be well to illustrate how important this advantage may be to the small retailer. Figures and operating ratios used are representative of many small general merchandise stores. Consider a store with annual sales of $50,000, stock turnover 3 times a year, rent 5 per cent of sales, and gross margin 40 per cent. If a turnover of 4 times a year is standard in the field, the situation can be summarized as follows:

Present Condition:

$50,000 ÷ 3 = $16.667.....average inventory at retail
$16,667 × 60% = $10,000.....average inventory at cost

[1] "Controlling Merchandise and Expense." One of the 17 booklets making up *Better Retailing*, pages 272–273. Dayton, Ohio: Merchants Service, The National Cash Register Company, 1941.

[2] Miller, Nelson A., *Establishing and Operating a Variety and General Merchandise Store*, page 143. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 35, 1946.

Goal or Standard:
$50,000 ÷ 4 = $12,500 ..... average inventory at retail
$12,500 × 60% = $7,500 ..... average inventory at cost

Excess inventory: $10,000 — $7,500 = $2,500
Interest on excess investment: $2,500 @ 6% = $150
Approximate rent for space used to store surplus inventory:
$50,000 × 5% ÷ 4 ($2,500 is ¼ of $10,000) = $625
The smaller inventory, turning more rapidly, might reduce markdowns, shrinkage, and handling costs by 2% of sales (estimate):
$50,000 × 2% = $1,000

Total Probable Gain $1,775

Average net profit for stores of this class might be 3%; $50,000 × 3% = $1,500. Therefore, the total gain from increased turnover in this example is greater than the average net profit. The more rapid turnover might change a losing concern into one with average or better than average profits.

In the illustration it is assumed that the turnover of 4 times could be accomplished with no increased expense, that the space occupied by the 25 per cent surplus stock accounted for 25 per cent of the total rent, and that when this space was released it could be used effectively for merchandise of average turnover. These would be reasonable assumptions in most cases. They are mentioned merely to caution the reader against overemphasizing the magic of increased turnover by failing to take related factors into consideration.

For most types of inventory control, as well as for other purposes, it is desirable to classify the goods carried into merchandise departments, i.e. to departmentize the store. Similar and related items are grouped together both in the store layout and in merchandise control records. Standard departmental classifications should be used as recommended by the trade association in the field.

Methods used

Methods of inventory control used by small retailers include: observation, physical check, on hand—on order—sold record,

and perpetual inventory. Observation may be sufficient in a very small store in which the variety of merchandise is not large, the rate of sale is fairly constant, and the owner keeps in very close daily contact with all goods. Usually, however, a physical check or count is necessary at intervals that vary according to the rate of sale and importance of the merchandise. It may be a simple or approximate check, as in the case of volume control of staple hardware items, or a careful and accurate one for higher-value shopping goods. The on hand—on order—sold record enables a retailer to know how to order sizes, colors, or styles in proper proportion. The form shown below is one filled in as in actual practice.

LIST NO. D-253
NAME OF SUPPLIER
STREET ADDRESS
CITY AND STATE
TERMS: Net 30

#420 Ladies' F.F. Hose 48¢

PACKED ½ doz. $8.75 doz.
MINIMUM SHIPMENT 15 doz.

ON HAND - ON ORDER - SOLD

	O.H. 8-16	O.O. 9-14 Rec'd	Sold	O.H. 9-18	O.O. 9-28 Rec'd	Sold	O.H. 9-18	O.O. 10-1 Rec'd	Sold	Season Sold
Dawnblush size 8½	3	3	2	4	6	7	3	9		
9	8	6	5	6	12	12	6	15		
9½	12	9	13	8	18	20	6	24		
10	5	6	7	4	12	12	4	15		
10½	2	3	4	1	6	5	2	9		
Rose Nude 8½	2	3	2	3	-	1	2	-		
9	4	6	4	6	-	3	3	-		

Explanation: O.H.—On hand on date noted.
O.O.—On order, same date.
Rec'd—Rec'd on date noted.
Sold—Number on hand on first date, plus number received, minus number on hand on next date.

Note: Tally on 6 (½ doz.), not on 5. All figures are units.

This control supplies the information needed to order in quantities that will sell out evenly, as illustrated in the example.

		Lot number				
		1	2	3	4	5
On hand	8/1	12	17	14	11	10
Received	8/11	..	12	24	12	..
On hand	9/1	3	14	16	6	2
Sold	8/1–30	9	15	22	17	8

The quantity sold is obtained by adding together the number on hand at the beginning and the number received, and deducting the number on hand at the end. The amount needed to bring stock up to normal is estimated and the order made out. Assuming that no seasonal change in sales is anticipated, that 30 days' supply is sufficient to order, that six is the minimum packing per lot number, and that 48 is the minimum shipment, the order is estimated thus:

	Lot number					
	Total	1	2	3	4	5
Sold 8/1–30	71	9	15	22	17	8
On hand 9/1	41	3	14	16	6	2
Needed to replenish stock.	30	6	1	6	11	6
Necessary to order 9/1...	48	6	6	12	18	6

True, 18 units more than are required for the next period are being purchased, but the merchandise is needed at once. Stocks will be balanced again at the time of the next check and order.

When the shipment is received, the contents should be checked against the on-order figures. If there are variations, the on-order figures must be changed to correspond if the next calculations of figures are to be accurate.

The on hand—on order—sold form is flexible and adaptable to all types of goods handled in limited-price variety and general merchandise stores. Varying the checking interval does not detract from the usefulness of the information obtained.[3]

Perpetual inventories are not likely to justify their expense in most departments of an average small store unless the complete Retail Method [4] is used or the perpetual inventory is confined to an important line of goods of high unit value and pronounced demand changes. With such a system the merchant knows at all times the amounts of goods that should be on hand, either in dollar value or in units, or both.

Control systems

Stores having a very small volume of sales and limited amounts of merchandise may not need much of a merchandise control system. Continuous first-hand contact with stocks on hand may be sufficient. Even in larger stores where persons responsible for inventory control are in training for positions as buyers or managers, emphasis is often placed on daily personal familiarity with merchandise on hand and merchandise needed. However, in most cases the small retailer should take advantage of a suitable merchandise control system as an aid to his numerous managerial duties.

Before deciding what type of merchandise control system to use, at least the following factors should be considered: (1) what information is needed, (2) what uses will be made of it, (3) by whom it will be used, (4) how much detail is necessary, (5) what expense is justified to obtain this information, (6) the type of merchandise involved, and (7) what systems are used by other stores of a similar type. The last consideration may

[3] Adapted from Miller, Nelson A., *Establishing and Operating a Variety and General Merchandise Store,* pages 144–146. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 35, 1946.

[4] See Chapter XXI for a discussion of the Retail Method of accounting control.

enable the merchant both to profit by the experience of other retailers in the same line of business in selecting the best system and also to compare his operating data with their results.

Basically there are two types of merchandise control systems: dollar and unit. In the former standards are set, operations are reported, and corrective action is taken in terms of the dollar value of the inventory concerned. Thus, planned sales for a department might be $10,000 for a six-month season; actual sales and purchases are reported in dollar value, usually at retail, and adjustments needed are made in terms of dollar value. This makes the buyer responsible for converting dollar amounts into specific items and quantities of goods. In unit control the same steps are carried out in terms of number of items of each kind of merchandise or inventory. Dollar control is ordinarily used for all departments and kinds of merchandise; unit control is employed primarily when an assortment or variety is included under one class or line of goods. Unit control frequently involves some form of perpetual inventory to cover in physical quantity each important variation within the line of goods concerned. The type of unit control to use depends upon: regularity of the relative sales of each variety, unit value of the merchandise, length of the selling season, store policy, and possibly other factors.

When each variety within a line or class of goods sells at a fairly constant rate throughout the year, a model stock system with periodic physical counts is sufficient. A check list may be used with clerical assistants to do the checking. Or maximum and minimum stock systems may be employed. In the case of seasonal goods or of others with a short selling period, such as skates, staple housecleaning items, or rubbers, checking should be more frequent and greater attention should be given by the buyer to prevent loss from "outs" or end-of-season overstocks. When the unit value of each item is small, unit control can be operated in terms of reserve stock or full cartons rather than of individual items. This is sometimes called a "requisition system."

The most valuable area for unit control is in shopping goods and especially in fashion merchandise of fairly high unit value, such as wearing apparel, shoes, furniture, and many house furnishings and appliances. For such merchandise, unit control is obtained by keeping a daily running record of sales and stocks of each variety of each item within the line or class of goods. Two types of systems are in general use: merchandise tag and clerk tabulation. In the former each piece of merchandise has attached to it a tag of some sort, usually perforated and ordinarily with two duplicate parts. Each time an article is sold, one part of the tag is removed and either sent in to the office with the salescheck or deposited in a special container by the salesclerk. Small stores often have each salesclerk record or tabulate the specific size, style, color, and other characteristics of merchandise as each item is sold. Sometimes this information is included on the salescheck instead of being kept as a separate record. Modern cash registers furnish stubs that are often used for unit control records. In all cases a unit control clerk, who may be the proprietor himself in a very small store, should summarize the data at least once a day so that a perpetual inventory in units of each variety may be kept.

To the small or beginning merchant, unit control seems like an unnecessary amount of trouble. However, it is the basis of modern merchandising. To be out of a particular size, style, color, price line, or other variety of a line or class of goods is the same as for a carpenter to have a saw but no hammer, a plumber to have pipe but no wrench, or a stenographer to be without a pencil. One merely lacks what it takes to do the job. Not only does the merchant lose the sale, but he helps his prospective customer acquire the habit of trading with competitors. There is probably no greater error in merchandising than to be out of wanted items, even occasionally! Naturally, however, this does not mean that a retailer should stock every item asked for by customers, no matter how infrequently.

Our emphasis on unit rather than dollar control has been deliberate. The whole trend of merchandising for three decades has been toward greater unit control. Dollar control is necessary, especially for the huge organization with hundreds of merchandise departments and scores of buyers; but it is unit control that spells merchandising success or failure in the small store. If the unit control is right, dollar control will take care of itself—to the merchant's profit.

Staple or fashion goods?

Merchandise differs as to the type of inventory control system most suitable. Stability of demand and regularity of sale are major factors. For staple items, such as pins, needles, brooms, nails, tooth paste, bread, milk, chewing gum, and cigarettes—products which rarely change and have fairly regular sales—simple routine merchandise control systems are best. Certain items are staples for particular seasons, such as fireworks, Easter eggs, Santa Clauses, overshoes, skates, and water wings. These differ from year-round staples principally in the timing aspect. Inventories should be large at the beginning and as small as possible to secure maximum profitable sales during the closing days of the season. Whether to close out or carry over an inventory is a matter of store policy. In either case the inventory of seasonal merchandise should be at a minimum at the end of the selling period.

Staple items are fairly well standardized. In modern merchandising many staple goods consist of a series or assortment of individual items that are not substitutes for one another and that sell at different rates. Three types of variation are especially important: size, kind, and brand. Others that often operate are color, price, quality, or characteristics peculiar to certain merchandise. There are few varieties or sizes of pins but many of needles and still more of nails. With cigarettes brand is important. In staple canned goods, brand, size, grade (quality), and price are major variables. Many items are staples with fashion-affected varieties, such as thread, bias tape,

and most yardgoods. White and black in popular sizes are likely to be staple, with other colors and patterns, as well as types of construction, affected by the current fashions.

Although it is not the function of merchandise control to predict demand or fashion changes, it is necessary to use different control systems when demand is erratic or subject to fashion influence. Information is needed concerning (1) the quantity of merchandise to be on hand at each time and (2) reports or warnings to be sent to buyers in case the inventory changes from that planned. If proper information is furnished by the buyers, the inventory can easily be controlled, for a balance can be maintained or due notification sent to buyers. Appropriate action is their responsibility.

Assortments, or variations within one line or kind of merchandise, are one of the constant factors even for fashion goods. The proper inventory of staple goods in relation to sales is called a basic stock; that of fashion goods is called a model stock. Use of a good basic stock list should keep a store supplied with items demanded well over 90 per cent of the time; a model stock list will help keep wanted items on hand about 80 per cent of the time. In either case the inventory control must keep goods on hand for each size, pattern, color, style, price line, or other basic variable in proportion to its rate of sale. Unit control is often necessary for this purpose.

Inventory taking

In retailing the trend has been to take physical inventories more frequently, at least twice a year and sometimes monthly or even weekly. With proper planning and organization this is not too difficult in most stores, and experience proves it to be well worth the extra trouble. A tickler, or reminder, file may be set up showing the dates to inventory each department. Thus faster sellers can be counted more frequently than staple items.

A serious weakness of many small retailers is regarding a physical inventory, like a dose of medicine, as a necessary evil.

Actually this should be a major source of profitable ideas. Proper planning, cleaning out old stock, remarking certain items, having forms on hand, and training counters will reduce the drudgery of actually taking the inventory. It should be taken carefully by important lines or classes of goods at retail and cost, if the older cost method is used, and by age or length of time each article has been in stock. Then *use* the inventory records for sales planning and promotion, especially to clean out old stocks and reduce overstocks, and for future buying, as well as to calculate profits and net worth.[5]

Conclusions

Most small retailers hope some day to be big operators. Before we leave this analytical discussion of merchandise control, attention should be called to a method that was originally confined to such control but now embraces the whole area of retail accounting.

The Retail Method of accounting control, which is discussed in Chapter XXI, is the only method that the authors recommend for most stores in view of its many advantages and continuing spread to additional fields. However, a beginning retailer might keep both retail and cost inventory records to advantage during the first few years. Under the Retail Method a perpetual inventory must be maintained at retail prices and careful records kept of all changes in the retail price. This gives a record of markdowns, discounts, and other changes that is a valuable management aid. It is independent of the unit control and has other limitations that should be understood by the proprietor. In particular, it must be used by departments or by merchandise classification, not on a storewide basis. In contrast, dollar control in retailing may include the total store inventory, or any subdivisions as needed. Usually the following subdivisions for dollar control are useful: de-

[5] Bedell, Clyde, *Seven Keys To Retail Profits,* pages 139–143. New York: McGraw-Hill Book Company, Inc., 1931.

partmental, price line, merchandise classification, and others in particular cases. Control should observe the rule of the Golden Mean—enough, but not too much.

Different merchandise control systems should be used as needed. The Retail Method is not suited to "manufacturing" departments like food service or alterations. Although some form of dollar control (physical or perpetual inventory) should be used for all merchandise, unit control may be needed to supplement dollar control in certain fashion lines. The use of several systems in a small retail store is illustrated in the following description of recommended practice.

Stock control for retailers of phonograph records has been selected for discussion because it illustrates how a merchant may need three different systems, each appropriate for one kind of merchandise. In retailing phonograph records these are: a perpetual inventory system for albums, a weekly physical inventory for popular records, and a "stock envelope" system for standard records.

The basis of the perpetual inventory is a filing card that contains such fundamental information as the title of the album, the name of the artist, the supplier, and the album number. The rest of the card is usually arranged in columns, with a heading for each; in the columns are recorded the date and the numbers ordered, received, sold, and remaining. When the clerk in charge places an order, the number ordered is set down. As the albums are received, this fact is recorded on another line opposite the date received. When one or more albums are sold, the date is listed, the number of albums sold is recorded, and the number remaining on hand is computed and set down, usually the first thing each morning for the transactions of the previous day.

To increase the accuracy of recording, salespeople make out a sales slip with the album number written on it for every album sold. The sales as indicated on the sales slips are then posted on the perpetual inventory cards. Another common but less satisfactory method is to place "markers" similar to

book marks in each album when it is received and put into stock. Each marker carries the number of the album in which it is inserted. When the album is sold, the salesperson removes the marker and drops it in a drawer. The next morning the clerk who keeps the inventory cards need only collect and tally the album markers to learn the daily sales. This is an adaptation of the stub system used for wearing apparel. Disadvantages of the system are that the markers get lost easily and careless clerks forget to remove them when they make sales.

The weekly physical inventory system is preferred for controlling stocks of the 25 or 50 "pops" carried in most stores. Inventory cards similar to those described for albums are used for recording weekly counts and computing the previous week's sales of each title.

For standard records the "stock envelope" system provides adequate information with a minimum of effort. The factory envelope is removed from one record of each title and the record is placed in a bright-colored stock envelope. Other records of the same title are placed by it.

On the stock envelope is placed a sticker bearing the catalog number, title, and maker of the record. The beginning inventory is listed, with the date, and subsequent entries are made when more records of that title are received. It is a simple matter for the clerk to count the number of records on hand for any title and subtract it from the original inventory and receipts to learn the sales volume to date.

The sticker has room for the clerk to record the date and the number of records ordered whenever he places an order for a particular title. Most dealers use the semi-annual inventory as a time to review every album and standard or classical item in their stock.[6]

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[6] Small Business Aids, No. 39, U. S. Department of Commerce, "Stock Control of Phonograph Records." Condensed from "Disc Stock Control." *Radio & Television Retailing*, September, 1946, New York, Caldwell-Clements, Inc.

Stock Control in Wholesaling

Wholesalers buy in large lots and carry heavy inventories. In the grocery field from 30 to 50 per cent of the wholesaler's total assets are investments in inventory. This is his largest single asset item.[7] The trend toward widespread acceptance of the low gross margin and high turnover principle, evident for many years in wholesaling, increases the need for accurate current information on inventories and good stock control. The aim of many wholesalers to supply to their independent retail customers all goods needed at prices competitive with those of chain stores and mail order houses can be effectuated only with good stock control.

In the wholesale hardware field the United States Department of Commerce found some years ago[8] that concerns using unit control had a maximum percentage of capital in inventory of 50.3, whereas the maximum of others was 75 per cent. Other significant findings in this survey were as follows: "Establishments using a stock-control system get a higher turnover. No establishment in this group had a turnover less than 2.5 times a year, and five of them had more than 4 turns. On the other hand, those with no system of stock control had as low as 0.9 turn a year, and five had an average turnover of less than 3 times.

"Establishments with a careful system of stock control were able to operate on smaller gross margins. One establishment using a stock-control system was operating on a margin of 14.5 per cent, and yet it gave a return to stockholders of 6.8

[7] Economic Series No. 14, U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, "Inventory Control." *Effective Grocery Wholesaling*, page 143. Washington: U. S. Government Printing Office, 1941.

[8] Although the specific data contained in the report of this study may not represent current conditions, the authors believe its findings have permanent validity; and they are supported in this by the Managing Director of the Southern Wholesale Hardware Association, Orlando, Florida, who has referred to the report as one of the most practical books published regarding hardware wholesaling.

per cent. Nine establishments using a unit-control system operated on a margin of less than 20 per cent, and the highest margin for the group was 20.8 per cent. Seven of the eleven establishments recording no systematic stock control had a margin of 20 per cent or larger.

"The maximum percentage of capital in inventory in establishments with unit-control system was 50.3 per cent, whereas the maximum in the others was 75 per cent. Four firms with poor or no systems reported inventory over 50 per cent of capital. The practical measure of the effectiveness of stock control, however, is on the basis of earnings and profits. In both items the earnings of those establishments with unit-control systems were much more stable than establishments with no control system." [9]

Inventory control is continuing to receive the attention of wholesalers. A committee of the National Electrical Wholesaler's Association in a report to the membership recently stressed many of the advantages of maintaining an adequate warehouse stock record system. The advantages mentioned, in addition to the value of reliable inventory records in case of fire, include: (1) convenience of having a continuous record in the office of items on hand and the quantity available for shipment; (2) ability to place replenishing orders without taking a physical inventory; (3) use of information contained on stock record cards to calculate rates of turnover and quantities to order for each item; (4) prompt filling of "back orders" when goods are received by placing a "rider" listing customer "back orders" on the stock record; (5) reduction of costly errors in ordering by including on each card such essential information as complete and accurate catalog numbers, description of the stock item, manufacturer's full name, standard package quantities, terms of shipment if minimum list

[9] Domestic Commerce Series No. 52, U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, "Buying the Wholesale Stock." *Hardware Distribution in the Gulf Southwest*, pages 72–73. Washington: U. S. Government Printing Office, 1932.

value or minimum weight factors are needed by the manufacturer to establish the most advantageous discount or most advantageous F.O.B. point; (6) use of the cards as a cross reference to indicate substitute items for "out of stocks"; (7) saving of the time of the sales manager, manufacturer's representatives, and salesmen by using the stock record cards to review inventory conditions; (8) "costing" of sales from data on the cards at the time of taking physical inventories; and (9) disclosure of misappropriation of merchandise, especially of small stock items.[10]

Even in the small wholesale firm the "office" where ordering is done and customer orders are received is usually physically separated from the warehouse where goods are stored. Thus, the accuracy and frequency of reports on inventories on hand are especially important. In the warehouse it is often desirable to store part of a shipment in "dead storage" rather than with that part used for current order filling. This introduces the danger of overlooking part of a lot of goods when securing information for stock control reports.

In wholesaling, as in retailing, merchandise is usually classified into departments for stock control, layout, and other purposes.

Before discussing methods and systems used for inventory control, we may call attention to the key position occupied by this activity as illustrated in Figure VIII.

Although small wholesalers use the same three basic methods of keeping track of inventories mentioned earlier—observation, physical count, and perpetual inventory—there are some variations by lines of business. One authority lists five methods suitable for small wholesalers: (1) actual physical inventory, (2) physical inspection, (3) continuous stock taking, (4) tickler method, (5) real perpetual inventory.[11] The last term, as

[10] For further study see *Report of Warehousing, Deliveries, Installations, Freight Rates and Claims Committee.* New York: National Electrical Wholesalers Association, 1946.

[11] Beckman, Theodore N., and Engle, Nathanael H., "Warehousing

it is used in wholesaling, usually refers to a perpetual inventory in terms of units (cases), not merely in terms of value.

In the grocery field the observation method is commonly used in small houses and by some larger firms. No record is

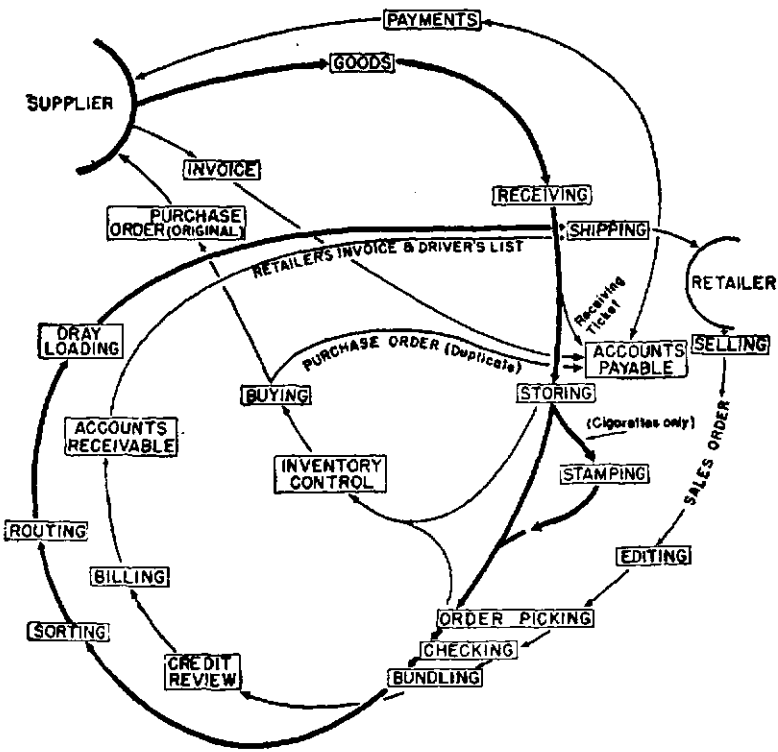


Figure VIII. Flow of goods and records.[12]

made of the amounts on hand. Either the manager or the warehouseman is responsible for observing stock frequently. If the warehouseman notices that a pile of merchandise does not diminish in size, he notifies the manager and the latter

and Stock Control." *Wholesaling*, Chapter 18, pages 360–361. New York: Ronald Press Company, 1937.

[12] Meserole, W. H., *A Study of Tobacco Wholesalers Operations*, page 52. Washington: U. S. Department of Commerce, Industrial Series No. 62, 1946.

decides what to do. Another duty is to guard against out-of-stocks. When a stock gets low, he has to report to the manager. Even in the smallest houses observation methods place great dependence upon the observation of warehousemen and the memory of buyers.[13]

In the hardware field the observation method is supplemented by the use of "short lists" or "outs," and "getting low" reports sent in to the office.[14] "Short lists" are records of lines usually in stock but temporarily out, for which orders have been received that cannot be filled.

Periodical stock count methods are widely used in the grocery and other wholesale fields and are recommended for drug wholesalers to replace their more expensive case labeling method.

The periodical stock count system is based on a periodic count, fast-moving items being counted frequently and slow-moving items being counted less often. This means that some items may be counted daily and others only monthly. Like purchases and goods received, the counts are entered in a stock book, usually one for each department. The pages in the stock book may provide for any desired number of items of information. However, the simpler the form, the easier the operation.[15]

Often "in and out" cards are used to record inventory counts as well as purchases, or a simple inventory card on which merely the date and amount of each count are recorded may be used.

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[13] Economic Series No. 14, U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, "Inventory Control." *Effective Grocery Wholesaling,* page 145. Washington: U. S. Government Printing Office, 1941.

[14] Domestic Commerce Series No. 52, U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, "Buying the Wholesale Stock." *Hardware Distribution in the Gulf Southwest,* pages 70–71. Washington: U. S. Government Printing Office, 1932.

[15] Industrial Series No. 68, U. S. Department of Commerce, Department of Domestic Commerce, *Effective Use of Wholesale Drug Warehouses,* page 31. Washington: U. S. Government Printing Office, 1947.

Few of even the larger wholesalers in the grocery and drug fields use a perpetual inventory system (by units) because of the extra expense entailed. An interesting analysis of stock controls used by hardware wholesalers was prepared by the U. S. Department of Commerce. Out of 76 establishments of all sizes, 30 had unit control, 13 used perpetual inventory control, and others relied upon devices as follows: 7 on buyer's records, 7 on a system of warehouse reports sent in by men in charge of the stock, 5 on reports of "shorts" from the warehouse, 1 on "want lists," 6 on special individuals such as warehouse foremen who were appointed to take the responsibility for watching the stock, and 7 on no system at all. Although every wholesale house had some system of stock control, 23 per cent of the wholesale-retail firms had no system at all. It was usually the larger firms that used unit control.[16]

An adequate inventory control system makes it possible to establish certain standards useful in controlling inventory and purchasing activities. Such standards include order points, which indicate when to buy; maximum and minimum stock standards, which are safeguards against out-of-stocks and overstocks; and standard-order quantities, which indicate how much to buy. These standards can be set up for each item in stock.

The order point will be based on the average time lapse that occurs between purchase and receipt of the merchandise and the maximum rate of sales during that interval, so that sufficient stock will be in the warehouse at the time of ordering to avoid out-of-stocks before the new goods are received. The minimum stock, which represents a margin of safety against out-of-stocks, can be computed by subtracting the average sales during the time required to fill an order from the quantity established as the ordering point. The maximum quantity of

[16] Domestic Commerce Series No. 52, U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, "Buying the Wholesale Stock." *Hardware Distribution in the Gulf Southwest*, page 71. Washington: U. S. Government Printing Office, 1932.

stock is, of course, the maximum old stock expected to be on hand when a new shipment is received plus the standard-order quantity. An example will clarify the concept of these standards:

	Cases
Minimum Stock	
Order point (maximum amount likely to be sold during the time in which order is being filled as shown by the inventory control)	50
Less: Average amount sold during time in which order is being filled (as shown by the inventory control)	25
Minimum-stock standard	25
Maximum Stock	
Order point	50
Less: Minimum amount sold during time in which order is being filled (as shown by the inventory control)	10
Maximum amount likely to be on hand when new order is received	40
Plus: Standard order	300
Maximum-stock standard	340

The order point and the minimum stock standard are based on (1) the time required to fill an order and (2) variations in sales during this period. These are relatively easy to determine. The maximum stock standard depends largely, of course, upon the size of the standard order. Although a good inventory control system permits setting the order point at lower levels of warehouse stock without incurring the danger of out-of-stocks, the size of the standard order has a greater influence in determining the average inventory and thus has a greater influence on the expense of carrying inventory.[17]

Forms for use in stock control are prepared to be used with

[17] Adapted from Economic Series No. 14, U. S. Department of Commerce, "Inventory Control." *Effective Grocery Wholesaling*, pages 156–158. Washington: U. S. Government Printing Office, 1941.

equipment made by many well-known companies. Many electrical wholesalers prefer some of the visual methods. Many stationery dealers can supply standard forms.

Inventory Control in the Small Factory

The frequency with which production would be slowed down or even stopped if some essential material or parts were not in stock led manufacturers years ago to recognize the importance of inventory control. Before stores control was introduced, an "out" condition of some important but inexpensive part was often accompanied by from one to ten years' supplies of other items.

In the small factory the variety of different materials and parts may not be large and inventory control need not be complicated or expensive. But it is always important.

Some control is likely to be needed for raw materials, fabricated parts, and finished products. A common plan is to use a certain number of days' supply as the standard. Quantities of individual items to have on hand are derived from this. For example, each unit of a certain product requires two pounds of material A, three feet of part B, and one fabricated part C. Planned production is 12 units per day and the desired quantity on hand is set at 10 days' supply. Obviously the ideal inventory would consist of 240 pounds of A, 360 feet of B, and 120 units of C. Quantities to order each time would depend on the usual factors, such as time required for delivery, supplier's shipping units, transportation costs, quantity discounts, stability of demand for each item, storage space available, price fluctuations, and company policy.

The results of a survey of inventory control in 37 small companies are summarized below.

Information Needed for Inventory Control. One of the most important types of information which a company needs is that which will give it effective control over its inventory. The following information is necessary. In some companies, it may be so simple to obtain that no records are required.

(a) The amount of stock on hand—raw materials, goods-in-process, fabricated parts, finished goods.
(b) Amounts on order (either production or purchase orders).
(c) Amounts allocated for certain jobs or customers.

Findings in Survey of Companies. Of 37 small companies surveyed by the author, 12 companies did not maintain a perpetual inventory of any kind. Nineteen companies had perpetual inventories for raw materials, 15 for finished goods, and seven for fabricated parts. Where there were no perpetual inventories, physical inventories were taken monthly in about half the companies. The remainder of the companies were divided rather evenly among those which took quarterly, semiannual, and annual physical inventories.

Only one company maintained inventory control records in terms of both dollar value and physical units. The other companies kept the record in physical units only. When it was necessary to compute inventory values for the financial statements, the number of units was multiplied by the unit cost.

When perpetual inventories were maintained, some method for comparing the inventory records with the actual goods in the stock rooms had to be used. In a few cases, the only comparison was made by quarterly or annual physical inventories. It was more common, however, to make spot checks of a certain number of items each week. In this way, each item would be checked at least once during the year. Sometimes this method had proved the perpetual inventory to be so accurate that the physical inventory at the end of the year merely consisted of some more spot checks of the items shown in the perpetual inventory records.

In many cases the perpetual inventory of raw materials was maintained only for certain important items. For instance, the manufacturer of molds and machinery kept a perpetual inventory only for steel, and the knit goods manufacturer kept the inventory only for yarn and thread. Other items were treated as supplies and were controlled through monthly or quarterly inventories with visual observation in between.

Inventory information usually was kept on cards. In most cases these cards were in drawers of the so-called visible card type where the bottom of each card protruded enough so that the item could

be indicated in the margin. The simplest forms of such cards showed only the order number, issues, receipts, and balance. About half the inventory cards showed not only this information but also information concerning the amounts on order (either production orders or purchase orders). When the order information was shown, it was common to have two cards instead of one.

In five or six companies, the cards showed allocations of material to certain jobs or certain customers' orders, thus preventing the use of the stock for other purposes.

A large proportion of inventory cards had spaces to record the minimum and maximum amounts beyond which the stock was not supposed to go. Several companies also had spaces to show the monthly usage. Both types of information were being entered very irregularly. Those who operated the systems felt that such figures were useful, but under the pressure of getting the work done these bits of indirect information were sacrificed in order to record primary information.

Why Inventory Information Was Kept. The executives interviewed mentioned a variety of reasons for wishing up-to-date information concerning inventories. In the case of raw material inventories, the executives wished to avoid running out of any important item and thus interrupting the production process. In those companies which performed assembly work, perpetual inventories of fabricated parts were considered necessary in order to make sure that enough parts were on hand to start the assembly. Another reason for wishing accurate information concerning the inventory of fabricated parts was to reduce the possibilities of losses when changes in design or materials made some of the items obsolete. In those companies where stocks of finished goods were maintained, the executives wished to keep track of finished stocks so as to minimize the number of back orders, at the same time avoiding accumulation of slow-moving items. When the materials or products were of such a nature as to tempt the workers to smuggle some from the factories, inventory control was desirable to detect thefts by showing the exact numbers that should be on hand.

In addition to these reasons for keeping track of inventory, the executives wished to make sure that the amounts invested in inven-

tory were kept within bounds. This information seldom was used during the month: perpetual inventories were not employed for such purposes. Ordinarily, the financial statements were used to determine whether the amounts invested in inventory were becoming too high.

Use of Visual or Card System. Whether inventory information was obtained by visual inspection or by using perpetual inventory cards depended upon the size of the company, the number of items in inventory, the number of stock rooms, whether the production was for stock or to order, and whether the production process included assembly. For companies in the early stages of growth the visual system was more common than perpetual inventories. The mere fact of growth, regardless of other factors, tended to force the keeping of perpetual inventories. As companies grew, there were larger volumes of goods on hand so that it became more difficult to count or estimate the amounts. Likewise, growth meant that more persons could take items from stock and forget to mention it.

In most of the companies that did not maintain perpetual inventories, adequate control apparently was achieved by visual methods. For the small companies with simple processes it was easy for the president to step into the stock room and look at a relatively small number of barrels or bins. In a few minutes he could tell whether he was getting low on any of the items in stock. To adopt inventory records under such circumstances would be foolish. It soon would be discovered that the records showed what easily was visible. Actually, such records, if started, invariably are suspended when some rush period occurs, or when somebody becomes sick, and are never reinstated.

Determining Amounts on Order. Inventory records showing the amounts on order are useful only when perpetual inventories are kept. After a company becomes large enough, and has a sufficiently large number of items to warrant a perpetual inventory, the chances are good that the order information should be written rather than kept mentally. The amounts on order change the whole significance of the amounts on hand. Experience indicates that information concerning purchase or manufacturing orders should be very simple in order to minimize possibilities that the data will be omitted when the clerks are rushed. A brief note on

production or purchase orders, however, can show the whole picture without recourse to thumbing through the order files.

Determining Allocations of Materials. The same general considerations apply to the presence of columns showing allocations of materials to certain jobs or of finished goods to certain customers. In companies where the amounts involved approach the magnitude of the amounts on hand, the need of showing allocations is definite. On the other hand, in some companies the amount of any material or finished goods that will be withdrawn for one order is only a small fraction of the amounts on hand. In such cases the information concerning allocations may well be omitted from the cards.

The use of a perpetual inventory for certain critical items provides a large proportion of the desired inventory control information with a minimum amount of work. The main consideration in employing such a system is to make sure that all critical items are included. Production, of course, can be stopped by the absence of minor parts just as thoroughly as the absence of more valuable material.[18]

As the findings of this survey brought out, small manufacturers are concerned with the control of inventories in units, not in terms of value. The basic record is the balance-of-stores card. An example of a simple perpetual inventory balance-of-stores record form is illustrated in Figure IX. If material allocated to future production jobs but not yet disbursed is recorded in a different color, the balance on hand will indicate actual quantities available.[19]

If the small factory carries stocks of different materials that

[18] Small Business Aids, No. 264, U. S. Department of Commerce, "A Survey of Inventory Control in 37 Small Companies." Condensed from "Inventory Control." From Lawler, Paul F., *Records of the Control of Growing Manufacturing Enterprises,* pp. 80–93. Cambridge: Harvard University Division of Research, Graduate School of Business Administration, 1947.

[19] For further study see: Heinretz, Stuart F., *Purchasing,* pages 416–419. New York: Prentice-Hall, Inc., 1947; and Lewis, Howard, *Procurement; Principles and Cases,* page 289. Chicago: Richard D. Irwin, Inc., 1948.

vary widely in relative importance to production, in price, or in other significant ways, inventories should be classified and appropriate methods of control adopted for each classification. For example, staples may be controlled by a simple maximum-minimum system when both their price and rate of use are fairly constant. If some raw material, such as cotton or grain, that has large and frequent price fluctuations is an important item in the cost of the finished product, a very exacting type

PURCHASING RECORD — MATERIALS AND SUPPLIES

SOURCES OF PURCHASE:
1. _____
2. _____
3. _____
4. _____
5. _____

USUAL QUANTITIES PURCHASED:
MAXIMUM _____
MINIMUM _____
TERMS:
FRT PREPAID ☐ FRT COLLECT ☐

ORDERED				RECEIVED						USAGE		BALANCE ON HAND	
SOURCE	DATE	P.O. NO	QUANTITY	DATE	QUANTITY	INVOICE AMT	FRT	DELD COST	UNIT COST	MONTH	QUANTITY	MONTH ENDED	QUANTITY

DESCRIPTION _____ UNIT _____ DEPT. _____ ACCT. NO _____

Figure IX. Simple balance-of-stores record.[20]

of inventory control operated under the close personal supervision of the owner may be required.

Inventory control in the small factory must be synchronized with production on the one hand and with purchasing on the other. This may involve more "paper work" than the small manufacturer cares to undertake. A firm in New York will

[20] Stuart F. Heinritz, *Purchasing*, page 416. New York: Prentice-Hall, Inc., 1947.

handle these details for him and provide counselling service in addition.[21]

Small factories that operate on a customer order basis, such as millwork companies, may require special inventory control methods. It is usually necessary to be able at any time to identify the customer for whom each article is being made and to know what items are still to be delivered on each incompleted order.

A simple inventory system that keeps all this information and more on two record cards, eliminates losses and duplicate orders, and expedites shipments from the mill has been developed by one company.

The system is based on a Customer's Order Card and a Delivery Record such as those shown here, and on a three-compartment Order File.

CUSTOMER'S ORDER CARD

Name John J. Doe — Millwork Co.'s Order No.
Address 256 West 5th Avenue — Order No. 7296
City Washington, D. C. — Order Rec'd 4-30-47
Phone No. 926-M — Date Promised —

Delivery Instructions Bin until notified us. Then deliver to our house at 1015 East Douglas.

Pieces	Size		Description	Deliveries
*5/19 6	24 x 24	2 Lb.	Wd. from D.C. B17	
5/19 1	24 x 18	"	" " B17	
6/19 1	36 x 18	"	" " B17	
1	3/0 x 6/8	1 3/4	R dr. fr **	***
1	2/8 x 6/8	1 3/8	R " "	

* Date of arrival of material.
** Bin No. in which material is stored.
*** When delivery is made date will be placed in this column.

[21] For further study see "Paperwork Farmed Out." *Management Review*, October, 1947, Vol. XXVI, No. 10, page 534. New York: American Management Association. (From *Business Week*, August 9, 1947.)

DELIVERY RECORD

Date of delivery	Order		Material	Buyer	Disposition	No.
	Date	Number				
5/19	4/20	6212	doors	Samson	deliver	122
5/19	4/30	7296	Wd fr.	Doe	bin	123
5/19	5/2	6315	Wdw	Peterson	deliver	124

When millwork is ordered for a given construction job, this is the routine followed from receipt of order to actual delivery of the millwork to the customer, with complete stock control at every stage:

1. Order entered on Customer's Order Card.

2. Order card filed in first slot of Order File (marked "Orders Not Placed"), awaiting placement of orders with mill.

3. Millwork order placed, date inserted on Customer's Order Card, and Customer's Order Card transferred to second slot of Order File (marked "Orders Sent But Not Confirmed"). Carbon of millwork order filed in manila folder.

4. Millwork firm's acknowledgment of order is checked against carbon of original millwork order and Customer's Order Card for accuracy. If correct—

(a) Acknowledgment is filed in manila folder.

(b) Carbon of original millwork order is discarded.

(c) Millwork firm's order number is entered in upper right hand corner of Customer's Order Card (date of placement of order was originally written here in pencil and erased when order number was inserted).

(d) Customer's Order Card is put in numerical order in third slot of Order File (marked "Confirmed Orders Awaiting Shipment").

5. When material arrives—

(a) Delivery ticket bearing original order number is checked against Customer's Order Card.

(b) Date of delivery is noted in extreme left hand margin of Customer's Order Card.

(c) Material on delivery ticket is marked either for storage in bins or delivery to site, and this disposition indicated on the delivery ticket.

(d) Delivery of millwork is noted on Delivery Record. This card keeps a record of all millwork deliveries and their disposition for the company. The record is valuable when a certain shipment must be located for pricing purposes.

(e) As shipment is entered on the Delivery Record, it is given a delivery number in the last column. This delivery number is entered in upper right hand corner of manufacturer's delivery ticket.

6. Delivered stock is marked according to disposition indicated on manufacturer's delivery ticket; that is, either binned or delivered to site.

7. If stock is binned, it is marked with bin number and placed in that bin. Tag on bin shows bin number and name of person whose material is binned there.

8. Customer's Order Card is marked with bin number, or delivery date is entered in last column if material has been delivered to customer.

9. Manufacturer's delivery ticket is filed in manila envelope to await arrival of invoice. Delivery tickets are checked against invoices as soon as they arrive. Both are filed together.

10. When customer needs delivery of binned material, it is quickly located from Customer's Order Card.[22]

Unless stores control makes it possible to locate each item quickly when needed, it is useless for current production. This requires some systematic plan for storing each item so that it can always be located. Various systems are in use, including: (1) numerical storage—storing each item according to a parts number; (2) storage by type and, within each type, by size; and (3) location systems. The last are the most flexible and

[22] Small Business Aids, No. 362, U. S. Department of Commerce, "Stock Control for Millwork." Condensed from "Fingertip Stock Control for Millwork." *Building Supply News,* November, 1946, Chicago, Industrial Publications, Inc.

seem to be gaining increasing favor in spite of the extra paper work required.

A location system operates by assigning location symbols to all storage space used. For example, "A10b" might designate aisle A, stack 10, shelf b. Usually similar materials are stored in the same section or area, but this is not essential. Card records show: (1) for each item, where it is stored, and (2) for each storage area, extent to which space is in use and available. Each item must be correctly described according to some standard nomenclature or terminology, and identification is facilitated by putting this identification mark on each item or container. Again symbols are often used. Whether to mark with pencil, rubber stamp, or tag, depends upon the type of material and similar factors.[23]

Inventory Control in the Service Establishment

Both in manufacturing and in service businesses, in contrast to merchandising, inventory control is entirely in terms of units and physical quantities. Naturally, the accounting records show the cost of materials and supplies purchased. In general, materials used in further production are of greatest importance to the manufacturer; supplies are the major items in the service business. However, repair shops and wood- and metal-working shops use parts and materials much as a factory does. To illustrate certain aspects of stores control in two types of service business, the following advice for a laundry and for a metal shop operator is presented:

"Supplies should be stored in a locked place with one person in the plant responsible for their issuance. The supply room should be kept clean and orderly, and if possible, a separate section should be assigned for each type of goods. Scales and measures available for the accurate measuring of all supplies used is one way to keep the supply cost down. Guesswork is

[23] Small Business Aids, No. 237, U. S. Department of Commerce, "Simplifying Stock Room Problems." Condensed from "Simplifying Stock Room Problems," by Benjamin Melnitsky. *Distribution Age*, February, 1947, Philadelphia, Chilton Company, Inc.

always costly. Make sure that the place in which the goods are stored is not damp, and guard strictly against all fire hazards." [24]

Stocks of fast-moving items are depleted quickly unless replenished frequently. Perpetual inventory control arranges for almost automatic re-ordering. This system involves determining the maximum stock which should be on hand or on order at any one time and the minimum amount below which stocks cannot, with safety, be allowed to drop. Between these extremes is the re-ordering point.

These data should be recorded on an inventory card placed in a bin or tacked on the wall near where each item is stored. The card also contains the amount to re-order each time, the date of each order placed but not yet received, and the running totals of orders received and of removals from the bin or rack. It therefore shows, with reasonable accuracy, the stock on hand. A simple form such as the following is the only stock control record needed for the small business.

PERPETUAL INVENTORY CARD

Unit of Issue:			Description:		
Location:		Unit Value		Time required to obtain:	
Maximum stock:	Minimum Stock:		Reorder Point	Minimum Ordering Point: (Quantity)	
Date:	Quantities in terms of units of issue:				Remarks
	On order	Rec'd	Del'd	Bal. on hand	

Several times a year the card total should be checked against the actual count for all stock items. Occasional spot checks (a

[24] Kramer, V. H., *Establishing and Operating a Laundry*, page 55. Washington: U. S. Department of Commerce, Industrial (Small Business) Series No. 37, 1946.

few scattered items at a time) in between regular inventory periods should be made to make sure that employees are noting removals on the card and that smaller items are not disappearing.[25]

Conclusions

Properly handled, inventories of merchandise, materials, and supplies, which are one representation of the owner's capital, may be his major asset. The peculiar thing about many businesses, both large and small, is the extreme care with which cash is guarded and the lack of care exercised over "cash" in the form of inventories. A good rule for the small businessman is to regard his supplier as his banker as far as materials are concerned. Once his funds are converted into inventories, why should he not guard the latter just as carefully as he would money withdrawn from the bank? Proper inventory control is the only safe way to do so.

Good inventory control depends in part upon whether the businessman can rely on receiving shipments within an allotted time. Good vendor relationships, fair treatment of suppliers in matters of claims, and prompt payment of bills will help to make this possible. In spite of excellent inventory control, emergencies will arise when unexpectedly depleted inventories must be replaced quickly. In such crucial times the value of good vendor relations is of the utmost importance.

Review and Discussion Questions

1. What are the points of similarity and of difference in inventory control for the merchant, the manufacturer, and the service business operator?

2. Why does the merchant emphasize the value of his inventory, whereas the manufacturer and service operator are concerned primarily with the number of units of theirs?

[25] Adapted from Meyer, William H., and associates, *Establishing and Operating a Metal Working Shop*, pages 119–122. Washington: U. S. Department of Commerce, Industrial Series No. 16, 1945.

3. Assume that you are starting a small business of a type not discussed specifically in this chapter. Outline an adequate inventory control system for this business and give any needed explanations.

4. What, if any, conventional accounting records are used in inventory control? What other records are used? How do you explain these differences? What conclusions can you draw from this situation?

5. Discuss the various ways inventory control in each of the three major fields is related to other departments or functions in each field. Be specific and give illustrations.

6. Assume that you have just bought a going business, and describe how you would proceed with your inventory control.

7. How, if at all, does the importance of inventory control vary with each of the following conditions: (1) size of town, (2) price trend, (3) age of the business, and (4) size or type of business?

8. Give several reasons why the distinction between inventory control and inventory control system is important.

9. About what percentage of the total number of workers is engaged in the control of inventories in a typical retail store? factory? service establishment? Examine a business in each of these fields to verify your answer.

10. Summarize the main points of similarity and of difference between inventory control as used in merchandising and in manufacturing. Discuss.

11. Does the importance of inventory control in each of the three fields of small business vary directly with the relative amounts of total capital invested in inventories? With any other factors? Discuss.

12. Review the discussion in the chapter concerning the risk of inventory losses in manufacturing as compared to merchandising. What management aids in addition to inventory control could be used to minimize these risks in each field? Explain.

13. In separate columns list the ways good merchandise control in the retail store can aid (1) buying and (2) selling.

14. Would a location system as described in the chapter for a

factory be useful for control of reserve stocks in a retail store? Under what conditions? Discuss.

15. Visit the reserve stock rooms of a department store, drug store, hardware store, and chain variety store. Compare the methods used to store, locate, and control stocks. Discuss your findings.

16. Visit an automobile repair, radio repair, and furniture repair shop and compare their methods of storing, locating, and controlling inventories of materials and parts. Discuss your findings.

17. Visit a machine shop (metal-working) and a woodworking or cabinetmaking and repair shop. Repeat the assignment of questions 15 and 16.

18. Assume that you plan to open a book, stationery, and office supply store in a town of about 100,000. Outline the inventory control and system you would use. Distinguish between your control of inventories and the system you would use. If possible, discuss your plans with businessmen in the trade and report the results.

19. Visit two factories making somewhat similar products, one a small firm and the other a large concern. Study and compare the inventory control and related accounting systems used. Discuss your findings.

20. Select a particular kind of business for an intensive study of inventory or stores control. After learning all you can from reading and talking to men in the field, see if you can find ways to simplify the paper work needed, reduce the time required to store and to locate items, and reduce losses common in this field.

Chapter XVIII

REGULATIONS AND TAXES

The small businessman has more interests in laws, regulations, and taxes than he may at first realize. Before the beginning of the Christmas selling season, a certain merchant was crowded for space and stacked boxes and articles of merchandise in every available square foot of floor area and right up to the ceiling. A local fire inspector told him to rearrange the goods to allow at least 15 inches between the top of all merchandise and the ceiling, and to clear aisle space from the entrance to the far side of the store room. The merchant was angry, but he knew he had to do as the inspector said. A few days later, fire broke out in a nearby store. Firemen were unable to get to the sources of the blaze because of a congested storage area and the inventory was a complete loss. Later it developed that this retailer's insurance policy was void because of his violation of local fire regulations. The loss forced him into bankruptcy. In an article that appeared in the local newspaper soon after this unfortunate event, attention was called to the fact that local merchants enjoyed a lower fire insurance rate than was common in other places largely because of local ordinances designed to reduce fire hazards. Generally these were strictly enforced. Possibly for the first time one small merchant began to realize some of the many benefits derived from laws and regulations.

Businessmen have long recognized the need for rules and regulations governing conduct. Some of these are standards of conduct adopted voluntarily by business groups as codes of ethics. Others are rules enforced by competent authority and

administered by properly authorized courts. The latter group are known as laws.

Laws have various objectives as well as origins. Some are designed to prevent undesirable acts by prohibiting certain kinds of conduct. Others, such as tax laws, require particular acts and are mandatory on all concerned. A third group, permissive laws, permit individuals to enjoy certain privileges provided they meet stated requirements. Many permits to do business in particular fields or to engage in professional occupations are of this type.

The origin of laws—that is, the source of their authority—in the United States is usually significant because of our multipower type of legal authority. Ours is essentially a constitutional type of government. The scope of the federal and of each state government's legal authority is defined primarily in its constitution and in the amendments thereto. Thus the federal government has been delegated in the Constitution the right to regulate commerce between the states (interstate commerce) and with foreign nations. Powers not delegated to the federal government are reserved to the states. Each state in its constitution is delegated, or presumes the right to exercise, certain powers that are generally of state-wide interest, such as the regulation of intrastate commerce. Authority over purely local matters is usually left to the local governing agency concerned, which may be the county, township, parish (relatively unimportant today), incorporated municipality, city, or town. Other minor governing units also exist for special purposes.

The small businessman is most interested in the federal, state, and local laws and regulations, including taxation, that affect his business. Even though he may be engaged entirely in activities within the state, or even within the city limits, certain federal laws and taxes, as well as those of his own state and local governments, affect his business and personal conduct. As a broad generalization subject to certain important exceptions, it can be said that the order of precedence or

authority is federal, state, and local, although in doubtful cases it is advisable to secure competent legal counsel.

There are many other aspects of law that should be understood by the independent businessman, only a few of which can be given even brief mention here. Criminal law deals with acts (crimes) considered injurious to society for which a penalty such as imprisonment or a fine is imposed and for the enforcement of which society, through its duly authorized courts and law enforcement officers, is responsible. Civil law, in contrast, is concerned with protecting the individual, especially his rights of private property, and providing that damages for injury sustained may be secured by the person concerned through such process as bringing suit against the offender. Some laws, such as the federal Robinson-Patman Act, have both civil and criminal provisions.

Almost all important modern laws are statutes—that is, acts passed by a federal or state lawmaking body—or constitutional provisions embodied in the original federal or state constitution and its amendments. Court decisions interpreting the various statutes and constitutional provisions provide guides to the meaning and application of every law.

In recent years many important statutes have been enacted that incorporate a special board, commission, or other agency charged with the administration of the law. Examples of these administrative laws are the Clayton Act, which is administered by the Federal Trade Commission; the National Labor Relations Act, administered by the National Labor Relations Board; and many state laws dealing with industrial relations, public health, and safety.

Finally, the common law, or old English guides to justice and fair treatment, may govern in situations not covered by specific legal enactments.

As in other fields that have developed a similarly extensive body of knowledge, the independent businessman cannot hope to be an expert in law, nor can he afford to call on expert counsel for every decision. He should endeavor to recognize

those situations that call for legal counsel and be ready to secure and pay for such advice, for the investment will usually be more than repaid.

Certain general principles of law, important legal instruments, and particular laws that have special significance for the small businessman must be considered. An understanding of these principles, instruments, and laws should help the businessman to carry on his activities without either breaking the law or sacrificing the rights and benefits to which he is legally entitled. It should also help him to recognize when legal counsel is needed and thereby serve a purpose the importance of which would be difficult to over-emphasize.

Principles of Law

Agency. Agency implies a business relationship between two parties that involves a third party. It is a contract whereby one person, the agent, agrees to represent another person, the principal, in business dealings with third parties. Persons usually deal with the agent as though they were dealing with the company or person (principal) he represents. People who would not take the statement or promise of a clerk employed in a store as the word of the employer on important matters would accept that of an agent. Some agents are given "power of attorney," involving the authority to make legally binding contracts for their principal. Since agents are usually appointed by definite agreements or contracts, the law of contracts applies to agency.

The small businessman has many dealings with agents and may have occasion to appoint his own agents or to serve as agent for some principal. The purchase of insurance, many real estate transactions (whether for lease or purchase), and the procurement of equipment, materials, or merchandise often involves dealing through agents. A small manufacturer may prefer to sell through agents rather than through his own sales force. Even small-scale retailers may secure special or exclusive agency rights for certain prestige merchandise. A very

important consideration whenever agency is involved is to ascertain and clearly define the authority delegated to the agent by his principal and the agent's duties or responsibilities.

Contracts. Almost every business act is based on agreements or promises, most of which are contracts. Mutual confidence among the various parties involved in business activities is so basic to modern society that it is difficult to conceive of the continued existence of civilization in the absence of contractual relations. A contract is an agreement between two or more competent parties to do, or not to do, some lawful act for a stated consideration. Although a contract is an agreement, or meeting of minds, not all agreements are contracts. The essentials of a valid contract are:

1. agreement—an offer that must be accepted as offered;
2. true consent—not under duress;
3. between competent parties;
4. some lawful objective; and
5. consideration—the value of which is immaterial.

In addition, the businessman should remember that most contracts with minors are voidable; that is, the minor can elect to be bound by the contract or not. All important contracts should be in writing with definite provisions that meet the essentials of a valid contract as stated above, and, according to the law in many states, certain contracts must be in writing. This is especially true of contracts not to be performed within one year and of those involving the sale of real estate. A written contract is usually desirable, even if not required by state law, whenever common sense indicates a possibility that certain provisions, or even the contract itself, may later be questioned or forgotten.

Sales. The businessman is concerned with the sale of either real property or personal property. Property in this sense is the right that a person owns in something, whether land, material, or merchandise. Ownership may be transferred by gift or inheritance as well as by purchase and sale. About two-

thirds of the states and Alaska have adopted a Uniform Sales Act, among the important provisions of which is the clear distinction between a sale and a contract to sell. Other points that should be clearly ascertained in any sale are: the time title passes, identification of the goods, and the right or power of the seller to transfer title. Certain sales must be evidenced by a written bill of sale. If the goods are not delivered immediately, most states require evidence of sale in writing when the amount involved is above some stated minimum, varying from $25 (Delaware) to $2,500 (Ohio). In the largest number of states $500 is the minimum.

There are so many variations of sales and payment plans that complete coverage would be impractical here. However, one question that arises frequently enough to deserve comment is the protection of the seller in case full payment is not made at or before time of delivery of the goods. For example, a retailer may buy merchandise on credit, sell the entire lot for cash to one or a few customers, and fail to pay the wholesaler or other suppliers. To protect the latter almost every state has adopted the Bulk Sales Law. This law requires advance notice to each creditor before sale of an entire stock of goods; if this is not given, the creditors can bring action against the goods even though they have passed into the hands of a third party.

A point that frequently causes confusion relates to the obligation of a business to sell goods or services to any person who may offer the full purchase price. A few broad classes of business enterprises, such as public utilities, common carriers, and hotels, are required to serve all persons alike who meet publicly announced requirements and are not obnoxious or otherwise objectionable to other patrons. The merchant is not in this class. He can refuse to sell to any person regardless of the latter's readiness to pay the full purchase price in cash. Manufacturers and other sellers not in the "public service" groups may also refuse to sell to any prospective purchaser at their discretion. The principal apparent exceptions to this

rule are certain public eating places where the law prohibits customer discrimination because of color or race and situations in which the businessman carelessly makes a derogatory remark about the prospective customer in refusing to sell to him. It is the derogatory remark, however, and not the refusal to sell, that is likely to cause serious trouble.

Negotiable instruments. Business transactions have been carried on to an increasing extent by means of negotiable instruments instead of money. Both serve as media of exchange; both facilitate trade and pass freely from person to person in connection with business transactions. Money, or legal tender, is universally acceptable and is required by law to be accepted in this country as adequate settlement of a financial claim. Although the same legal compulsion does not exist for negotiable instruments, custom, convenience, and confidence have all contributed to their widespread use. The common check or bank draft is a good illustration.

Negotiable instruments may be classified into two groups: promissory notes and bills of exchange. According to the Uniform Negotiable Instruments Law, any instrument must satisfy the following requirements if it is to be negotiable:

1. It must be in writing and signed by the maker or drawer.
2. It must contain an unconditional promise or order to pay a sum certain in money.
3. It must be payable on demand or at a fixed or determinable future time.
4. It must be payable *to order* or *to bearer.*
5. Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty.

Although the meaning of most of these requirements seems obvious enough, a few points deserve emphasis. One is that every important element must be definite and clearly expressed in the instrument. For example, the familiar IOU is not a definite promise to pay; it is merely an acknowledgment of

a debt and therefore is not a negotiable instrument. It is important to note that a promissory note must be payable in money and only in money. Finally, if a businessman does not want to have a promissory note passed on he can accomplish this objective by the wording.

Bills of exchange differ from promissory notes in that one person, the drawer, *orders* a second person, the drawee, to pay on demand, or at a fixed or determinable future date, a sum certain in money to order or bearer, the payee. Bills of exchange consist of different forms of drafts in addition to checks, which are the most common and widely used type of this kind of instrument. By endorsement the original payee may transfer a check either to bearer or to a particular person. It is well to remember that endorsement of a check creates a contingent liability to make good in case of default, such as refusal of the bank to honor payment because the drawer of the check has insufficient funds.

This brings us to the obligation or liability of the drawee. In the case of checks, a bank will ordinarily make payment unless: the drawer lacks sufficient funds and has not made prior arrangements for an overdraft; the drawer has stopped payment on the check; or the bank has reason to believe the person presenting the check has no legal right to do so. In the case of other drafts, the drawee must accept the draft drawn against him to create a liability or promise to pay.

The practice of having a draft accepted is used frequently in selling goods on credit. The seller draws a draft on the buyer, often a retailer, for the exact amount of the invoice. This must be accepted before the goods are actually delivered to the buyer. Thus a promise to pay is created. The seller or drawer of the draft can often discount this trade acceptance and so secure his own money before the due date of the invoice while at the same time granting credit to his customers.

A check is a negotiable order payable on demand if it is drawn on a bank. Personal checks, bank drafts, certified checks, and Travelers Cheques may all be encountered by the

small businessman. A Travelers Cheque is peculiar in that it provides a means of easy identification even when the person cashing it is a stranger to the person to whom it is presented. Promissory notes may be: unsecured notes, collateral notes, judgment notes, mortgage notes, bonds (long-time notes), certificates of deposit issued by a bank, and conditional sale notes. Although drafts are sometimes accepted by a bank, by arrangement and for a fee, these banker's acceptances are far less common in domestic commerce than is the trade acceptance. Distinguished according to time of payment, there are sight drafts, drafts payable after date, and those payable after sight.

It is well to remember that drafts may be valuable even before they are "accepted," but acceptance creates an actual promise to pay. Time drafts, checks, and promissory notes should be presented for payment when due or as soon as possible. Even though they may be legally valid claims for a reasonable time after maturity, practical considerations of security and custom dictate such prompt presentation for payment. Special cases deserve special consideration and usually require competent legal counsel.

Regulations Pertaining to Competition, Trade Practices, and Public Welfare

Laws of this kind are mostly restrictive or permissive. In general the aim is to encourage competition and stimulate progress by restricting anti-competitive and anti-social acts.

Competition

In most areas of business that are not natural monopolies, competition is still considered to be desirable. However, unregulated business has repeatedly shown tendencies to seek monopoly powers in varying degrees. Our anti-trust laws, both federal and state, have been enacted to protect business itself against these tendencies. The Sherman Anti-Trust Act of 1890 was passed by the federal Congress after the states had

tried unsuccessfully to check the growing monopolies of that time. Although not completely successful, it did make possible the dissolution of many monopolistic trusts in sugar, whiskey, oil, and other industries, in addition to at least rendering more difficult certain practices commonly used to crush competition, such as combinations and conspiracies in restraint of interstate trade, tying contracts, and drastic price cutting in areas where such local price discrimination was the common method used to stifle small competitors as they were starting.

More than 20 years ago a new approach was taken with the passage of the Clayton Act and the Federal Trade Commission Act in 1914. Emphasis was now placed on preventing the growth of monopolies by "cleaning up competition," or restricting practices that would lead to monopoly. In 1938 the Wheeler-Lea Act extended the coverage of the Clayton Act, especially with reference to misrepresentations in advertising. This administrative type of law has enabled the Commission to build up a long list of unfair trade practices over the years since its inception. Among these are the following: price cutting for the purpose of eliminating competition, misbranding, secret rebates, spying on competitors, boycotts, disparagement of competitor's goods, use of misleading names, false and misleading advertising, forced-line selling, and predatory practices in general.[1]

Although both the Sherman and the Clayton Acts were federal laws and therefore applied only to interstate commerce, most states enacted similar legislation to regulate intrastate commerce. In addition, decisions regarding unfair methods of competition as arrived at by the Federal Trade Commission have set the pattern both for state courts and for practices approved by the various trade associations. Final authority for approving trade practices, however, rests with the Commission. Many of the prohibitions were arrived at only after extensive

[1] For further study see *Prentice-Hall Labor Guide,* Trade Regulation Edition.

hearings and conferences between the Commission and trade representatives. These trade practice conferences have been developed into an important technique. Although benefits to the small businessman resulting from the works of the Federal Trade Commission would be difficult to assess directly, there is no doubt that they have been enormous.

Price regulation

In a truly competitive market, price acts as the regulator adjusting supply to demand. Attempts to manipulate prices in various ways have existed since the beginning of our price economy. In this country four broad areas of peacetime regulation by law have appeared: price fixing, price discrimination, price cutting, and resale price maintenance.

Under the anti-trust laws prior to the 1930's, all agreements to fix or set prices were generally considered illegal. Even agreements between a manufacturer and his dealers setting the price at which the goods could be resold by the dealer were unenforceable. Also, discrimination in price between different localities for the purpose of stifling competition was and still is illegal under both federal and most state laws.

Price fixing. Price fixing, under court interpretations of the anti-trust laws, includes agreements among competitors engaged in interstate commerce to stabilize prices or to hold competitive prices in any fixed relationship to each other. It is not limited to the fixing of uniform prices. Also, provisions for price agreements that have been considered illegal apply to many indirect methods that taken together have the end result of price fixing. Thus agreements to maintain uniform discounts, markup or methods of calculating markup, delivery charges, and many similar practices among competitors may be illegal when applied to interstate transactions.[2]

Price discrimination. In 1936, the Robinson-Patman amend-

[2] For further study see Bock, Betty, *Small Business and Regulation of Pricing Practices,* pages 30–32. Washington: U. S. Department of Commerce, Economic (Small Business) Series No. 61, 1947.

ment to the Clayton Act declared personal price discrimination to be illegal. Differences in price of goods of like grade and quality to different buyers in competition are declared to be illegal unless justified by differences in costs of manufacture, selling, or handling, provided such discrimination may have the effect of "substantially lessening competition, tending to create a monopoly, or injuring, destroying or preventing competition with other persons." A seller is, however, permitted to meet lower prices of competitors in certain cases without violating the law. Burden of proof that price discriminations are economically justifiable rests with the seller, and the buyer who knowingly accepts such illegal price discrimination is made equally liable with the seller. The reason for making the buyer liable to prosecution for accepting discriminatory prices was the fact that many buyers for large chain stores or mail order houses had formerly bargained for low prices that sometimes exceeded the economies resulting from their large orders. Methods commonly used to conceal price discriminations were also declared illegal. In particular they include the following: allowances for advertising and sales promotion that are in excess of a fair payment for services actually rendered by the buyer and that are not made on proportionately equal terms to all competing customers; brokerage fees collected from the seller when the "broker" was also acting with the buyer as principal; and services or facilities furnished by the seller to certain buyers unless made available to all purchasers on proportionately equal terms.

It should be noted that the Robinson-Patman Act did not prohibit all price discrimination but only that on similar goods to buyers who are in competition where the difference in price exceeds economies connected with the lower-priced sale. It should also be remembered that the retail or other buyer is liable for violation equally with the seller.

A small retailer with a good location and large window display space is called upon by a salesman representing the manufacturer of a new line of clothing. The salesman offers a ten

per cent advertising allowance, saying that the manufacturer is anxious to secure good representation in the town. He also states that he is not making this offer to other merchants in the town who carry his line of goods. After buying and receiving the line of clothing and taking the ten per cent advertising allowance, the retailer does not display the merchandise in his windows or mention it in his newspaper advertising. The line sells satisfactorily but no more so than similar goods that he has been promoting. The merchant regards the advertising allowance as an added discount to induce him to stock the goods. Later, when he attempts to reorder under the same terms, he is surprised and resentful at being asked to prove that the advertising allowance received has been spent for advertising this line of goods. If the case stops with a reprimand and a new understanding between the retailer and his supplier, it will be fortunate. However, if a competing dealer who did not receive an advertising allowance were to challenge the transaction, both manufacturer and retailer would probably be held in violation of the law.[3]

Price cutting. Excessive price cutting when used solely for the purpose of eliminating competition has quite generally been considered to be an unfair method of competition used especially by large concerns to drive small competitors out of business. If permitted, it is normally followed by a very high or monopoly price once effective competition is driven from the market. The temporary benefits to consumers resulting from lower prices are lost during the subsequent period of high prices.

From the 1930's on, several states have passed laws to regulate excessive price cutting. These are of two general types, unfair practice and anti-loss leader laws. The unfair practice laws prohibit below-cost selling that injures competition. Cost is defined as invoice cost plus a fair share of the expenses of

[3] For further study see *Prentice-Hall Labor Guide,* Trade Regulation Edition, ¶ 21,071 and 21,071A.

doing business. Especially in merchandising, where a large variety of articles are handled, this is so indefinite and it is so impractical to determine cost when applied to individual items that these laws have been ineffective. A partial solution has been to interpret "cost of doing business" arbitrarily as some fixed markup over cost, say six per cent.

The second group of laws provide an objective and definite measure of what constitutes too low a price by setting up some nominal markup figure like six per cent above landed cost as the standard. These anti-loss leader laws are enforceable, although usually the necessary policing is done by each trade group rather than by state law enforcement officers.

Soon after the enactment of these laws, when the country began to feel the effects of World War II on prices and merchandise shortages, the emphasis shifted to limiting price increases. Wartime price regulation, especially under the Office of Price Administration, was the outstanding feature of this development.

Resale price maintenance. Beginning with California in 1931, the various states enacted so-called "Fair Trade" statutes that legalized resale price maintenance contracts for trademarked articles or merchandise identifiable as to producer. These laws permitted vertical contracts between manufacturer and wholesaler or retailer stipulating either the price at which the identifiable article was to be sold or minimum price below which it could not be sold. Contracts on the same level of distribution, between different manufacturers or different wholesalers or different retailers, to set the resale price were left unenforceable. A provision that one contract between a manufacturer or his duly authorized wholesale agent and one retailer in a state became binding on all other dealers in the state, was part of the law. By 1937, the majority of the states had passed resale price maintenance laws, and the federal government made the practice generally legal in interstate commerce by passing the Miller-Tydings Act. All but a few states now have these Fair Trade laws.

After carrying a line of Fair Trade merchandise for six months, a local jobber decided to discontinue the line and instructed his salesman to offer retailers a 20 per cent discount on it. The offer was accepted by several retailers, who then ran cut-price sales on the whole line of goods. Several weeks later the jobber received a notice from the manufacturer that the Fair Trade agreement had been violated; he was instructed to return any goods on hand and to buy back stocks in dealers' hands for return also. The next day he was notified by the manufacturer's legal department that suit had been filed against him for violation of Fair Trade, including a claim for $100,000 damages for injury to the good will of the manufacturer's brand in the community. Consulting his own attorney, the jobber was surprised to learn that he could be held legally liable in this case. He was advised to exert strenuous efforts to recover merchandise in dealers' hands for return to the manufacturer and to seek a settlement out of court. Under the law in his state, he should have notified the manufacturer of his intention to discontinue the line. The manufacturer could then buy back all stocks of his goods at original prices or give the jobber authority to sell them at reduced prices. If the manufacturer had been notified and failed to answer within 60 days, the jobber could then have reduced prices and cleaned out the line without violating the state law.

Soon after the experience described in the foregoing case, a small retailer involved noticed a window display of attractive-looking merchandise accompanied by a sale sign that stated some of the merchandise was slightly damaged. An investigation disclosed that two lots of goods were on display in the store, both offered at reduced prices. The price sign with one display stated the articles were substandard but good value for the money. Many items in this display carried the identification of makers whose goods were normally sold under "Fair Trade." The other display contained merchandise that looked familiar but from which all maker identification had been removed. The price sign made no reference to the goods being

damaged or substandard. Further investigation showed this lot of goods to be a "Fair Trade" line which the dealer wished to close out quickly. Both cases were allowable exceptions to resale price maintenance agreements; namely, damaged or substandard goods and regular merchandise from which the maker's identification had been removed before the price was cut.[4]

Merchandise regulation

Food, Drug and Cosmetic Act. Laws designed to protect the health and to some extent the pocketbook of the consumer have been enacted by federal, state, and local governments. The Federal Food, Drug, and Cosmetic Act of 1938 revised the earlier Pure Food and Drug Act of 1906 by extending the coverage to include certain curative devices and cosmetics (except soap). It also provided for testing before certain drugs that might cause sickness or death are put on the market. More complete disclosure of habit-forming ingredients as well as others that might be injurious to certain types of individuals is required. Like its predecessor, the new law deals mostly with adulteration, misbranding, and information that must be given on the label. The small businessman manufacturing or handling foods, drugs, devices, or cosmetics should study and observe in detail the provisions of this law. Even if he is not engaged in interstate commerce, it will be good business to meet the requirements set forth in the federal law.

All states and most cities have legislation and regulations dealing with the processing and handling of food for the public. Many have laws governing drugs and similar merchandise. Pharmacy is recognized in every state as a profession which should be practiced only by qualified pharmacists, but the detailed regulations are not uniform for all states. Either the manufacture or the sale of certain other products is fre-

[4] For further study see *Prentice-Hall Labor Guide*, Trade Regulation Edition.

quently regulated by state law or local ordinances. Some of these are mattresses, bedding, eyeglasses and similar optical goods, and a long list of synthetic foods and drinks.

Wool Products Labeling Act. According to the federal Wool Products Labeling Act, all articles made of wool, except floor coverings, must be labeled as to the percentage of virgin wool and of reprocessed and re-used wool contents. If any fiber other than wool is present in excess of five per cent, its percentage must also be given on the label. It is illegal for the retailer or other businessman dealing in such products to remove or deface the label containing this information.

Patents and trade-marks. Patents and trade-marks are regulated by federal laws administered by the Patent Office. Securing a patent is a highly complex proceeding and should be handled by an attorney trained in this specialized field. Competent attorneys should also be employed in all trade-mark matters. A patent gives an inventor the right to exclude all others from making, using, or selling his invention for the term of 17 years, and may be granted only after a determination of utility and completeness of disclosure of the invention and a search to determine its novelty. No patent is granted upon a mere suggestion or idea. The patent law affords no protection prior to the actual issue of a patent, although it is common practice to serve notice of application by stating that a patent has been applied for.

A trade-mark is a distinctive word, emblem, symbol, or device, or a combination of any of these, used in connection with goods actually sold in commerce to identify the manufacturer or seller. It must have been used in interstate commerce before an application for registration can be filed in the Patent Office. Since July, 1947, provisions of the Federal Lanham Act replace those of the Trade-Mark Act of 1905. Under the new law, registration of trade-marks on the Principal Register becomes almost essential to secure future protection. Also, a trade-mark need no longer be physically affixed to the merchandise; protection is thus given to well-advertised trade-marks for such

products as brands of gasoline and to "service marks" of service establishments. In addition to federal registration, many states have passed laws concerning the protection of trade-marks used in intrastate commerce.[5]

Advertising

Federal regulation of advertising has been administered by the Federal Trade Commission as part of its work of maintaining fair competition. In general, false and misleading advertising is condemned. This includes the use of deceptive and misleading names and expressions like "Cylk" or "artificial silk." Many names formerly used to describe lower-quality furs in such a way as to suggest the genuine article have been banned. The Wheeler-Lea amendment to the Federal Trade Commission Act gives the Commission power to regulate advertising to meet the labeling requirements of the Food, Drug, and Cosmetic Act. It also gives the Commission authority for the first time to take action against advertising that is injurious to the *public* even though it may not directly affect competition. Many states also have laws regulating false and misleading advertising.

Labor legislation

Federal legislation governing labor relations may be divided into three broad groups: (1) settlement of labor disputes; (2) regulation of wages, hours, and working conditions; and (3) social security, which is also an important division of business taxation.

Settlement of labor disputes. The National Labor Relations Act, or Wagner Act, of 1935 became the first important law concerned with labor disputes and is administered by the Na-

[5] For an excellent analysis of the Lanham Act see the booklet *Preparing for the New Trade-Mark Law.* New York: Research Institute of America, Inc., 1946. For further study see Watson, Barnett, *Small Business and Trade-Marks.* Washington: U. S. Department of Commerce, Economic (Small Business) Series No. 68, 1948.

tional Labor Relations Board. It provides that employees shall have "the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in concerted activities, for the purpose of collective bargaining or other mutual aid or protection." According to the act, certain practices on the part of an employer are considered to be unfair, including the following: (1) interfering with, restraining, or coercing of employees in the exercise of their guaranteed rights; (2) dominating or interfering with the formation or administration of any labor organization; (3) encouraging or discouraging membership in any labor organization by discrimination in regard to hire, tenure, or condition of employment; (4) discharging or otherwise discriminating against an employee for filing charges or giving testimony under the act; (5) refusing to bargain collectively with representatives of employees.[6]

The Taft-Hartley Act of 1947 changed some provisions and interpretations of the National Labor Relations Act in an effort to correct certain undesirable conditions that had developed in labor relations. The Taft-Hartley Act represents one attempt to equalize the position of labor and management. It prohibits the closed shop, mass picketing, the use of violence in connection with a labor dispute, jurisdictional strikes and secondary boycotts, strikes against the federal government, and any labor organization from having a standing under the act if its officers refuse to sign statements that they are not members of the Communist Party. The Act permits a modified union shop; requires that labor be held equally responsible with management for fulfillment of the terms of a contract agreed upon; and creates a Federal Mediation and Conciliation Service outside the Department of Labor.

The Taft-Hartley Act provides a bill of rights for the individual

[6] For further study see Roper, Burt W., *Small Business and Government Regulation.* Washington: U. S. Department of Commerce, Economic (Small Business) Series No. 58, 1947.

worker because it, in addition to protection against abuses by employer bosses, also protects him against abuses by labor bosses. . . . No longer can there be excessive initiation fees and fines.

. . . The only way a man can be thrown out of the Union today is for non-payment of dues. . . . No longer is the National Labor Relations Board investigator, prosecutor, jury and judge all rolled into one. Today it is merely a quasi-judicial board that shall pass on the evidence presented to it.[7]

Regulation of wages, hours, and working conditions. Federal regulation of wages and hours is covered by the Fair Labor Standards Act of 1938, which provides for minimum wages and maximum hours. One objective of federal regulation has been to secure greater uniformity of wage and hour provisions among the various states. Groups excluded from the provisions of the act fall into three broad categories: (1) certain executive and professional employees, (2) workers engaged in occupations covered by separate laws, such as railway employees and seamen, and (3) those in distinctly local or intrastate activity, such as agricultural workers and employees in a retail or service establishment the greater part of which is devoted to intrastate business. The employment of minors under 16 years of age, with certain exceptions, is prohibited by the act.

The various states also have laws with both fair labor standards and wage and hour provisions that apply to local problems and enterprises.

State regulation is more active in the field of working conditions, especially with reference to industrial accidents. All states but one provide by law for industrial accident compensation. Many also limit work in hazardous occupations, night work, and so-called "industrial home work." The small businessman should investigate the laws in his state governing employee relations of the type mentioned.[8]

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[7] Hartley, Honorable Fred A., Jr., "The Truth of the Taft-Hartley Law." *Hardware World,* November, 1947, Vol. 44, No. 11, pages 74–76.

[8] For further information regarding labor legislation consult *Prentice-Hall Complete Labor Equipment.*

Social security. The following instructions prepared by a federal government agency warrant close study by any businessman:

If you are a businessman and hire even one person, you should inform yourself about the provisions of the Social Security Act as they apply to you. This Act provides for two kinds of insurance: (1) Federal old-age and survivors insurance and (2) State-Federal unemployment insurance.

Federal Old-Age and Survivors Insurance. This program provides a regular monthly income for the worker and his family when he is too old to work and for his family when the worker dies. The cost of the program is met by taxes levied at equal rates on both you and your employees. It is your responsibility to deduct this tax from your employees' wages. Four times a year you have to send the amount deducted from your employees' wages plus your tax to the U. S. collector of internal revenue for your district. Along with the money must go a report of the wages paid each employee. In order to make these reports you must follow certain specific directions as follows:

1. Get an Employer's Identification Number. This is your own identification by which the Federal Government, which administers this insurance program, distinguishes you from anyone else who might have the same name. To get your number, go or write to the nearest field office of the Social Security Administration or to the collector of internal revenue for your district, and ask for Form SS-4. Fill this form in and send it to the office from which you got it. Later, you will be sent a copy of Form SS-6, which will show your identification number. This number is used on all your quarterly reports when you pay your taxes.

You should never use more than one identification number. If, for some reason, you have more than one, go to your nearest collector of internal revenue, tell him what numbers you have, to what name and address they were issued, and your present address. He will then tell you what number you should have.

If your business was previously owned by someone else, do not use his identification number. Apply for a new number.

2. Get the Number on Each Employee's Social Security Card.

If an employee has no social security account number, he can get one by filling in Form SS-5. He, or you, can get this form from the nearest field office of the Social Security Administration. If there is no such office in your town, the form can be obtained from the local post office. When filled out, this form must be taken or mailed to the nearest social security office, which will then give the employee a social security card with his account number on it. The address of the social security office may be obtained from the local post office.

When you make your quarterly report to the collector of internal revenue, you will need the name and the account number of each of your employees. Hence you should copy the names and numbers of your employees into your permanent records.

If you have an employee who has applied for an account number but has not yet received it, he may have an official temporary card without a number on it. This card is acceptable until the expiration date shown on the card. Write into your records the employee's name and address, the date on which his temporary card was issued, the date it expires, and the address of the field office that issued the card. Ask the employee to let you know his number as soon as he gets it. If he leaves your employ without telling you his number, get in touch with the field office and get his number.

If ever you are unable to get the social security number or a temporary card of an employee immediately, you may save yourself time and inconvenience if you will ask the employee to complete and sign Form SS-5 without delay. If a Form SS-5 is not available, write down in your records the employee's full name, present address, date and place of birth, father's full name, mother's full name before marriage, employee's sex and color, and a statement as to whether the employee has ever filed a Form SS-5 and if so, the date and place of filing. Do not fail to get this information because you may need it when you report his wages to the collector of internal revenue.

If you employ a worker who has lost his social security card, have him apply at the nearest office of the Social Security Administration for a duplicate card. Remind him not to ask for a new card

but instead for a duplicate card, which will have the same number as the card he lost.

3. Keep Accurate Payroll Records. Each employee's tax is computed on his wages up to $3,000. The rate of the tax is shown on Form SS-1a (Employer's Tax Return), which you can get from the collector of internal revenue. The employees' tax applies to all workers no matter what their wages are or whether they are employed regularly, part time, or for only a few hours. It must be deducted from each employee's wages every time you pay him.

When you have deducted the tax from the first $3,000 you pay an employee in any one calendar year, don't deduct any more tax from any additional amounts you may pay him that year. In determining whether you have paid an employee $3,000, count the total amount of wages you have paid him. For example, if you pay your employee partly in money and partly in goods, meals, or lodging, count all these as a part of his wages.

For social security purposes your payroll records must show the following: The employee's name; his occupation, address, and social security number; the amount of each payment to him (including any amount withheld); the date of each payment; the period of service covered by each payment; and the amount of social security tax deducted from the wages paid. If the employee's tax is deducted at any time other than when the wages are paid, the date of deduction must be recorded. If all, or any part of the wage payment is not taxable (that above $3,000, for example), the reason must be included in your records.

The rate of your own tax as an employer is also shown on Form SS-1a. It is computed on the total wages you pay each employee up to $3,000 in each calendar year.

4. You Must Make Your Tax Payments and Reports on Time. File your return on Form SS-1a every quarter of the calendar year as follows:

Quarter ending	*Date due*
March 31	On or before April 30.
June 30	On or before July 31.
September 30	On or before October 31.
December 31	On or before January 31.

At the proper time send or take your return to the United States

collector of internal revenue for the district in which your principal place of business is situated.

At the same time, pay the collector the amount of your employees' tax plus your own employer's tax. If you pay by check or money order, make it payable to the Collector of Internal Revenue. After your first return has been filed, the collector will mail you a copy of Form SS-1a every three months. If your Form SS-1a does not reach you on time, let the collector know promptly, so that he can send you one in time to make your report.

When filled in, the Form SS-1a must show three facts for each employee: (1) his social security account number; (2) his name; and (3) the amount of taxable wages you paid him in the three-month period.

5. Give Each of Your Employees a Receipt for His Taxes. Each employee is entitled to receive from you a statement showing the amount of the wages you paid him and the amount of tax deducted from his wages. This receipt should be in a form suitable for safe-keeping. It may be made to cover each pay period or several pay periods, but each employee must be given a receipt at least once a year. If a worker leaves your employ, you must give him a receipt when you pay his last wages. Each receipt must have the following items on it: Employer's name,[9] the period for which the receipt is issued, total amount of wages paid within that period, amount of employee's tax deducted. If you choose to give the receipt each time you pay wages, you may show the date of the wage payment instead of the period covered by the statement.

The law provides that employers who willfully fail to furnish these statements to employees are subject to a civil penalty of not more than $5.00 for each such failure.

It is essential that you report wages correctly, since an employee's benefits are figured on the basis of the wages he receives.

State-Federal Unemployment Insurance. This program provides a worker who is unemployed, through no fault of his own, with weekly payments for a limited time between jobs. The cost of paying unemployment benefits is met by a State tax on the employer's payroll, and in two states, by a tax on employees also. As an employer, you are also required to pay a tax under the Federal Un-

[9] The employee's name is also required.

employment Tax Act; but you can get credit for the State tax against the Federal tax.

The Federal Unemployment Tax applies to you only if you have as many as eight employees in covered employment on at least one day in each of 20 calendar weeks during the calendar year. Most states have laws that apply to employers with fewer than eight employees; therefore, you had better make a careful investigation of the law in the state in which you do business.

Under the Federal Unemployment Tax Act you have certain duties as follows:

1. Making a Return. If the tax applies to you as explained in the paragraph above, get a copy of Form 940 from the United States collector of internal revenue for your district. Not later than January 31, file with the collector your return for the preceding calendar year. With the filled-in form send or take your tax payment. You may pay the tax in quarterly instalments if you prefer, but the first instalment must be paid on or before January 31. After your first return has been filed, the collector will mail you a copy of Form 940 once every year. If you do not receive it on time, let the collector know promptly so that he will send you a copy in time to make your return.

2. Figuring Your Tax. Figure your tax according to the instructions on Form 940. The rate is 3 per cent of the total taxable wages paid by you during the calendar year. The employee does not pay any part of this tax.

Take credit on Form 940 for your contributions to the state unemployment fund as follows:

(1) Contributions for a particular year may be credited against your Federal tax on Form 940 for that year only.

(2) The total credit so taken must not exceed 90 per cent of the Federal tax for that year. The amount of your credit generally will be your contribution to the State fund plus the amount by which your contribution is reduced through the operations of any experience-rating provision of the State law.

(3) In order to get maximum credit, you must have paid your contribution into the State unemployment fund on or before the due date of your return on Form 940, which is January 31.

Where to Get Further Information. In case you have any ques-

tions about points that are not clear to you, get in contact with the following people or agencies:

If you want information about Federal Social Security Taxes, consult the United States collector of internal revenue.

If you want information on old-age and survivors insurance benefits, consult the nearest Social Security Administration office.

If you want information about your State unemployment insurance law, consult the State Unemployment Compensation Agency (called Employment Security Agency in some States).

For the address of any of these offices, consult your telephone directory or inquire at the post office.[10]

Restrictions and permits

Some state laws restrict business activity (1) by permitting only licensed practitioners to engage in particular occupations, such as pharmacy, barber shop or beauty parlor operation, and public accounting, and (2) by requiring minimum equipment, facilities, or processes for sanitation and the health of employees and the public. However, in general most regulation of this sort is local, defined by city ordinance and enforced under the police powers of the governing unit.

A license is a permit granted by the governmental power to a person or company to pursue some business subject to regulation under the police power. Licensing is used both to regulate business and as a source of revenue to the government granting the license. For example, plumbers, electricians, pawnbrokers, and auctioneers, as well as dance halls, taxi companies, hotels, amusement places, and food service and drinking places, are usually licensed and frequently inspected or supervised to see

[10] Small Business Aids, No. 429, U. S. Department of Commerce, "What an Employer Must Do Under the Social Security Act." Condensed from *Employer's Duties Under the Social Security Act and the Federal Insurance Contributions Act and the Federal Unemployment Tax Act* (ISC 30). Federal Security Agency, Social Security Administration. Washington: U. S. Government Printing Office, 1948. For further information regarding social security legislation consult *Prentice-Hall Social Security Tax Service.*

that regulations for protection of the public health, safety, and morals are observed. Other businesses, such as retail stores, may not be required to have a license but be subject to minimum regulations necessary to reduce fire hazards.

In many cities licensing is used to enforce zoning restrictions. Licenses will be granted to operate a given type of business only in areas where zoning regulations permit this particular type. For example, a retail store will not be licensed to operate in a district zoned exclusively for residences and a dry cleaning "store" may get a license to operate in a retail shopping district but the dry cleaning plant using certain dangerous fluids will be licensed to operate only in the industrial district.

Licensing is also used to restrict competition, as when itinerant vendors selling from temporary quarters, on the sidewalk, or from house to house are required to pay a relatively heavy license fee. Some regulation of this class of merchants is considered desirable to protect the residents or public from "gyp artists" and fly-by-night peddlers. It is often difficult to draw the line between licensing for necessary customer protection and that designed to lessen competition for the local merchants.

Many other regulations and restrictions are enforced locally, such as those pertaining to use of the business premises, alleys, adjoining sidewalks, parking spaces, store signs, wiring, plumbing, heating, delivery equipment, and similar things. In addition, the small businessman will usually find among the established businessmen certain social controls relating to store hours, acceptable types of advertising, "going" rates of pay, pricing, and expected community services. Although these lack the compulsion of actual laws, they are very powerful.

Taxes

Federal income and withholding taxes and state sales taxes are covered in Chapter XX, "Records and Record Keeping." Social security taxes are discussed earlier in this chapter. Certain types of business may encounter special taxes, such as a

manufacturer's excise tax, railroad siding tax, use tax, and special products taxes. A corporation will usually have taxes in addition to those of a proprietorship or partnership, such as capital stock tax and a "foreign" tax if it operates in states other than the one in which it is incorporated.

In addition to the taxes already mentioned, most businesses will be required to pay both real and personal property taxes, usually at the county or city level. These are based on property valuation rather than income or profit and have been declining in importance, especially in relation to income taxes. Various fees for inspections covering the building, exits, fire hazards, machinery, elevators, ventilation, trucks, and other sources of possible damage to employees or the public are often in effect merely additional business taxes.

Conclusions

The regulation of business by government through laws, licenses, and taxation is probably as old as business and government. Law constitutes the organized body of rules of conduct enforceable by government agencies. In this country we have two important levels of legal authority (federal and state) as well as many minor levels (city, county, and other political subdivisions). Certain legal areas have developed general principles, such as the law of agency and the law of contracts. Although a great many legal documents are in use, a relatively small number are of great importance to most businessmen; among them are contracts, bills of sale, mortgages, and negotiable instruments.

With reasonable effort the small businessman can gain an understanding of the more important laws and legal documents that affect his business. He can also gain familiarity with the major forms of taxation. However, both law and taxation are complex fields requiring extensive specialized training and experience. *In all important cases it is well to see competent counsel on legal and tax matters.*

Review and Discussion Questions

1. Is legal authorization required to take and hold a debtor's property as security for an unsettled debt? Discuss.

2. Under what circumstances is a lawsuit inadvisable? advisable? Explain.

3. What are the essential characteristics of a law?

4. What are the primary objectives or purposes of law?

5. If business is based on mutual trust and confidence, why do we need so many laws relating to business?

6. Under what conditions would a written contract be more binding than an oral one? When is the reverse true? Explain.

7. Distinguish between an agreement and a contract.

8. What are the important provisions of the Uniform Sales Act?

9. Under what conditions is it necessary to secure a written bill of sale when the full purchase price is paid at the time of sale and delivery of the article sold? Discuss.

10. When does title pass from seller to buyer on a shipment made by common carrier on a straight bill of lading?

11. State and explain the provisions of the Bulk Sales Law.

12. How should a promissory note be worded to be certainly negotiable?

13. What is meant by endorsement? What responsibilities does it carry?

14. Discuss the meaning and purpose of discounting a note.

15. What, if any, liability does the drawee of a bill of exchange have? Discuss. Explain the same for the drawer.

16. What, if any, advantages are there to securing endorsement before accepting a negotiable instrument payable to bearer?

17. What is meant by "power of attorney"? Are the transactions carried out by the agent for the principal legally binding? Discuss.

18. What are the minimum powers of a true agent?

19. What classes of business are required to serve all persons alike? Give reasons for requirements.

20. In what additional ways not mentioned in the chapter are the users of trade-marks aided under the Lanham Act?

21. Retailer Jones has a lot of X brand merchandise under "Fair Trade" and decides to discontinue the line. What procedure should he follow to dispose of the entire lot in the shortest reasonable time?

22. Look up and report on the law governing advertising in your state. Is it enforced? Discuss.

23. What non-governmental agencies are active in enforcing laws relating to business? restrictions on unfair competition or unethical business practices? Discuss.

24. Select some line of business and determine the various licenses and permits required for operation.

25. Why is it considered more important to secure competent counsel on legal and tax matters than for other problems facing the small businessman?

26. Of what significance is the fact that many of the recently enacted laws governing business are administrative laws?

27. What kinds of small business are affected most by federal laws? What kinds are affected least? Discuss.

28. Look up the Federal Food, Drug, and Cosmetics Act and list as many ways as possible in which it affects small-scale retailers, manufacturers, and operators of service establishments.

Chapter XIX

CREDIT AND THE CUSTOMER

Experience shows that, in the retail field at least, credit-granting firms are more profitable and do a larger volume of business than strictly cash stores. This is true in spite of the also well-known facts that credit stores sell for slightly higher prices than cash stores, some firms fail because of unwise credit extension, and the long-time trend in retailing has been toward more cash sales.

The small businessman can use credit extension to increase his profits and expand his business in many ways. Among his special reasons may be some of the following: to secure additional business that can be handled at practically no extra expense; to attract new customers who need or want credit; to expand his sales rapidly up to his optimum capacity, and thus to reduce unit costs by using alternately with advertising or cut prices as a sales promotional device; to draw customers from cash stores by offering them the advantages of credit; to build good will and a desirable reputation by the way he handles his credit accounts; to compete with large-scale retailers like chain stores, mail order houses, and "supers" who do not extend credit; to secure a financial return over and above his merchandising profit in certain lines like durable consumers' goods that are purchased on instalment contracts; to increase customer traffic by encouraging customers to pay their accounts in person in the store; and to take advantage of the mine of valuable customer information available in the list of charge customers.

Most of the advantages of a credit business mentioned in the preceding paragraph need no further explanation. Some may

not apply to certain types of small business, and others that might be important in unusual cases may not have been mentioned. Our principal objective here is twofold: to counteract the loose thinking now prevalent that all small businessmen should sell only for cash and to suggest ways that the small business can use credit extension to the greatest advantage.

One of the best sources of extra business for a store is its charge account list, though doubtless many stores fail to realize this and strive instead for more and more customers. The opportunities for increasing sales of goods to this class of consumers may be greatly enhanced by acquiring broader information as to their likes, dislikes, hobbies, special interests, and avocations. Also, the charge account becomes much more efficient as an instrument for increasing sales when certain privileges and inducements are attached to it.

Credit is a service extended to customers. Like that of other customer services, its primary purpose is to maintain or promote business. Companies vary in their policy toward credit. At one extreme is the strictly cash business and the other the firm that uses liberal credit as the dominant appeal in promoting sales. Most concerns are found in between these extremes, some granting as little credit as possible and others featuring it, though not as a dominant appeal.

In most fields of business we find both cash and credit firms, with a sizable proportion of the concerns selling both for cash and on credit. The small businessman will consider his preferences and those of his customers, balance the cost and risk of credit extension against the extra business to be expected, and compare the capital needed for a credit business with his own resources before deciding what policy he will follow.

Credit extension is almost a necessity to the successful operation of a few kinds of business. By definition, family credit clothing and jewelry stores are in this group. Retailers selling expensive and durable consumers' goods like new automobiles, refrigerators, and farm equipment would probably find non-

credit customers in most communities far too few to justify a strictly cash business. These are hardly suitable kinds of business for the small businessman with limited capital who does not want to operate a credit business. Even though most of the sales are made on instalment account and the customer paper, or contract for payment, is discounted or sold to finance companies, they are still fields dominated by credit business with all the trouble and risk this involves.

Credit permeates the structure of American business to a surprising extent. The vast majority of commercial transactions are made on credit—that is, on the trust and confidence businessmen have in each other. Many authorities have estimated that over 90 per cent of small businessmen could not continue in business without the credit furnished by their suppliers. According to the 1939 census, credit was the basis for approximately 90 per cent of the sales of manufacturers' branch houses with stocks, over 75 per cent of the business of wholesalers, and approximately one-third of the retail business of the country. Census averages like these cover a broad area and do not show certain variations significant for the small businessman, but they do indicate the importance of credit in our economy.

Credit is the acceptance by a seller of a buyer's promise to pay in the future for goods or services received now. It increases customer good will by serving his convenience and by implying a feeling of trust and confidence. Credit customers in good standing are also better customers than others because they trade more frequently with a creditor firm and have a tendency to purchase more.

After the decision to grant credit, which is a matter of policy determination, is made, the question of how much credit to extend arises. The businessman should weigh both the advantages and disadvantages; among the former are:

1. A more personal relationship can be maintained with credit customers, who feel they are a part of the firm.

2. Credit customers are likely to be more regular than cash customers, who tend to go where bargains are greatest.

3. Credit customers are more interested in quality and service than in price.

4. Good will is built up and maintained more easily.

5. Goods can be exchanged and adjustments made with greater ease. If necessary, goods can also be sent out on approval.

6. A list of credit customers provides a permanent mailing list for special promotions.

Some disadvantages are:

1. Capital is tied up in merchandise bought by charge customers.

2. If the merchant has borrowed the extra money required when credit is granted, the interest is added to the cost.

3. Some losses from bad debts and customers with fraudulent intentions are bound to occur.

4. Some credit customers, knowing they do not have to pay for the goods at the time of purchase, overestimate their ability to pay in the future.

5. Credit customers feel more at liberty to abuse the privileges of returning goods and having goods sent out on approval.

6. Credit increases operating and overhead costs by adding the expenses of investigation and of the bookkeeping entailed in keeping accounts, sending out statements, and collecting payments.

The relative importance of credit in a particular field and customers' basic needs are also necessary considerations. To illustrate, manufacturers selling to the trade may do over 80 per cent of their volume on credit, but one firm selling almost entirely to a few large buyers could dispense with credit because it would not be needed. The type of credit called for will be influenced by the custom in each field as well as by the nature of the goods.

Types of credit

Two types of credit are recognized according to the purpose implied: consumer credit and mercantile credit. The former is extended to consumers for the purpose of facilitating the sale of consumption goods, which may be either merchandise or services. The latter, often called commercial or production credit, has as its purpose the encouragement of production, which may be of either a physical or a business nature, as in manufacturing and merchandising, respectively.

A second important classification is that based on characteristics of the credit instruments used, namely, legal aspects and methods of payment. In addition to open account or charge credit, instalment credit, and coupon books, pre-payment plans may be included, for, although they are not strictly a type of credit, they are used frequently in retailing as a substitute for other forms of credit extension.

Instalment accounts. In the small business instalment credit is likely to be called for if fairly durable goods of high unit cost are sold. Even wearing apparel is sold on the instalment plan. When lay-away sales are encouraged, a variation of instalment credit is employed. In the past, small stores have not made extensive use of coupon books good for purchases within the store, the books being paid for by small weekly instalments. However, this may be a good way to secure regular payments from customers of limited income who want to buy like credit patrons.

Instalment selling involves different methods from those used for open accounts, although procedures of credit application and investigation are similar. To protect the seller, two forms of legal devices are usual in extending instalment credit: the conditional sales contract and the chattel mortgage. The conditional sales contract states that the title remains with the seller until the full price agreed upon has been paid, even though the goods have been sold and delivered to the purchaser. In case of failure to make payments, it is easy from a legal standpoint for the seller to repossess the goods. This device is

more convenient from the seller's point of view. Under the chattel mortgage, title passes to the buyer at the time of sale, but he either transfers it back to the seller, on the condition that he will get it back when he has fulfilled all the provisions of the mortgage, or gives the mortgagee a first lien on the goods. Because provisions made by state laws for each of these legal devices vary, the seller should make investigations to determine which form is the more favorable.

Carrying charges must usually be added to instalment purchases because of the extra bookkeeping and other costs involved in carrying the account. Each instalment must be recorded and the unpaid balance carried forward. If payments are delinquent, notices of delinquency must be sent out. The common practice is to charge one-half of one per cent a month on the unpaid balance. This is fair enough, as it does not put an excessive interest charge on the whole cost of the merchandise. If customers resent the fact that carrying charges are added, higher prices of goods may be the result or the merchant may be willing to absorb these costs himself. The best way to handle this problem is the one most suited to his type of business.

Instalment credit is more expensive than open account credit because more record keeping is involved and the length of the credit period is usually longer. Working capital requirements are not the only financial problem of the seller. Employees must be hired to judge the customer's ability to pay—his creditworthiness. The sales must be written up, the payments scheduled, the forms filled out, and the books posted. All this takes employee time and costs money.

The great expense, however, comes not in making the sale but in collecting it. Direct labor and material costs are the major part of this item in a well-operated department, but overhead expense burdens will add to the cost in departments where employee time is poorly handled. One point to remember, however, is that the customer pays for part or all of the added instalment credit expense, whereas open account costs are levied against cash and charge customers alike.

Credit bureaus

Credit bureaus are service agencies organized to compile and distribute for the use of local business and professional men information concerning the credit status and bill-paying habits of consumers.

Their never-forgetting files carry complete credit histories for the convenience of member firms. Merchants are usually the chief supporters of the bureau. Since retail credit bureaus all belong to a nationwide system, a newcomer's credit record may be easily and rapidly traced by a local branch, although the independent businessman would have a difficult time doing this for himself.

Credit bureaus are either mutually or privately owned. Mutually owned bureaus are supported by all stores desiring the service, contributions being made according to size or volume of sales and someone being hired to take care of the business. Members of privately owned bureaus pay a fee each month and are charged for any extra services; the cost of collections, for example, is usually a percentage of the amount collected. Two methods are used to determine membership fees, the meter plan and the flat rate. Under the meter plan, a member pays a minimum amount each month. A schedule of fees for each service rendered by the credit bureau is prepared and members are billed for any excess. Although this is the most widely used system, many smaller bureaus use the flat rate plan, by which each member is classified according to the approximate amount of services the business will use and is charged a small flat monthly fee. In return for this fee the member is entitled to as many verbal (usually telephone) credit reports as he needs. He also receives at no extra cost what is often called the Weekly Service Bulletin, a report that most bureaus publish and that members agree in their written membership contracts to respect as containing confidential information. Special written reports and other extra services are charged for at existing rates.

The vast majority of credit reports are requested and given orally, usually over the telephone. Precautions are taken to insure identification and see to it that unauthorized persons will not receive this information.

Of the various types of written reports in use, one is the Standard Consumer Credit Report, or Inter-Bureau Report No. 1, shown in Figure X. A short form consisting of the upper third of this form and known as the Trade Clearance Report No. 3 is used from time to time to secure up-to-the-minute credit information. The Previous Residence Report No. 5, or Transfer of Record Report, shown in Figure XI, is a widely used type of report. These are all standard forms used by most of the 14,044 local credit bureaus of the United States and Canada that are affiliated with the Associated Credit Bureaus of America, Incorporated.

Most local credit bureaus do not furnish business credit reports, partly because they do not maintain files of adequate information about each business and partly because there is not much demand from local businessmen for credit reports on other local businessmen; furthermore, in some states the law does not permit local bureaus to operate in this field of mercantile credit.

It is the duty of the credit bureau to act as a depository of information. Credit bureaus do not give ratings on customers because these are apt to change frequently. When information is called for, the prospect's past record of payment is given and the decision as to whether to extend credit is left to the store. Use of the credit bureau can eliminate 15 per cent of a store's bad debt losses, conservatively speaking.

The credit bureau receives from the court house a list of property transfers, building permits, marriages, divorces, tax delinquents, and other information that may be available in regard to legal acts. The bureau cannot sell or give these lists to the merchants. However, some of the information may be used in the Weekly Service Bulletin and the remainder in preparing certain reports requested by the merchants. Deroga-

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ASSOCIATED CREDIT BUREAUS OF AMERICA
INCORPORATED

AN ASSOCIATION OF CREDIT BUREAUS SINCE 1906

CONFIDENTIAL

INTER-BUREAU REPORT
ACBofA No. 1
compiled by member bureau

1 REPORT ON:	ROE (Surname First)	MR. (Mr. or Mrs.)	JOHN JAMES (Given Name)	MARY (Spouse's Name)
2 RESIDENCE ADDRESS:	162 Pine Street (Street Number)	Utopia (City)	Rose (County)	Any State (State)

IDENTITY	3. Number of years covered: A. In file	A	10 years
	B. In investigation	B	10 years
	4. A. Age. (If near 21, confirm)	A	46 years
	B. Racial extraction (White, Black, Red, Yellow, Brown)	B	White
	5. A. Marital status	A	Married
	B. Number of dependents?	B	Wife and 4 children
HISTORY	6. A. Name of employer	A	Comm'l. Radio Co., 512 Main St.
	B. Type of business	B	Radio & Appliance, Sales, etc.
	7. A. How long so employed	A	10 years
	B. Position held	B	General Sales Manager
	8. A. Does applicant have record of steady employment?	A	Yes
	B. Any recent employment changes? (If yes, explain in remarks)	B	No
	9. Any suits, judgements or bankruptcies? (If yes, explain in remarks)		No
Character	10. Is applicant well regarded as to character, habits and morals?		Yes
	11. Is applicant favorably regarded by employer?		Yes
	12. Any suspicion of illegal practice past or present?		No
RESOURCES	13. A. Estimate monthly income from present employment	A	$500 & $1000 annual bonus
	B. Estimate other income such as rentals, investments, etc.	B	$800 from investments
	C. Estimate income of others in household	C	None
	14. Own home, rent or board?		Owns home at above address

CREDIT RECORD: (If feasible include whether subject has satisfactory bank checking account)

Trade Line	How Long Selling	Date of Last Sale	Highest Credit	Terms of Sale	Amount Owing	Amount Past Due	Manner of Payment
Grocery	8 yrs	1/16/49	70.00	Open	35.00	35.00	Pays monthly
Hardware	5 yrs	8/28/48	253.00	Install	55.00	none	$20 mo.
Shoes	9 yrs	1/2/49	22.50	Open	none	none	30 days prompt
Department Store	8 yrs	1/13/49	115.00	Open	70.00	none	30-60 days
Electric Supply	2 yrs	2/16/48	174.00	Install	none	none	$15 mo.
Drug	8 yrs	11/3/47	25.00	Open	14.25	none	30-60 days
Automobile	5 yrs	3/9/48	400.00	90 days	none	none	satis.

REMARKS: A. Give brief word picture of subject's history, explaining any unusual condition.
B. Amplify any incomplete or adverse information in answers above. Use other side also for full details.
C. Include estimate of net worth if possible.

Subject is also director and owns stock in Empire Specialty Company, dealers in electrical equipment. His house and lot are assessed for $5700 on basis of 40% actual value. Good citizen and active in civic and business affairs. Report from previous place of residence, Fairville, New State, indicates prompt paying record and good moral integrity. No court or derogatory record; subject is estimated to be worth between $15,000 - $20,000. Assets consist of home, personal property, car and stocks.

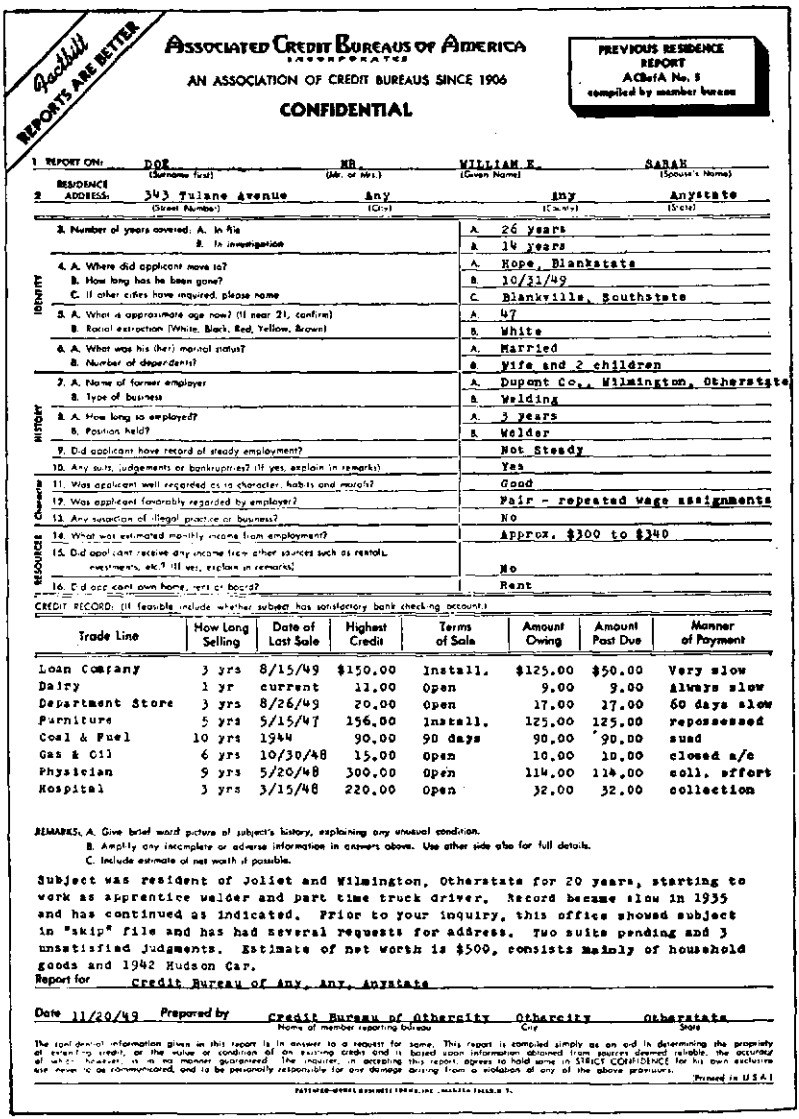
Report for Credit Bureau of Excelsior, Excelsior, Other State

Date 2/15/49 Prepared by Credit Bureau of Utopia (Name of member reporting bureau) Utopia (City) Any State (State)

The confidential information given in this report is in answer to a request for same. This report is furnished subject to an implied agreement with the recipient of extending credit, or the value or condition of an existing credit and is based upon information obtained from sources, some of which, however, is in no manner guaranteed. The recipient, in accepting this report, agrees to hold same in STRICT CONFIDENCE for the sole exclusive use, never to be communicated, and to be personally responsible for any damage arising from a violation of any of the above provisions. (Printed in U.S.A.)

PATTERSON-ROBERT BUSINESS FORMS, INC., BUFFALO 13, N.Y.

Figure X. Inter-Bureau Report.



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REPORTS ARE BETTER

ASSOCIATED CREDIT BUREAUS OF AMERICA
INCORPORATED
AN ASSOCIATION OF CREDIT BUREAUS SINCE 1906

PREVIOUS RESIDENCE REPORT
ACBofA No. 5
compiled by member bureau

CONFIDENTIAL

1 REPORT ON: DOE (Surname first) MR. (Mr. or Mrs.) WILLIAM E. (Given Name) SARAH (Spouse's Name)

2 RESIDENCE ADDRESS: 343 Tulane Avenue (Street Number) Any (City) Any (County) Anystate (State)

IDENTITY

3. Number of years covered. A. In file	A.	26 years
B. In investigation	B.	14 years
4. A. Where did applicant move to?	A.	Hope, Blankstate
B. How long has he been gone?	B.	10/31/49
C. If other cities have inquired, please name	C.	Blankville, Southstate
5. A. What is approximate age now? (If near 21, confirm)	A.	47
B. Racial extraction (White, Black, Red, Yellow, Brown)	B.	White
6. A. What was his (her) marital status?	A.	Married
B. Number of dependents?	B.	Wife and 2 children

HISTORY

7. A. Name of former employer	A.	Dupont Co., Wilmington, Otherstate
B. Type of business	B.	Welding
8. A. How long so employed?	A.	3 years
B. Position held?	B.	Welder
9. Did applicant have record of steady employment?		Not Steady
10. Any suits, judgements or bankruptcies? (If yes, explain in remarks)		Yes

Character

11. Was applicant well regarded as to character, habits and morals?	Good
12. Was applicant favorably regarded by employer?	Fair - repeated wage assignments
13. Any suspicion of illegal practice or business?	No

RESOURCES

14. What was estimated monthly income from employment?	Approx. $300 to $340
15. Did applicant receive any income from other sources such as rentals, investments, etc.? (If yes, explain in remarks)	No
16. Did applicant own home, rent or board?	Rent

CREDIT RECORD: (If feasible, include whether subject has satisfactory bank checking account.)

Trade Line	How Long Selling	Date of Last Sale	Highest Credit	Terms of Sale	Amount Owing	Amount Past Due	Manner of Payment
Loan Company	3 yrs	8/15/49	$150.00	Install.	$125.00	$50.00	Very slow
Dairy	1 yr	current	11.00	Open	9.00	9.00	Always slow
Department Store	3 yrs	8/26/49	20.00	Open	17.00	17.00	60 days slow
Furniture	5 yrs	5/15/47	156.00	Install.	125.00	125.00	repossessed
Coal & Fuel	10 yrs	1944	90.00	90 days	90.00	90.00	sued
Gas & Oil	6 yrs	10/30/48	15.00	Open	10.00	10.00	closed a/c
Physician	9 yrs	5/20/48	300.00	Open	114.00	114.00	coll. effort
Hospital	3 yrs	3/15/48	220.00	Open	32.00	32.00	collection

REMARKS: A. Give brief word picture of subject's history, explaining any unusual condition.
B. Amplify any incomplete or adverse information in answers above. Use other side also for full details.
C. Include estimate of net worth if possible.

Subject was resident of Joliet and Wilmington, Otherstate for 20 years, starting to work as apprentice welder and part time truck driver. Record became slow in 1935 and has continued as indicated. Prior to your inquiry, this office showed subject in "skip" file and has had several requests for address. Two suits pending and 3 unsatisfied judgments. Estimate of net worth is $500, consists mainly of household goods and 1942 Hudson Car.

Report for Credit Bureau of Any, Any, Anystate

Date 11/20/49 Prepared by Credit Bureau of Othercity (Name of member reporting bureau) Othercity (City) Otherstate (State)

The credit information given in this report is in answer to a request for same. This report is compiled simply as an aid in determining the propriety of granting credit, or the value or condition of an existing credit and is based upon information obtained from sources deemed reliable, the accuracy of which, however, is in no manner guaranteed. The inquirer, in accepting this report, agrees to hold same in STRICT CONFIDENCE for his own exclusive use never to be communicated, and to be personally responsible for any damage arising from a violation of any of the above provisions.

Printed in U.S.A.

Figure XI. Transfer of Record Report.

tory information may be given out in special cases but cannot be used for malevolent purposes by the stores. This comes under the title of "privileged communications." Only information applying strictly to credit can be given and only that information which is pertinent to the prospect in question. No complete list of legal actions can be given to a store.

Many other sources of information are used, such as police records, vital facts clipped from the newspaper, and so on. However, the most valuable source consists of the members of the credit bureau. Each member agrees in his membership contract to supply information concerning how his customers pay their bills, including those who are in arrears on their accounts. Thus the bureau secures and can furnish much more information about customers than any businessman could obtain from other sources.

To obtain maximum benefit from credit bureau membership, the small businessman should display his membership sign where customers can see it, keep the bureau informed about his customers, and call upon the bureau for a credit report before opening each new account. Information obtained by the credit bureau is treated confidentially and never disclosed to consumers.[1]

One of its most valuable services is toward newcomers to a city. If the bureau hears of a new person in town, it investigates through the bureau in the town where that person lived and, if he seems to be a good risk, gives his name to the local stores. They can solicit his account if they want to and can gain his good will by opening an account for him immediately if he comes into the store. Some towns have a newcomers' club which welcomes and solicits credit business. In case the credit bureau does not hear of a newcomer to the city before he

[1] Small Business Aids, No. 434, U. S. Department of Commerce, "The Credit Bureau as an Aid to Profitable Credit Selling," by Finance and Tax Division, Office of Small Business. Washington: Government Printing Office, 1948.

applies for local credit, it can still secure information easily by contacting the person's previous residence.

Local credit bureaus in most towns provide collection services for their members. Often a person feels that he has really jeopardized his credit record when the credit bureau takes over and that he must pay his bills as soon as possible. Too, the credit bureau is interested primarily in collecting the bill rather than in maintaining good will, although it tries not to incur ill will. It can collect from a more impersonal viewpoint and can be more frank with the customer. If it is unable to collect the bill, it may turn it over to an attorney, although it never brings suit itself. The attorney acts in the name of the store, not of the credit bureau.

Recently some bureaus have been using, with considerable success for members, a personal letter typed on stationery of the Credit Bureau and addressed to customers who are delinquent in their accounts with member firms. The letter describes the work of the bureau and shows how it benefits customer and store alike. It goes on to say that in the periodic reports received from member stores the addressee's account has been listed in arrears with a certain store (mentioned by name) in a stated amount since the date given. Attention of the customer is then called to the bureau's practice of requesting verification before making an unfavorable entry on the customer's record maintained in the bureau. The customer is requested to report any error or to verify the amount in arrears. It is suggested that the danger of an unfavorable entry can be prevented by making arrangements with the store immediately.

Many debtors respond by paying their accounts promptly at the store and the credit bureau receives no collection fee. A small charge per letter written plus stenographic expense is the only fee charged by the bureau in such cases. However, for the regular collection service the bureau charges a percentage of the amount collected.

To illustrate the usual method of charging for accounts collected, the following scale used by the local bureau in a

small town is presented: All fees are based on amounts actually collected. The age of an account is the time elapsed since either the last charge or the last payment, whichever is smaller. For accounts of any age for amounts under $10, the fee is 50 per cent. Fees for amounts over $10 are: 25 per cent (minimum charge) for accounts less than six months old, 30 per cent for accounts from six to 18 months old, 40 per cent for 18 months to three years, 50 per cent for "skip" accounts, and 50 per cent for accounts which another agency has previously undertaken to collect. "Skip" accounts are those of debtors who have moved to another city. The high fee is explained by the fact that the credit bureau in the other town charges the bureau initiating collection proceeding 33⅓ per cent. The high fee for accounts once turned over to another agency is intended to discourage the use of fly-by-night collection agencies. The latter are out-of-town firms that send high-pressure salesmen into a town to get local merchants to have them handle collections. Collection letters from the firm's home office, the address of which is often only a post-office box, are then written to the delinquent accounts. Even when the debtors pay the collecting firm, the local merchants may not receive any of the proceeds.[2]

Customer control analysis

Small businessmen who do a credit business are losing most of the advantages of this method if they fail to capitalize on the information their records provide for additional sales promotion. This is particularly true of open account customers. Large stores call this "customer control analysis," but in the small business it means simply watching each customer's account (1) to discover opportunities for suggesting the purchase of certain items considered appropriate in the light of previous purchases, and (2) to detect any decline in purchases that might suggest a drifting away from the store. When such a trend is discovered in time, an alert merchant can often investigate the

[2] Most of the facts contained in the preceding discussion were supplied by Mr. A. M. Johnson, Manager, Credit Bureau of Fayetteville, Inc.

cause and take appropriate steps to prevent what would otherwise result in the permanent loss of regular customers.

There are three major ways the small enterpriser can secure extra business as a result of credit extension: by making the charge account attractive to customers, by using information contained in the records of customer accounts to plan and promote sales, and by using management research based on closer contact with credit than with cash customers.

If special services are offered with the charge account, customers will be more anxious to open an account, to maintain their credit standing, and to make greater use of the account than they would if it is merely a means of deferring payment. Providing charge customers with hard-to-get merchandise during periods of scarcity is one example. Many stores issued courtesy cards to charge customers, entitling the holder to buy nylon hosiery and other scarce articles during World War II. Most stores will cash personal checks and order special merchandise more readily for charge than for cash customers. Manufacturers and other small businessmen who want to expand their credit business should investigate special services that could be used to make an account more attractive to their customers. Naturally, care should be exercised not to alienate any of their cash customers.

Probably one of the best ways to secure extra business from charge customers is to use the information available in the charge account records for planning and promoting sales. From the records of past purchases management may develop case histories for each customer, showing his purchasing power, buying habits, time of purchasing, special merchandise preferences, and similar data. Information available from the records may be supplemented by that obtained directly from each credit customer at the time application is made for an account, through personal contacts, and by means of a judicious use of questionnaires. Such information can be used for direct mail advertising, special sales promotions, timing buying and merchandise showings, selecting small lots of special merchandise

for particular groups of customers, and in many other ways. A special advantage to be derived from such knowledge about each customer is that it makes possible the most appropriate and effective promotions, whether for individual customers or for selected groups. Indiscriminate use of direct mail enclosures or package stuffers is not only likely to be ineffective but may antagonize customers to whom the wrong type of advertising is sent.

Management research in most small concerns should not, of course, be confined to credit customers. There are sound reasons, however, why the charge customers constitute a better group than cash customers for these purposes. The obvious ones have been implied in the ready accessibility of records of this group. Two others deserve careful study by management. First, charge customers as a class are usually steady repeat patrons of the company. Management action based on what this group wants is likely to be on firmer ground than that based mainly on other sources of information. Second, a fundamental principle of successful credit business is to keep the charge customer on the books. To do so requires continuous knowledge of the customer's needs, changing status, interests, and so forth. Successful management in any area of business involves forecasting and continuously adjusting to conditions, especially those relating to major groups of customers. Instead of seeking new charge customers and neglecting the changing desires of present ones, as so many owners do, it would be far better to study the present credit customers and keep the business adjusted to their needs. Of course, some pioneering for new customers is always necessary for any business to continue successfully, whether its customers buy for cash or on credit.[3]

[3] Small Business Aids, No. 443, U. S. Department of Commerce, "The Charge Account List—A Source of Extra Business." Condensed from "Full Exploitation of the Charge Account List," by Walter Alwyn-Schmidt. *Credit World,* January, 1948, St. Louis, National Retail Credit Association.

Collections

It would be difficult to overemphasize the importance of collections for the small business that extends credit. This is the "make or break" area. Although charge business can be very profitable, too many slow accounts will probably cause the store to suffer a loss.

Slow accounts prevent a merchant from making a profit because:

1. They cause bad debts. The older an account becomes, the harder it is to collect.
2. They take time away from other duties in attempts made to collect the money due.
3. They encourage formerly good customers to avoid trading at the store because it is embarrassing for most customers to meet the retailer to whom they owe money. This is an unfair but common practice among slow paying charge customers.
4. They tie up funds needed to operate other divisions of the business. As a result, the retailer's own credit suffers; he is not able to take advantage of cash discounts and eventually may not be able to maintain his stocks of wanted merchandise.

Experience shows that unless a retailer doing credit business is continually alert to the danger of slow accounts he may find himself in a hopeless situation before he realizes that something is wrong. The following examples illustrate this danger and how it can be avoided.

A New Jersey grocer was doing a good business and apparently was making a profit. Sales were averaging $800 a week, about $300 of which were charged. The terms were weekly. Suddenly this grocer found himself cramped for money and unable to pay his bills. An examination of his customers' ledger showed $3,100 due, an amount equal to more than 10 weeks' charge business—although he granted credit on a weekly basis. He insisted that the accounts were good, but that if he "dunned" his customers they would quit his store. This

grocer's creditors could not persuade him to change his collection practices, and eventually he went out of business.

Another grocer doing about the same total volume has charge sales amounting to about $400 a week. Every Monday morning this grocer runs through his customers' accounts with his small adding machine and determines the amount owed at the time. He has 210 accounts in a visible ledger and it takes him about an hour to do the job. In front of the ledger he keeps a form, such as that shown here, and enters in the first column the total sales of last week. In the next column he records the amount owed by customers as shown by the total he has just obtained on the adding machine.

FORM FOR DETERMINING AVERAGE AGE OF ACCOUNTS

Date	*Last week's charge sales*	*Amount due today*	*The number of days' business on the books* *
Feb. 7	410 —	740 —	10½
14	446 —	770 —	11
21	390 —	800 —	11½
28	420 —	840 —	12
Mar. 7	450 —	730 —	10½

* Amount due today divided by average charge sales per day last month.

The balance due is usually higher near the end of the month, but then drops back again right after the first of the next month.

"That column to the right is what I go by," said this grocer. "I don't mind if a few are late, but I can't afford to have everybody late. Those figures stand for the approximate number of days of charge business that are on the books right now. My charge sales last month were running a little over $400 a week, about $70 a day. If I have $700 on the books, it means about 10 days' business still uncollected. I don't mind if it gets up to 14 days—that is, not quite a thousand dollars—but that is the

limit. It doesn't get up there often, but when it does I know I've been careless about following up customers when going over those slips the past weeks. Some individual accounts needed attention."

This grocer makes a net profit of six per cent on sales. His losses on bad debts are almost nothing. The familiarity with all his customers' accounts obtained from his weekly inspection is an advantage that he cannot gain in any other way. The weekly comparison that he makes serves as a constant yardstick of his own efficiency; yet it is simple, quick, and profitable.

Two methods are used to measure the trend toward slow accounts, charge sales compared to collections and charge sales compared to the amount owed by customers.

When a retailer's charge sales during a week amount to more than his collections on charge sales, it may mean either that his charge business is increasing or that his collections were poor. There should be a close relationship between collections and charge sales. The danger sign is when collections lag behind charges week after week.

When charge sales made during the credit period amount to much less than what is "on the books" (the amount owed by customers) at a particular day, some accounts are past due. If terms are weekly, the outstanding accounts at the end of any week should approximately equal the amount of one week's charge business. However, customers do not always pay their bills on time and unfortunately most retailers do not do much about it. For that reason the amount on the books is usually in excess of the charge sales during the credit period. This excess should not be allowed to become unduly large.[4]

Accounts should be collected when due. Once an account is past due it becomes progressively harder to collect the longer it remains unpaid. Most stores send the customer a statement of

[4] Adapted from Welch, Charles H., and Sevin, Charles H., *Small Business Problems; Record Keeping for Small Stores,* pages 16–18. Senate Committee Print No. 11, 77th Congress, 2d Session. Washington: United States Government Printing Office, 1942.

the amount due at the end of the month. Because experience shows that some families pay the first bills to arrive and let the others wait, it is good practice to get statements out promptly. A smaller number of stores, especially grocery stores, do not send the customer a monthly statement. Instead, the customer is expected to come into the store before the tenth, or due date, pay the account, and receive the charge sales tickets as receipt. This system requires less paper work but should be watched carefully for overdue accounts.

Once an account becomes past due, there is a twofold objective to accomplish—getting the money and retaining the patronage and good will of the customer. Prompt follow-up after the due date is desirable, whether by letter, telephone, or personal call. If payment is not made promptly, it is well to get the debtor to state when the account will be paid or to get part payment and an agreement regarding settlement of the balance. It is considered unwise to threaten a delinquent debtor except as a last resort when he has refused to pay. The better practice is to put the account in the hands of the credit bureau for collection.

When a customer has not paid his account within the specified time, the merchant may suspend the account—that is, rule that no further charges may be made until the account is paid or a new agreement reached. In making this decision, the merchant must use considerable judgment and discretion.

Before threatening a customer who does not pay his account, the merchant should propose a plan by which matters can be straightened out. For instance, if the customer owes $40, the merchant may propose that he pay $4 a week for 10 weeks. Once a new agreement has been reached, the merchant should insist on its being observed. However, when a customer is able but unwilling to pay, either in full or according to some periodic payment plan, the merchant should act decisively and under competent legal advice. The customer should be warned that the account will be turned over to a collection agency or a lawyer unless it is paid by a certain date. Once the warning is

issued, the merchant should follow through with it if he does not wish to acquire the reputation for being easily put off.[5]

Credit in Merchandising

The trend in retailing for some time has been toward less and more closely controlled credit. The rise of strictly cash stores in many lines of retailing has demonstrated that credit is not the essential customer service it was formerly considered to be. Most voluntary chains encourage member stores to sell only for cash. However, many small retailers find it necessary or desirable to extend some credit.

How much credit business is to be accepted or even encouraged will depend upon particular circumstances in each case. First, the local situation is important. It is not always necessary to follow competitors' policies, but if credit is extended by all other stores in the same line of business in the community, customers will probably expect either it or some inducement for paying cash.

Second, and of probably even greater importance, are the class of trade desired and what they expect in the way of credit. This is not always the simple relationship so often assumed. The fact that people in the upper income bracket do not *need* credit is no assurance they will buy for cash. Rural customers may be in the habit of buying on credit, but when agricultural conditions are favorable they might prefer to pay cash. The retailer may find that even customers who think they want credit because of habit, convenience, pride, or financial need will discover the desirability of buying for cash when the right inducements are offered. For example, service groceries have operated self-service departments on a cash basis successfully by meeting the preference of many customers for making their own selections by personal inspection, feeling and

[5] Adapted from Small Business Aids, No. 111, U. S. Department of Commerce, "Using a Controlled Credit System." Condensed from "Will Credit Sales Help My Business?" by Rees D. Stith. *Domestic Commerce,* November, 1946, Washington, U. S. Department of Commerce.

handling the goods, and the same is true to a lesser extent in the case of wearing apparel.

Some merchants encourage the payment of cash by cashing customers' personal checks. This is equivalent to changing from one type of credit business to another, but it has two advantages. If purchases are paid for at the time by check, the period of credit extension is reduced from an average of about 45 days to two or three and the risk is greatly lessened. In the second place, even customers who are habitually dilatory about paying their charge accounts are hesitant about writing a bad check.

Some retailers who desire to limit their credit business find it advantageous to feature free and efficient delivery on cash purchases in order to remove the prejudice based on the frequent association of cash and carry in customers' minds. This can be done with profit to the store and convenience to the customer. Sometimes merely holding a customer's purchases at a convenient place in the store until she has completed her shopping or sending the goods to her parked car will serve the purpose as well as the customary home delivery.

For each kind of business and local situation an alert merchant may find profitable ways to reduce the amount of credit he feels obliged to grant. Many of the principles and practices governing successful credit extension are in reality efforts to accomplish this same objective, namely, elimination of all but profitable, minimum-risk credit business.

In any case, the final determinant will be the retailer's financial resources. Credit extension of any amount requires more capital and involves greater risks for the small retailer than most other activities. Total costs of open account credit extension are likely to be from three to well over five per cent of credit sales. The following distribution of costs was obtained for department stores with over $2,000,000 annual sales, about half of which were made on credit:[6]

[6] Duncan, Delbert J., and Phillips, Charles F., *Retailing: Principles*

	Per Cent of Total Sales
Bad debt losses	0.30
Payroll	0.75
Interest on accounts receivable	0.50
Cost of additional returns	0.57
Total	2.12

Although the data do not establish similar open account costs for the small store, it seems unlikely that they would be lower for the small operator.

Using a controlled credit system

Properly controlled, credit can increase sales and bring the merchant steady, well-satisfied customers; handled in a slipshod manner, it can cause an overinvestment in accounts receivable, large bad debt losses, and perhaps eventual failure of the business. The basic principles of a sound or controlled credit system are:

1. Applicants for credit are investigated thoroughly.
2. Decision is made carefully.
3. Limit on credit is set.
4. Terms of payment are defined.
5. Account is controlled by the merchant.
6. Delinquent accounts are followed up promptly.

1. The first step in the investigation should be an interview with the applicant. During the interview the merchant's appearance, friendliness, and manner of obtaining information can help to gain the applicant's good will and confidence. Since an applicant usually will speak more freely when relaxed, the interview should be in complete privacy, if possible, and in a pleasant atmosphere. In order to have a record of the desired information, the merchant should have the customer fill out and sign a credit application. This is a good time to secure information to be used later in promoting sales, such as birthday dates of members of the family, hobbies, likes, and dislikes.

and Methods, Revised ed., page 629. Chicago: Richard D. Irwin, Inc., 1947.

An application-for-credit form should be filled out whether the customer takes the initiative in seeking credit or the store solicits the account. This form contains blank spaces for all information considered to be essential for the merchant to decide whether the applicant is entitled to credit or not. "Most credit offices find the following information sufficient: (1) full name; (2) home address; (3) if less than two years at this address, previous place of residence; (4) business affiliation and address; (5) name of one or two personal references; (6) trade references (other accounts); and (7) bank." [7]

The National Retail Credit Association, which is composed of over 21,000 local credit bureaus, has adopted a standard form that should be used if possible. Figure XII shows this form.

Three general methods are used in distributing credit applications. The most common plan is to have the applicant fill out the blank in the credit department, to which customers inquiring about credit are referred. In other stores salespeople give the application blanks to customers who are interested or appear to be good prospects. Some stores enclose the credit application with merchandise that is wrapped for certain customers. If the customer applies at the credit department in person—a procedure which in the small store may mean merely talking to the executive in charge of credit—a preliminary interview is usually held at this time.

During the interview the store's credit policy and terms will be explained. A skilled interviewer can get some clues to the applicant's character, capacity, and capital—the three "C"s of credit. Each of these may be investigated further from information given on the application blank.

The next step should be to obtain credit information on the

[7] Small Business Aids, No. 421, U. S. Department of Commerce, "Setting Up a Credit System in a Men's Wear Store." Condensed from "Setting Up a Credit System," by J. Gordon Dakins. *Apparel Arts*, July, 1947, copyright, 1947, by Esquire, Inc., Esquire Building, Chicago, Ill.

APPLICATION FOR CREDIT

ADOPTED BY AND FOR MEMBERS OF THE

NATIONAL RETAIL CREDIT ASSOCIATION

NUMBER_____ DATE _____

FULL NAME (HUSBAND FIRST)	FULL GIVEN NAME	INITIAL	AGE	GIVEN NAME, HUSBAND — WIFE'S MAIDEN NAME
RESIDENCE	MAIL ADDRESS		TELEPHONE	HOW LONG
FORMER ADDRESS				HOW LONG
BUSINESS OR OCCUPATION	BY WHOM EMPLOYED		BUS. ADDRESS	HOW LONG
FORMER BUSINESS OR OCCUPATION	BY WHOM EMPLOYED		BUS. ADDRESS	HOW LONG

WIFE OR HUSBAND EMPLOYED? CAPACITY BY WHOM

OWN REAL ESTATE	GIVE LOCATION	MORTGAGED TO	AMOUNT
			$

	OWNED	MONTHLY RENTAL	CHILDREN	
			AT HOME	EMPLOYED
RENT — FURN. APARTMENT?				
RENT — UNFURN. APARTMENT?				
RENT — RESIDENCE?				

NAME OF NEAREST RELATIVE [illegible] RELATIONSHIP (OTHER THAN HUSBAND OR WIFE) ADDRESS

PERSONAL REFERENCE

BANK — (NAME OF BANK) (CHECKING) (SAVING) BRANCH

LIFE INSURANCE	NAME OF INSURANCE CO.	APPROX. INCOME
$		$ PER

TRADE REFERENCES

FIRM OR STORE	KIND OF MDSE. BOUGHT	ACCOUNT IS NOW	
		OPEN	DATE PAID

LIST ON REVERSE SIDE OF THIS APPLICATION ANY UNPAID BALANCES ON INSTALLMENT ACCOUNTS AND MONTHLY PAYMENTS THEREON.

THE ABOVE INFORMATION IS FOR THE PURPOSE OF OBTAINING CREDIT, AND IS WARRANTED TO BE TRUE. I AGREE TO PAY ALL BILLS UPON RECEIPT OF STATEMENT OR AS OTHERWISE EXPRESSLY AGREED.

SPECIAL TERMS IF ANY.

SIGNATURE _____

AMOUNT CREDIT	APPROVED
$_____	

Figure XII.

applicant from the local credit bureau or, if there is none in the community, from other stores and businesses, the applicant's place of employment, and his bank and neighbors.

2. After completing his investigation, the merchant should make a careful decision on the application. In this he should consider the applicant's character and credit record, his earning power and ability to pay, and his capital and property. Along with these factors the merchant must take into account the personal background of the applicant—his social standing, general reputation in the community, and business career.

3. A limit on credit should be set. The merchant should not decide to open an account without considering the dollar amounts involved. The amount of credit granted to a customer should be based largely on his income and will vary, of course, with the type of store. A credit limit is usually set so that a customer will not buy beyond his capacity and in doing so jeopardize his credit record. To let him know that his account has been accepted, the store writes him a friendly letter telling how pleased they are to count him as a regular customer and also restates the conditions under which credit is granted.

4. Terms of payment are defined. As a safeguard against bad debt losses, the merchant should have a definite understanding with the customer as to the credit terms. He may stipulate that payments are to be weekly, monthly, or on pay days. The time for which credit is extended on open accounts is frequently one month for salaried workers and weekly for wage earners, especially in food and other convenience goods stores. Usually payment by the tenth of the month for the previous month's account is customary on regular open accounts.

5. The account is controlled by the merchant. From the day the account is opened, the merchant should control it carefully to see that the customer upholds his part of the agreement. If credit is on a monthly basis, some merchants permit no further charges on an account if it is not paid by

the end of the month in which payment is due. Others insist on giving personal approval to additional purchases on such accounts.

A well-operated credit business can keep bad debt losses down to about one-half of one per cent of net sales, but lax control can quickly put a business into bankruptcy. Credit control involves adequate records and prompt collections. For a small business, the best system of records has to be decided upon by the proprietor. The important provisions are an individual record for each customer, a filing system to keep the records straight, and a follow-up file to take care of delinquent accounts. The credit limit is often placed on each account record. It is important to keep up with customers at all times—to know just how they stand and how they pay. Cultivate the best customers and if possible gradually drop the poor ones, remembering that they can frequently be converted into good cash customers.

6. Delinquent accounts are followed up promptly for several reasons. It is much easier to collect an account soon after it has become past due than later when benefits secured from the charge purchase have been forgotten. Customers have greater respect for a merchant who handles credit in a businesslike manner. Prompt follow-up is likely to show delinquent accounts to be the result of (1) oversight on the part of the customer, (2) temporary financial difficulty, or (3) unwillingness to pay. In the first case, a reminder by the merchant will usually result in prompt payment. In the second case, once the retailer understands the customer's difficulty a mutually agreeable payment plan can be arranged. The third situation may be the result of customer dissatisfaction that could be settled agreeably if understood and acted upon promptly, or it may represent the typical "dead beat" charge customer. When the dealer has determined the reason why each account is delinquent, the appropriate action to take is usually apparent. Aggressive collection procedures should be instituted if neces-

sary, but should be delayed in favor of remedial action when the latter is indicated.[8]

Charga-Plates

There is one exception to the usual procedure of starting the credit process by securing a credit application. Sometimes the local credit bureau takes the initiative and issues "Charga-Plates" to a selected number of individuals who have already established good credit records. Certain stores have formed an association under an agreement to extend credit to all customers to whom a "Charga-Plate" is issued. Coöperating stores all accept this "Charga-Plate" as evidence of credit approval.

The National Retail Credit Association

The National Retail Credit Association, with headquarters in St. Louis, Missouri, publishes a variety of useful material that may be purchased through local member bureaus or direct from headquarters. The application-for-credit form has already been mentioned. Over three dozen different stickers and inserts each dealing with some aspect of credit administration are available at a very low cost. These are attractively printed in color with an appropriate message for such purposes as thanking the customer for a remittance, informing the customer that the store knows his account is paid in full, inviting the use of inactive accounts, and warning politely that accounts are overdue. The following wording on one of these stickers is representative of several used to keep customers reminded of the importance of their credit record: "Your Credit Record is an Open Book. By the way you pay, you write your own record in the files of the Credit Bureau. Millions of cards in the files of the Credit Bureaus of the United States and Canada, form

[8] For further study see Small Business Aids, No. 111, U. S. Department of Commerce, "Using a Controlled Credit System." Condensed from "Will Credit Sales Help My Business?" by Rees D. Stith. *Domestic Commerce,* November, 1946, Washington, U. S. Department of Commerce.

the basis of credit reports—used by creditors and employers to judge the trustworthiness of individuals. Prompt Payments *Make a Good Credit Record.*"

An illustrated insert contains the following wording, the purpose of which is self-evident:

We have Your Name in this Who's Who. As a member of the Credit Bureau we are called upon to report, at frequent intervals, the credit standing of our customers. This report is available to every merchant or professional man who is a member of the Credit Bureau.

Your account with us at the present time is Past Due. To maintain a good credit record, you should make a payment Now or arrange for an early settlement.

Customer's Name .....
Firm Owed .....
Balance $..... Past Due.....
Date .....

Guard Your Credit as a Sacred Trust.

Correspondence courses in various aspects of credit management are offered by the National Institute of Credit, 1 Park Avenue, New York 16, New York, and by extension divisions of certain universities. Ample material in book and pamphlet form is available to the small businessman who cares to learn more about this subject.

Obtaining financial assistance

Two types of agencies assist the merchant in financing his instalment sales, sales finance companies and banks. The latter are also used frequently for other working capital needs.

Sales finance companies. Five plans are commonly used by sales finance companies, the "Cash Availability" plan, the "Direct Collection," the "Coöperative" or "Indirect Collection," the "Revolving Fund," and the "Schedule" plans. Basically, these plans are all alike. The sales finance company purchases the retailers' accounts receivable, advances a certain percentage

in payment, and retains or holds back another percentage as a "deferred payment reserve" that serves to increase the security of the advances made by the sales finance company.

Although charges to the retailer for this type of financing vary from store to store and from territory to territory, sales finance companies may charge as much as 1/30 of one per cent per day plus six per cent interest per year on the unpaid balance. In special cases, the rates are much higher because of the character of the receivables being financed. On the other hand, some companies have charged as little as four per cent discount on the face value of the note plus eight per cent interest per year, or less. In some cases sales finance companies purchase the accounts receivable outright, pay the retailers the full value of the notes immediately, charge a five per cent flat rate on the accounts payable over 12 months, and assume the complete risk and the job of collecting from the consumer. When the retailer himself collects from the consumer, the amount of money advanced to him immediately by the sales finance company may range from 70 to 100 per cent.

Banks. Banking services to finance accounts receivable differ from those of the sales finance companies principally in a somewhat tighter credit policy on the part of the banks and elimination of some of the controls deemed necessary by sales finance companies.

Bank charges for services to retailers tend to be low. In certain large cities a fairly usual rate is three and one-half to four per cent discount on the face amount of the accounts receivable. When the retailer does the collecting from the customer, many banks charge a three per cent discount plus six per cent interest per year. Advances to the retailer by the bank range from 75 to 90 per cent of the face amount of the accounts receivable. The bank usually requires that the retailer himself be entirely responsible for payment of the accounts.[9]

[9] Adapted from Small Business Aids, No. 185, U. S. Department of Commerce, "Ways and Cost of Financing Retail Instalment Accounts."

Making the most of instalment credit

Instalment credit should be used by the small retailer only for articles that have repossession value and only after checking with the credit bureau to determine that the applicant is not already overloaded with debt payments, and when the following principles are observed:

1. Merchandise should be priced sufficiently high to cover all costs, including the possible cost of repossession, reconditioning, and reselling.
2. Merchandise—not terms—should be sold. When terms are emphasized, the customer tends to think less of the merchandise, and is more likely to return it.
3. Adequate down payments should be obtained to prevent the account from becoming bad. When a customer pays a sizeable part of the price he feels that he is the owner and the merchandise will more than likely be paid for in full.
4. Terms should be made as short as possible, within the customer's ability to pay.
5. Collections should be made regularly. Instalment payments require more attention than regular accounts.[10]

Many retailers prefer to have instalment payments made in person at the store. This enables the merchant to keep in touch with the customer and offers further opportunities to sell additional goods.

Credit in Wholesaling

Wholesalers sell principally to small retailers, about 90 per cent of whom need credit. The credit manager of the wholesale house is also one of the most valuable advisors for retailers who will consult with him. By granting or refusing retailers credit, he exerts a powerful influence on trade. If by extending

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Condensed from "The Cost of Financing Your Instalment Accounts," by Otto Lorenz. *Credit Management Year Book for 1946.* New York: National Retail Dry Goods Association.

[10] "Instalment Selling Principles" from the booklet "Credit and Collections." One of 17 booklets making up *Better Retailing,* page 226. Dayton, Ohio: National Cash Register Company, 1941.

credit he carelessly encourages a new business to start or a nearly defunct one to continue the hopeless struggle, the wholesaler does an injustice to all concerned, including innocent competitors. The latter usually suffer when the failing business is forced to run close-out sales at a loss. Because of their strategic position in commerce, wholesalers are probably better able than any other type of businessman to give sound credit advice to retailers.[11]

Since the small wholesaler has the dual responsibility of protecting his own investment and encouraging promising small merchants while discouraging hopeless ones, a customer analysis is highly desirable. The following examples and related advice should make this point clear.

One wholesale house in the hardware trade made a simple and inexpensive analysis and was surprised at the information which it revealed. A number of policies and many operating procedures were eventually changed as a result of this study.

The bases of the investigation were confined to company records and the knowledge of the officers regarding customers. All records needed and used were:

1. Name of each credit customer (cash business was negligible and ignored in the study).
2. City or town in which customer was located and his distance from wholesaler's warehouse.
3. Type of business of the customer (hardware store, filling station, and so on).
4. Number of each customer's purchases over a six months' period.
5. Total dollar value of each customer's business during this period.

Where the kind of business was not apparent from the records, the information was supplied by the general manager, credit manager or salesman.

The information from the records necessary for the analysis was

[11] Minichin, Howard W., "Credit Problems Return." *Credit and Financial Management,* May, 1946, Vol. 48, No. 5, page 23.

placed on 3″ by 5″ cards, one to a customer. These cards were sorted and classified according to the subject under investigation at that moment. For example, in order to determine the number of small orders and their value, the cards were sorted into three piles: those for which the total sales of the customer for the period of six months were less than $100; those for which the sales were between $100 and $499; and those of $500 and over.

After this sorting was complete, the number of customers and the value of their purchases were added up on an adding machine separately for each of the three groups. A similar method was employed to determine the other figures presented below in this statement.

Examples lifted from the report of the hardware wholesaler will illustrate the kind of information which any wholesale house can expect from such a customer analysis.

A large proportion of your customers buy very little from you, place small orders and probably cost you a great deal of service. An example would be:

Total sales to each customer for period	*Number of customers percent*	*Value of wholesale sales percent*	*Average value per order in dollars*
Less than $100....	55.6	5.2	$11.18
$100 to $499.....	28.4	20.8	16.94
$500 and over.....	16.0	74.0	31.56
	100.0	100.0	

A further detailed breakdown can be made if desired, to show smaller dollar purchase groups and their relations to totals. These figures will show the large number of customers whose total purchases are so small that their value is doubtful. While startling, these figures are probably not unusual.

Your salesmen are calling upon types of business for which you are not either a primary or secondary source of supply. Our hardware house found out that its salesmen were calling upon 71 different kinds of business *in addition* to hardware stores, garages,

filling stations, general stores, lumber yards, furniture stores, tire stores, and drug stores. These eight kinds of business, however, accounted for 80 percent of the number of customers and 88 percent of the value of their orders.

On which types should selling efforts be increased, and on which discontinued? It is fairly simple to determine the number of customers of each type and the value of wholesale sales in percentages for each type. You then have relative values in terms of dollars of sales for all types of customers.

Some of your salesmen may be traveling territories which are too far from the warehouse to be profitable. The locations of customers are important. It costs more to call on the customers two hundred miles away, than those twenty miles away. At what distance is it unprofitable to solicit business?

One hardware house found its breaking point at 175 miles. About 75 percent of its customers were located within such a radius and these customers accounted for 83 percent of the sales volume. If other records are available, sales volume, gross margin and operating expenses can be studied to secure a more refined answer to this question.

A great many customers place small orders very infrequently. A wholesaler can take steps to increase sales effectiveness or he can discontinue soliciting small buyers, if he is not convinced that the small buyer will eventually become a larger and more profitable one.

The significance of this question is shown on the records of our hardware house by the fact that 51 percent of its credit customers placed four or fewer orders during a six-months period and accounted for only slightly more than six percent of the dollar volume of that period.

At the other extreme, three percent of the customers ordered 75 times or more and accounted for slightly more than 29 percent of the total volume. Without any additional information, steps might be taken to change the buying habits, or eliminate customers who bought too infrequently, or whose orders were plentiful but too small to be profitable.

These examples may bring to mind other analyses which would be valuable. The study could go further and determine accounts that show the greatest gross profit or the accounts that are least expensive to service. The opposite will also be shown. A con-

centrated effort could then be made to increase gross profits and decrease selling expenses on those accounts that are least profitable. If these accounts do not warrant those efforts, then solicitation can be discontinued with the full knowledge that only unprofitable business is being eliminated.

First determine what figures and comparisons will help you. Then get them with the least possible delay. Above all—use them. Carefully planned and selective selling will eliminate unnecessary expense, secure more profitable sales, and increase net profits.[12]

Mercantile credit differs from consumer credit in many respects, two of which are our immediate concern: ratings and insurance. The financial standing of many business firms is rated by agencies like Dun & Bradstreet. Since a favorable credit rating is highly desirable, businessmen strive to safeguard this precious asset. However, "ratings" are not always up to date, and many small-scale or newly established retailers do not have one. These facts limit the value of the mercantile agency's service in many cases, especially as far as the wholesaler is concerned. However, the agency may still be employed effectively in the case of doubtful credit prospects to secure special credit reports that are likely to be somewhat more reliable than the wholesaler's independent appraisal.

The second difference between commercial and consumer credit is credit insurance, which is available only for the former. It is guaranty of accounts receivable as additional security for loans to business concerns. Briefly stated, credit insurance is a form of insurance to protect the merchant against loss arising from sales on credit to debtors who have one of the stipulated mercantile agency ratings. Credit insurance coverage is limited to manufacturers, jobbers, or wholesalers who sell to the trade. There is no provision for insuring retail credits.

The insurance policy provides protection against all known forms of debtor insolvency and guarantees the payment of all

[12] Small Business Aids, No. 451, U. S. Department of Commerce, "Wholesaler's Customer Analysis," by Wilford White. Office of Small Business. Washington: U. S. Government Printing Office, 1948.

past-due accounts filed with the insurance company within 90 days after due date in accordance with the provisions of the policy.

The insurance company does not attempt to replace the credit manager of a concern, but rather aims to widen the efficient credit work of businessmen and to educate them in the importance of building up well-equipped credit departments. The policyholder is required to bear a small percentage of the covered loss as coinsurance. The insurance is only against loss in excess of this normal loss, which is borne by the merchant himself. In practice, the merchant's expected loss is regarded as an expense of doing business.[13]

Credit in the Small Factory

Credit management in the small factory has certain conditions in common with that in wholesaling. Both deal in mercantile credit, except when the small factory sells direct to consumers exclusively. Uses by both of commercial ratings and other sources of information on the financial standing of business firms are similar, although the nature of their customers may introduce significant differences. For example, the small wholesaler is more likely to have a preponderance of retail store customers who either are not rated or whose ratings are less reliable than those of the small manufacturer's customers. Offsetting this is the wholesaler's more favorable position in becoming personally familiar with his customer's business.

Customers of the small factory will usually be other businessmen. Merchants or service establishments to which direct sales are made will be either established firms with ratings or small concerns in the vicinity of the factory. Other factories that make purchases are likely to be larger concerns. In any case it is well to be familiar with sources of information and the

[13] Jones, H. Lloyd, "Credit Insurance—Boon to Small Business." *The Casualty and Surety Journal,* March, 1945, Vol. 6, No. 3, pages 37–44.

various services available in the field of mercantile or commercial credit.

A very excellent source is Dun & Bradstreet, Inc., which publishes reference books containing ratings of business concerns, issues special reports to members, supplies analytical reports, provides a continuous report service, offers a limited credit-checking service, prepares business analyses, may collect over-due accounts, will conduct special surveys, and publishes *Dun's Review.* Although some of these services are available only to members, credit information is available to any small businessman for a small fee. Perhaps Dun & Bradstreet's most important service available to the small businessmen is its credit rating books, which may be found in most banks or obtained direct from the company. However, these should be used with caution, because some ratings must of necessity be based on insufficient information and opinions of others and are therefore not entirely adequate.

Information on new or prospective customers may be obtained from other creditors through direct exchange, either personally or by correspondence. Credit bureaus maintained by associations of credit men for the exchange of ledger experience and information are another source, and trade credit bureaus operated by trade associations are also useful. Information may be obtained from sales representatives who are familiar with the company under investigation, and salesmen of creditors, attorneys, and banks may be able to tell if the firm is a good risk. Other sources of information are corporation manuals, corporation financial services, trade and financial publications, credit character reports, and the *Credit Manual of Commercial Laws,* which is published annually by the National Association of Credit Men. Before giving credit, of course, the manufacturer may wish to have a personal interview with the prospect and perhaps secure a financial statement directly from him.

Credit terms

If the prospect seems to be a good risk, credit is extended and

an account opened for him. Terms must be decided upon at the beginning. Slow accounts are just as dangerous in manufacturing as they are in a retail or service business. Not only do they tie up working capital, but if they are not collected over a period of time they will slow down production. In most trades, cash discounts are offered for payment within a certain length of time, otherwise the total amount must be paid. Such terms are stated "2/10, net 30," which means that a 2 per cent discount is allowed if payment is made within 10 days and that the total amount must be paid within 30. Some businesses buy in small quantities and frequently. In such cases the manufacturer may extend M.O.M. or E.O.M. terms. Under M.O.M. (*middle of month*) terms, all purchases bought before the middle of the month are billed as of the fifteenth; if such a discount as that granted in the terms "2/10, net 30" is allowed, it can be taken through the 25th of the month. For example, an invoice dated March 3, terms 2/10, net 30, M.O.M., could be discounted at 2 per cent if paid on or before March 25, the net amount of the invoice being due April 15. Another invoice dated March 16, with the same terms, could be discounted up to April 25 or paid net May 15. E.O.M. (*end of month*) terms are very similar to M.O.M., except that all purchases are billed as of the end of the month instead of the middle and discount periods as well as due dates are based on that date. Other terms often used are: R.O.G. (*receipt of goods*), which means that the discount period starts only after the goods have been received; *extra dating*, which indicates that the discount period is extended for so many days after the regular allowed term; and *season dating*, which is another form of extra dating but is for a much longer period of time, because buyers are reluctant to pay immediately for goods purchased as much as seven or eight months in advance of demand.

A misuse of credit in so far as cash discounts are concerned may occur when some firms remit the amount of the bill less the cash discount even though the discount period has passed and, in some cases, the net period as well. Permitting such a

practice would certainly be unfair to the prompt-paying customer. Sometimes the remittance must be accepted, but no further credit should be extended. The amount of the discount may be added to the next bill, or the check may be returned with a note reminding the debtor that the discount was not to be taken and asking him please to remit the proper amount. Laxness in enforcing terms will only bring loss to a company.

Both wholesalers and manufacturers have occasion at times to sell on a C.O.D. (*collect on delivery*) basis. Goods sent C.O.D. are usually sent to credit risks that are known to be undesirable or to simply unknown firms. Instead of sending merchandise C.O.D. and letting the shipping company collect for the merchandise, the manufacturer may wish to send a sight draft with a bill of lading attached. A bill of lading is evidence of title when the goods are shipped by a common carrier. When the merchandise arrives, the buyer is notified and he comes down to pay the amount of the draft and receive title to the goods. This applies only to a cash transaction.

Manufacturers often find it desirable to relate credit terms to the size of the order. This procedure has a dual purpose. By this limitation of credit to orders above a minimum quantity, customers are encouraged to place orders of sufficient size for economical handling; furthermore, encouraging the larger orders favors the better-established firms and thus tends to reduce the risk of granting credit.

Credit in the Service Business

Because services are by their very nature intangible, nonreturnable, and "consumed" when rendered, credit extension is more risky and less common in this than in the other fields of small business. However, small service establishments with regular customers and frequent repeat sales, like laundries and dry cleaning establishments, often find credit extension a convenience that is attractive to many customers. This is especially true when it is accompanied by pickup and delivery

service. Naturally, prices will have to be higher than if the business were run on a cash-and-carry basis.

Personal service establishments like beauty parlors and many types of repair services find credit extension an aid to increased business. In all such cases, credit is primarily a customer convenience and is based on the willingness and ability of customers to pay. There can be no reliance on tangible goods as security except in such special cases as when the law permits a hotel to retain the baggage of non-paying guests.

Except for these differences, credit for the service business is similar to that for the retail store. Usually only open account credit is appropriate, although major repairs on durable goods may be paid for on the instalment plan. Account solicitation, sources of information, investigation of applicants, record keeping, and credit control are very similar in both fields.

Probably the typical service business has more to gain and less desirable business to lose by striving to reduce its credit business to a minimum than do firms in other fields. Since the quality of service rendered is of major importance, this will often be a more powerful means of attracting business than the credit extension.

Conclusions

Although credit carelessly handled can ruin any small business, carefully controlled credit has two major advantages. In many cases business gravitates to the credit-granting firm. *The mere availability of credit is sufficient to attract and hold many customers who would not trade with the firm if credit were not extended. Furthermore, information furnished by the credit customers' records can serve many purposes of management.* This aspect deserves more attention in the small business than it usually receives. Although credit is primarily a customer service, proper handling can make it also a powerful tool of management.

Many surveys show the total cost of consumer credit extended by retail stores to be close to three per cent of net sales, bad debt

losses accounting for about one-half of one per cent. Credit-granting stores, however, tend to be more profitable than strictly cash stores.

Certain principles governing credit extension have been well established and should be observed. One is that the length of the credit period should not exceed the useful life of the merchandise.

Credit bureaus and many other sources of useful information are available to small businessmen. Experience shows that using them greatly reduces losses resulting from credit extension.

Review and Discussion Questions

1. Differentiate between consumer and mercantile credit, showing why each point of difference is significant to the small businessman.

2. Why is credit insurance restricted to business accounts?

3. For each of the three major fields of small business, explain *fully* how the records of credit customers can be used as a tool of management.

4. Discuss the merits of different types of credit bureaus.

5. Interview several small businessmen with reference to their use or non-use of the local credit bureau and report your findings and conclusions.

6. Credit extension in the small business may show bad debt losses ranging from less than one per cent of sales to enough to put the firm out of business. Why is the danger of reaching this upper limit much greater for the small than for the large business?

7. Select some line of business in which customer credit is widely used and show how you could profitably operate in this field on a strictly cash basis.

8. What other divisions or activities of a business are closely related to its credit policy and administration? Discuss these relationships.

9. Explain how, if at all, the desirability of credit extension varies for manufacturers of different kinds of products as it does for

different types of retail and service businesses. What conclusions do you draw from this?

10. If credit is a customer service, explain how, if at all, a policy of no credit could also be a customer service.

11. Assume that you have purchased a going business in which liberal credit has been the policy for years and that you want to operate on a strictly cash policy. Explain how you would proceed.

12. Some firms that have a large number of charge accounts distribute the work of sending customers statements evenly throughout the month by dividing accounts into three or more groups. Each group has a regular credit period and time for payment; for example, for Group A all purchases charged from the 25th of one month to the 25th of the next will be billed and due before the 10th of the following month, Group B accounts run from the 5th to the 5th and become due on the 20th, and so on. This procedure is known as cycle billing. How would you expect cycle billing to affect the payment of accounts by customers who receive their statements after the tenth of the month? Check your answer by interviewing credit men who have had experience in using cycle billing.

13. Under what conditions would it be advisable for the small businessman to promote deposit account credit (that is, having customers deposit in advance the amount they plan to spend at the store for a certain period) to replace open accounts? Discuss.

14. As a small manufacturer selling entirely to small retailers, explain how you would (1) get many customers to buy for cash and (2) reduce credit losses from other customers to a minimum.

15. Look up in some good retail advertising or management text like *Retail Advertising and Sales Promotion* (Edwards, Charles M., Jr., and Howard, William H. New York: Prentice-Hall, Inc., 1943) the topic of "customer control." Prepare to discuss the ways a credit-granting store could use its customer ledger information for other objectives of management. Discuss how a customer control analysis could also improve credit administration.

16. Explain how the same approach of customer control as used in a retail store could be applied to a service establishment and to a small manufacturing business.

17. How is cost accounting as used by a wholesaler or a manufacturer related to his credit department? Discuss.

18. A man with several years of experience in credit insurance proposes that you go into business with him to sell credit insurance for the retail stores in your home town, which has a population of 20,000. You both realize this would be a new venture. Explain how you would analyze the business possibilities and profit prospects involved. Outline a plan for launching such an undertaking on a sound basis.

19. If you were to start a collection agency in a town of 50,000, describe exactly how you would proceed.

20. Since most surveys show that credit-granting stores are more profitable than stores selling only for cash, how do you explain the steady expansion of cash-and-carry retailing?

Chapter XX

RECORDS AND RECORD KEEPING

Records are an important aid to the management of any small business and should be used for this purpose. Since few, if any, small businessmen make a fetish of record keeping, the customary warning to keep only those records that are actually used should be replaced by two admonitions that experience shows to be needed. The first is to keep adequate records, for, as a group, small businessmen are notoriously negligent about doing this. Far too much reliance is placed on memory, on close personal contact with the business, and on some simple system that the owner believes replaces conventional records. The second admonition relates to the average small businessman's failure to make effective use of the few basic records he does keep. Evidences of this shortcoming have already been noted in his failure to use inventory records for sales promotion and changes in buying or merchandising policies, and charge account records for customer analysis and sales promotion.

Records as a tool of management affect almost every activity. Without adequate records it is not possible for the modern small business to handle buying, inventory control, credits and collections, expense control, personnel, and most other aspects of management efficiently. Most of the necessary records and their proper use have been discussed in the chapters concerned with managing the major divisions of business and need not be considered again here. However, three groups require additional consideration: accounting, tax, and miscellaneous records.

Certain information provided by the accounting records is used for expense control and has been discussed in the chapter

on business expenses, and use has been made of data secured from the accounting records in other places throughout the book.

Basic tax records are mandatory for any business regardless of size. Of particular importance to the small businessman are records needed for federal and state income taxes, because memory and estimates are not admissible for these purposes. To a lesser but still important degree, records are required in the small business for sales, social security, personal property, and other taxes.

Miscellaneous records are needed for the efficient conduct of many activities not important enough to have warranted treatment in separate chapters. Such of these as correspondence, filing, and production control are discussed later in this chapter; and, in addition, some records used to help operate several divisions of the business that could not logically be assigned to other chapters are included in the section dealing with miscellaneous records.

The importance of maintaining adequate, up-to-date records is underlined by the fact that surveys have repeatedly shown a large per cent of all small businesses that fail to have been operated with merely a single entry memorandum record of transactions or, in some cases, with no records whatsoever except possibly check stubs. Conversely, the managers of successful concerns have placed "complete and accurate records" on their list of "musts" for efficient management.

Accounting Records

Any experienced businessman knows that it is just common sense to keep an accurate, written record of every transaction. The man who had no oil pressure gauge on his automobile would have no way of knowing whether his motor was being properly lubricated until a knock in the motor or the mechanical failure of some moving part showed that it was not. Similarly, the lack of proper accounting and record keeping in the business concern makes it impossible for the manager to

know how his enterprise is functioning, and in the majority of cases the first indication that something is wrong comes too late. Failure is already upon him.

Small business operators tend to keep their records in a single entry memorandum style, with no system of checks or balances and without preparing financial statements that reflect the condition of the business and warn of impending failure; and they do this because, failing to realize the importance of accurate record keeping and its relation to efficient business management, they try to economize by eliminating the expense of double entry records and bookkeeping advice. Actually, this is false economy, for there can be no wiser expenditure than money spent to maintain complete records. In many cases the amount saved in bookkeeping expenses is more than balanced by the amount lost in overpayment of income taxes due to the lack of adequate records.

During recent years a great deal of emphasis has been placed upon record keeping in the small business. Provisions for Federal Old Age and Survivors Insurance and Unemployment Insurance, as well as the lowering of income tax brackets, have encouraged better record keeping, since those affected must keep sufficiently detailed records to prepare the required reports. In addition to this, managers in small business have come to recognize the need of information available only from good records when they have to borrow funds from banks. The creditor will invariably ask for the most recent balance sheet of the business and sometimes for a copy of the profit and loss statement of last year's operations.

One can now begin to see the fallacy in the common view of the small store manager: "I know the condition of my business because of my close association with every transaction. I really don't have the time or the knowledge to keep detailed records, and I don't make enough to hire a full-time bookkeeper." In the first place, he cannot remember many of the details which he will need later on in preparing his income tax return; secondly, he can't keep a set of books that will be of much help

by just jotting down figures in a pocket-size notebook. As for the time needed, it is time well spent and will more than pay for itself. If, however, the owner finds that he actually does not have enough time to keep adequate records, himself, it would be wise for him to engage the services of a local bookkeeper-accountant to keep the records on a part-time basis at a reasonable cost. A "Mail Me Monday" or similarly organized system for servicing small businessmen—practically a mail order bookkeeping service—is operated in most cities.

Needs met by accurate records. The following are only a few of the more common questions to which a businessman may be called upon to furnish the answers:

1. What was your income last year? What were your expenses?
2. What article is your best seller? Which is your worst?
3. What are your assets, liabilities, and net worth?
4. How much cash business do you have? How much credit business?
5. Are you carrying too large or too small an inventory?
6. What is the current value of your building, delivery equipment, and other fixed assets after deduction of depreciation allowance?
7. How much did you lose last year from bad debts?
8. What was the net gain realized on that piece of store equipment you sold last year as "used equipment"?

In addition to these, a proprietor should consider the following questions in order to take care of his business in the most efficient manner:

1. How much do my charge customers owe me now? How much of this is overdue, and how long overdue is it? When does the remainder fall due? Am I extending too much credit or could I stand some more accounts?
2. How much ready cash do I have with which to meet my obligations? Will my income during the next 30, 60, or 90

days be sufficient to take care of obligations I have assumed?

3. How much money do I actually have invested in my business, and what rate of interest am I earning on my investment?

4. How do the trends of sales, purchases, expenses, and other items in my store compare with those in similar stores? How do they compare with my own operations during previous years?

5. In what respects can I cut down on or eliminate some of my last year's expenses?

Simplicity of record keeping. Many small businessmen labor under the misapprehension that bookkeeping is difficult and complicated. Nothing is further from the truth, for keeping a set of simple records that will be fully adequate for small businesses is an easy matter. Illustrated and explained in the next chapter is the record known as the "one-book" system because all records of income and cash payments are combined in a single book. This type of record is very popular among small retailers who prefer to use as few separate books as possible.

Sales records. Properly kept sales records are very definitely a requirement for successful business management. Regardless of how small or how large the business is, the owner will want to know the answers to one or more of the following questions, which apply with slight modifications to any field:

1. Advertising Results. Have I had a sufficient increase in sales to justify my advertising expenditures? How do my sales and advertising for this month compare with my sales and advertising for last month and for this month last year?

2. Departmental Information. Which department in my store is making the most profit for me? Which department operates on the closest margin? Should I hold a clearance sale or do some type of special advertising to close out slow-selling articles?

3. Efficiency of Sales Clerks. Which one of my sales clerks

is making the most sales for me? How do their individual selling records compare with their wages?

4. Trends. Did I make as many sales last month as I did during the same month last year? During the same month two years ago? Three years ago? How do my sales for the month just ended compare with my sales for the past six months? How do my daily (or weekly) sales compare with daily (or weekly) sales of past months or years? Are my sales increasing or falling off?

The answers to all these questions are easily found in the sales records if they have been properly made and preserved. Illustrations of simple forms for the analysis of sales figures will be presented later. Monthly sales totals are merely transferred at the close of each month from the sales column of the "one-book" record to the sales analysis statement, which may be totaled at the end of the year. Daily sales figures may be obtained in one of several ways: by totaling the sales slips which are made out for each sale, by taking the total as recorded by the cash register, or by having sales clerks keep individual records of sales on a form designed for that purpose for the particular store. The total daily sales of each department can be checked by using individual sales slips for each department, by using departmental keys on the cash register, or by keeping an individual cash register in each department. Sales of each clerk can be kept separate by requiring the clerks to initial their sales slips or to use the identifying letters assigned to them when ringing up sales on the cash register. In some businesses it might be practical to assign an individual cash register to each clerk.

Both cash and charge sales are recorded daily from the sales slips in stores that use the sales slip system. If the sales are posted from the cash register totals, however, it will be necessary to post charge sales from the sales slips in order to arrive at total sales. Totals of individual sales slips are posted daily to the customers' ledger sheets in the customers' ledger. Many

small retailers have found that an easier way to maintain the customers' ledger is to purchase a filing device designed especially for filing sales slips. This device has a number of hinged shelves that contain spring clips to hold the sales slips in place. When the clerk makes a sale on credit, he merely itemizes the articles on the sales slip and files the slip away in the special file. Many small business managers require the customer to sign the sales slip as evidence of his having received the goods, but this is a matter of the individual store's policy. All subsequent sales to the same customer are handled in the same way, all sales slips being pinned together. When the account is paid, the slips are given to the customer and his charge account file is empty. If merchandise is returned for credit, a credit memorandum is issued and a duplicate is filed in the customer's file at the close of the day. With this system it is unnecessary to maintain a separate accounts receivable ledger for charge customers, since the file is in itself an accounts receivable ledger, and much bookkeeping detail is eliminated.

Accounting for cash payments. Questions like the following are continually arising to challenge the proprietor, and the man who keeps careful records is the man who is going to have the advantage, other things being equal. If it became necessary for you to furnish a statement of cash disbursements showing in detail what happened to every sales dollar you took in last month, how much work would the preparation of such a statement entail? Could you account for every dollar spent without having a sizable amount in a miscellaneous account? If you find that your expenses are running too high, which ones are you going to reduce?

One of the best methods of accounting for cash disbursements and receipts in modern business is to deposit to a checking account in the bank all money taken in and to write a check for each and every expenditure except for very small items (costing, say, two dollars or less) like postage, window cleaning, or express charges. The bank helps to keep the firm's records, because cancelled checks furnish a complete record of each

disbursement. Each check is a written receipt for the payment and may prove very useful if the Bureau of Internal Revenue calls for substantiation of some expenditure.

The matter of small cash disbursements is easily taken care of through what is known as a "petty cash fund." A small fund of from $10 to $50, depending upon the need, is set aside to cover minor expenses. Each time an expenditure is made, a petty cash form is filled out for the amount of the expenditure in order to provide information for charging it to the proper expense account. When the fund is exhausted, a reimbursement check is drawn on the checking account, with the expense accounts being charged as indicated upon the petty cash forms. The manner of recording expenditures in the "one-book" system will be explained later.

Purchase records. Almost all small businesses do a certain amount of buying on credit. It is more convenient than having to pay for merchandise when ordered because the owner can make his purchases as often as needed during the month and settle for all purchases at one time at the end of the month. This eliminates the detail involved in paying for each purchase individually, and it permits the manager to check the merchandise for quantity and quality before paying for it. Another advantage of credit is that it actually amounts to an addition to working capital during the credit period. When the businessman buys on credit, he can make purchases that he could not have made if it had been necessary for him to pay cash, and usually by the time the account becomes due he has sold enough of the merchandise to pay the bill.

Since credit is such an important asset, it is important that it be diligently safeguarded at all times. Invoices must be paid promptly when they become due. A good plan to insure prompt payment is to keep an invoice file with a section for each day of the month. As invoices come in, they should be filed under the date upon which they fall due or when they should be paid to secure cash discounts if these are offered. It then becomes a relatively easy matter to check this file daily

and make payment on all matured invoices. After payment, each invoice is filed in an alphabetical file under the name of the company concerned. In the case of payments for which no invoices are available, a memorandum invoice should be prepared, giving the name of the person, the amount, the date, and the article purchased or service rendered. In this manner, a complete record of all purchases is made instantly available at all times. Invoices should always be marked with the check number and date of payment in order to eliminate the possibility of duplicate payment. Credit memorandums should be attached to applicable invoices upon receipt so that they will be deducted from the invoices before payment is made.

Equipment records. Regardless of the type or size of business operated, the owner will need a certain amount of equipment. In many cases he will have to purchase new equipment each year in order to keep up with competitors and with the trends in his type of business. Many times this equipment will be rather expensive and its use will raise operating expenses, but if it brings in enough additional business at a gross margin greater than the increase in expenses, it will prove to be a good investment.

Equipment records should be maintained on all equipment owned by the business. These records may be kept in book form or on cards in a card file. On a separate sheet or card for each piece of permanent equipment should be shown the following:

Cost of equipment
Amount of down payment
Monthly payments
Balance due
Yearly depreciation

Each time a payment is made on a piece of equipment, it should be entered on the equipment record card. Also, at the end of each year depreciation should be computed and entered on the card. This depreciation is an expense of the business, just as much as rent, utilities, or salaries. The simplest and

most practical method of computing depreciation is known as the "straight line" method, an example of which follows:

Original cost of equipment	$500.00
Estimated trade-in or scrap value	50.00
Amount to be depreciated	$450.00
Yearly depreciation (estimated life: 10 years)	$ 45.00

Interpretation of financial statements. If the records are complete and accurate, it is a small matter to draw up the two basic statements universally used in successful business management, the balance sheet and the profit and loss statement. The latter statement, as the name implies, is a summary of business transactions that have taken place during the year (or month), resulting in either a profit or a loss. It is like a motion picture of business operations during the period covered by the report; by careful analysis of the profit and loss statement, one can clearly see what has happened and determine why the business is now where it is. The balance sheet is the statement that shows exactly where the business stands; it can be thought of as a snapshot of the business as it stood on the last day of the accounting period. The balance sheet shows where the business is; the profit and loss statement shows how it got there. Used wisely, these two statements will give a good indication of what may be expected in the future.

The profit and loss statement summarizes the business transactions as follows:

Sales	$5,000.00
Deduct Cost of Goods Sold	3,500.00
Gross Margin	$1,500.00
Deduct Expenses	1,000.00
Net Profit	$ 500.00

The records make readily available all these amounts except the cost of goods sold, which is easily computed as follows:

Inventory, beginning of period	$2,000.00
Add Purchases of Goods during period	4,500.00
Goods Available for Sale during period	$6,500.00
Deduct Inventory on Hand, end of period	3,000.00
Cost of Goods Sold	$3,500.00

Now that we have the profit and loss statement, we are ready to proceed with the analysis. In analyzing a set of figures we want to compute certain ratios. These may be expressed as percentages of a common base—usually the total net sales figure—to make them comparable. These percentages are obtained by dividing the amount of each item in the statement by the net sales figure and multiplying by 100. To keep the illustration simple, we will take the previous example for our computation, although in practice the various types of expense would be listed and the percentage of net sales computed for each.

		Per Cent
Sales	$5,000.00	100
Deduct Cost of Goods Sold	3,500.00	70
Gross Margin	$1,500.00	30
Deduct Expenses	1,000.00	20
Net Profit	$ 500.00	10

What significance do these percentages have? How can they be of use in the determination of policies for future operation of the business? First, the owner can compare the ratios of his business with standard ratios.[1] These can be obtained from

[1] See Chapter XVI for a discussion of standard operating and merchandising ratios.

publications of Dun & Bradstreet and the trade association in his field, or from the local banker, who usually has access to these or similar publications. Of course, there will be some items on the profit and loss statement that will necessarily be different from standard ratios because of peculiarities of the individual business. One company might have some expense item not commonly found in this type of business or might not have some expense that is commonly found. By making adjustments for unusual items, one can readily see how his business compares with the average business. In addition to this, he can measure his success by comparing his ratios with those of a successful, profitable business similar to his own. If he notices certain items in which the percentages of his business vary considerably from those of others, he should make an immediate investigation to ascertain the cause of the differences; by so doing, he may stop a leak somewhere in the business that would lead to ultimate failure unless corrected. Many businessmen also find it helpful to management to compare their ratios for the period under scrutiny with their own ratios for previous periods. If profits are declining, they can quickly check their ratios and ascertain the cause for the decline. If the ratios are not checked, a businessman might be misled by comparison of dollar figures. It is altogether possible that increased sales volume may produce a greater dollar profit from one month to the next although profit in relation to sales might be down by a rather large percentage.

If the profit and loss statement is like a motion picture of the business for the month or year represented, the balance sheet can be compared to a still of the business on the closing date of the period. The owner can see how much cash he has in his cash register and in the bank, how much inventory is on hand, how much the customers owe the firm, the value of his equipment, how much is owed to creditors, and the "net worth," the latter being the difference between what he owns and what he owes. Here is a simple balance sheet:

Assets

Current Assets:		
Cash on Hand	$ 150.00	
Cash in Bank	800.00	
Accounts Receivable	650.00	
Merchandise Inventory	900.00	$2,500.00
Fixed Assets:		
Furniture and Fixtures	300.00	
Building	3,000.00	3,300.00
Total Assets		$5,800.00

Liabilities and Net Worth

Current Liabilities:		
Accounts Payable	$ 375.00	
Notes Payable	125.00	$ 500.00
Fixed Liabilities:		
Mortgage Payable		2,500.00
Net Worth:		
Capital		2,800.00
Total Liabilities and Net Worth		$5,800.00

This is called a "balance sheet" because the total assets balance with, or are equal to, the total liabilities and net worth. It is very closely related to the profit and loss statement, in that almost any entry made in the financial records affects both statements. An addition to cash in the balance sheet is usually an addition to an income account in the profit and loss statement. A deduction from cash in the balance sheet is usually charged to some expense account or to the cost of sales in the profit and loss statement. And when the two statements are drawn up at the close of the accounting period, the amount of net profit or net loss for the period as shown in the profit and loss statement is exactly the sum that is needed to effect a balance between the capital account plus liabilities and the total assets as shown in the balance sheet.

The balance sheet should be used in conjunction with the profit and loss statement in the management of a business. As

in the case of the latter, ratios make it easier to analyze and use the data contained therein. The current ratio, which is one of the most common, is the ratio between total current assets and total current liabilities. In other words, does the business have enough customers' accounts coming due to enable it, when they are added to its cash and to the income it will realize from sales during the next two weeks, to pay all the accounts that will fall due to creditors within the same period? Dividing total current assets by current liabilities will provide a current ratio that can be compared with the standard ratio or with former ratios of the business. A current ratio of two to one is usually considered a satisfactory but not in all cases a necessary indication of ability to pay current obligations.

In order to guard against purchasing too many fixed assets, a businessman should try to keep his ratio of net worth to fixed assets around one to one. In other words, he should have enough capital invested in the business to pay for most, if not all, of his fixed assets.

He can determine the amount his investment is earning for him by finding the ratio of net profits to average net worth as shown on his balance sheets at the beginning and at the end of the period.

Quoting from *Record Keeping for Small Stores,* by Welch and Sevin:

> An analysis of your balance-sheet ratios will enable you to visualize the financial condition of your store. This analysis will show you whether the amounts of your various assets and liabilities and the amount of your net worth are of sound proportions, when related to each other.
>
> Do you have enough cash on hand and in the bank? Is your inventory too high or too low? Are your accounts receivable too high? Are your accounts payable and notes payable too large in amount? Are your fixed assets too great in amount? Do you have enough capital invested in your business? A study of your balance sheet will provide the answers to these questions.
>
> Analysis of your balance sheet may reveal an unfavorable com-

bination of resources which you may be able to remedy before it is too late. Such an analysis will assist you in making the most effective use of the resources at your disposal (your cash, inventory, fixed assets, credit, and so on) and thus will assist you in operating your store on a sound financial basis and in maximizing your profits.[2]

Another analysis that should be made when a business extends credit is one according to the age of accounts receivable. Those that are past due should be divided into suitable groups, such as those that are 30, 60, 90, and more than 90 days past due. Separate ratios are then computed for each group. This analysis will disclose important trends and danger signals very useful for successful credit management.

Tax Records

Regardless of what kind of business one may decide to take up, he will always be confronted with the preparation of tax returns for the state and federal governments. Since the laws of the different states vary, it would be impractical to attempt to give in detail the requirements for any individual state or states. Some of the taxes that may be expected in most states are sales taxes, income taxes, workmen's compensation, and unemployment taxes. Before going into business one should check with the managers of a few stores and service establishments in the community in which he expects to locate, and find out what state taxes he may expect to encounter. It would be wise to write to the state revenue department to inquire as to what forms must be submitted to comply with the law.

Federal tax requirements, on the other hand, are uniform throughout the United States, and it would be well at this point to consider some of the requirements in regard to federal income taxes, federal old age benefits, and unemployment com-

[2] Welch, Charles H., and Sevin, Charles H., *Small Business Problems; Record Keeping for Small Stores,* page 77. Senate Committee Print No. 11, 77th Congress, 2d Session. Washington: U. S. Government Printing Office, 1942.

pensation. Since the income tax laws change from year to year, the businessman should supplement the general discussion that follows by studying explanations of each important change. If an owner keeps his records in good shape throughout the year and prepares a standard profit and loss statement at the end of the year, it will be a simple matter to copy the figures from the profit and loss statement onto the income tax Form 1040. The instructions accompanying Form 1040 usually are helpful in answering questions that arise in a business connected with income tax procedure. One particularly important point that is often misunderstood is that depreciation of equipment used in an enterprise is just as much a business expense as cash paid for rent or salaries. One should maintain accurate and complete depreciation records.

Federal social security taxes are divided into two classes, the Old Age and Survivors Insurance Tax and the Unemployment Insurance Tax. The Old Age and Survivors Insurance system applies to employers with one or more employees, and under its provisions as an employer you must:

> Keep a record of the social security account number of each of your employees. Enter the numbers on your permanent records.
>
> Keep accurate payroll records showing the name, address, and social security account number of each employee, the amount paid to him and the amount of employee's tax deducted from his wages.[3]

The Old Age and Survivors Insurance system requires that you as employer deduct a small per cent (which may be changed from time to time) from each employee's wages, match it with an equal amount, send the amount thus deducted and contributed to the United States Collector of Internal Revenue for your district. The remittance must be accompanied by Form SS-1a, which gives each employee's name, social

[3] *Outline of Employer's Duties Under the Social Security Act, and the Internal Revenue Code as amended August, 1939.* Issued jointly by the Social Security Board and the Bureau of Internal Revenue, Washington, December, 1939.

security number, and individual amount to be credited to that number. Form SS-1a contains the following instructions:

> Each employer must keep sufficient records to enable him to fill in the return accurately for each employee, and to enable the Collector to verify the amount of taxes due. Such records must be retained for a period of four years from the date when the taxes were paid, and must at all times be open for inspection by Internal Revenue officers.

Form SS-1a must be filed not later than the last days of April, July, October, and January of each year. Copies of this form may be obtained from the Collector of Internal Revenue in each district. It is advisable to ascertain current provisions.

You must pay the Federal Unemployment tax if "you have eight or more employees in covered employment on at least 1 day in each of 20 weeks during the calendar year." [4] This law would not apply to many small businesses since few (except in manufacturing) have more than seven employees. However, it should be noted that most states have laws that apply in the case of fewer than eight employees. In fact, in some states unemployment compensation taxes are required where there is only one employee. An employer should be sure to check the unemployment compensation law of the state in which he wishes to establish his business, since each state administers its own law.

Another federal tax requirement that will give an employer many headaches unless watched carefully is the withholding tax. This is a tax that is withheld from the wages of all employees (regardless of how many employees one has) before salary or wage payments. It represents an instalment on each individual employee's income tax liability for the current year. Withholding tables, which one may use in determining the

[4] *Employer's Duties Under the Social Security Act, and the Federal Insurance Contribution Act and the Federal Unemployment Tax Act.* Issued by the Federal Security Agency, Social Security Administration, Washington, November, 1947.

exact amount to be withheld, are furnished by the Bureau of Internal Revenue. By making these deductions an employer is acting as an agent of the federal government, and he is required to account for all money withheld. The information of the greatest importance that his records should show in connection with the withholding tax is: (a) number of persons employed during the year, (b) amount of wages paid to each person subject to withholding, (c) periods of employment of each person, and (d) amounts and dates of wage and salary payments and withholding tax deductions therefrom. In addition to these records, he must keep in a safe place copies of all withholding exemption certificates and notices of changes in exemptions for all employees.

There are three different reports that must be filed with the Collector of Internal Revenue in connection with withholding tax procedure. These are:

1. Quarterly return of income tax withheld on wages (Form W-1).
2. Annual statement of income tax withheld on wages (Form W-2).
3. Reconciliation of quarterly returns of income tax withheld with statements of income tax withheld (Form W-3).

The quarterly return (Form W-1) must be filed on or before January 31, April 30, July 31, and October 31, for the quarter ending one month before each date. Payment of the tax withheld must accompany the report. Employers who withhold a total of more than $100 in any month must pay their tax amounts to an authorized bank by the tenth day after the close of the month. Deposit slips from the bank are credited against the tax shown on the quarterly report.

The annual statement of income tax withheld (Form W-2) shows for each employee the wages paid and the amount of tax withheld during the calendar year. The original of the statement, for each employee, must be delivered to him on or before January 31 of the year following the taxable year re-

ported upon. The duplicate of this statement is attached to the final quarterly report for the year and filed with the Collector of Internal Revenue.

The reconciliation of quarterly returns (Form W-3) is merely a report that reconciles the amount shown on the statement of income tax withheld (Form W-2) with the sum of the four quarterly reports (Form W-1) that have been submitted previously. The reconciliation should accompany the final quarterly return and duplicate statement (Form W-2) that are to be mailed as described in the preceding paragraph.

In connection with a businessman's own individual income tax liability, it will be necessary for him to file a "Declaration of Estimated Tax," which is to accompany his individual income tax return. When the "pay-as-you-go" plan of collecting income taxes was enacted, it was decided to collect the taxes by the withholding method. This was a relatively easy way to collect the taxes from salaried taxpayers and wage earners. But owners of business enterprises and professional people, whose income is from the profits of their efforts, cannot have their taxes deducted and withheld by an employer. Therefore, as manager of a business, the owner is required to make an estimate before March 15 of what he expects his taxable income to be during the current year. From this estimate he computes his estimated tax for the year and pays this amount, either in one lump sum or in quarterly instalments. If during any quarter of the year he realizes that his tax estimate was too small or excessive, he is to submit a revised estimate. At the end of the year, if he finds that his estimate was too low, he will have to pay the difference plus any penalty that may be applicable for underestimation. If he has overestimated and has paid too much tax, he may request either a refund of the amount overpaid or that he be given credit for the amount of the overpayment against his estimated tax for the next year.

The following facts should be kept in mind in connection with the withholding tax:

1. Failure to file on time is likely to result in a penalty of from 5 to 10 per cent, but cannot exceed the latter.

2. Failure to pay an instalment on time imposes a penalty of from 5 to not over 10 per cent of the unpaid amount of such instalment.

3. If 80 per cent of the actual tax as finally determined exceeds the estimated amount (an underestimation of more than 20 per cent), it subjects the taxpayer to whichever of the following penalties is the smaller:

(a) Six per cent of the difference between the amount of the final tax and the amount of the estimated tax, or

(b) The difference in dollars between 80 per cent of the final tax and the estimated tax.[5]

Another type of tax about which a businessman will need to secure information is the sales tax. Various states and cities levy such taxes, with the rate varying from place to place. One should contact the state or local revenue office for information that will acquaint him with the applicable law; having done so, he can adapt his records to the requirements.[6]

If such taxes were always levied upon gross sales, they would present no appreciable difficulty. But in almost all of the states or localities having retail sales taxes there are specific exemptions, either on a certain class (or classes) of merchandise, or a particular group of customers. In most states the applicable road tax on gasoline does not apply to fuel used by farmers in their tractors. In many instances cigars, cigarettes, and tobacco are exempt from sales tax because a specific tax already has been levied upon them. Because of such exemptions, in keeping his records, a manager will need to devise some type of control by which he can distinguish tax-exempt

[5] Information concerning federal income and withholding taxes is obtainable in the *Prentice-Hall Federal Tax Service.*

[6] Information concerning state taxes may be found in the *Prentice-Hall State and Local Tax Service.*

sales that will be deducted from his total sales at the end of the taxable period.

In most cases there will be certain other items that may be deducted from gross sales after tax-exempt sales have been subtracted. Some of these are:

1. Cash discounts to customers and refunds for returned goods.
2. Bad debts charged off.
3. Finance and interest charges.
4. Allowances on trade-ins.
5. Freight and transportation charges.

One should be sure to study carefully the deductions allowed by the particular state and/or city in which his business is located in order to prevent the overpayment of sales taxes.

Some business enterprises will find it necessary to keep records of the sales of certain items that are subject to federal excise taxes. Under provisions of the Federal Revenue Act of 1947, a tax of 20 per cent is levied on the retail sales of jewelry, furs, and toilet preparations. In order to discern between taxable and non-taxable items, one will need to refer to a pamphlet issued by the Treasury Department [7] describing the tax. The following statements contained in this pamphlet are pertinent here:

Each person required to report a tax on the sale of any of the articles covered by these regulations must make a return on Form 728A in accordance with the instructions thereon. The return must be made in duplicate under oath for each calendar month . . . (Sec. 320.60).

Every person required to file a return and pay tax on the sale of an article at retail shall keep . . . accurate records and accounts of all transactions. . . . The records shall contain sufficient information to enable the commissioner to determine whether the correct amount of tax has been paid. Such records . . . shall be maintained for a period of at least four years from the date the tax became due. . . (Sec. 320.62).

[7] Regulations 51, relating to the Retailer's Excise Taxes under Chapter 19, Internal Revenue Code.

In regard to the computation of the tax on an article, the amount of the federal excise tax is not considered to be a part of the sales price of the article before tax. In other words, if the price the retailer wants to get for himself is $2.00 and the federal tax is 20 per cent, the sale price will be $2.40. The 1947 Revenue Act provides, however, that any retailer who represents to his customers that he is absorbing the tax (not charging it to them) shall be liable to penalty. Thus if a seller does not charge the tax to his customers as a separate amount, he should not make any written or oral statements that will cause any person to believe that the price of the article does not include the tax.

The relation of state sales taxes to the procedure of determining federal excise taxes is covered in Regulations 51, previously referred to (Sec. 320.7).

When a state or community retail sales tax is imposed on an article subject to the federal excise tax and billed as a separate item, it may be excluded from the taxable price. Thus in our previous example a 5 per cent state or local sales tax would raise the price to the consumer to $2.50, not to $2.52 as it would if the 20 per cent federal tax were figured on the retail price including the state sales tax. Whenever such a state or local sales tax is excluded from the taxable sales price of the article, the merchant must retain a copy of the invoice or other record of sale rendered to the purchaser that will prove to the Commissioner that the retail sales tax so excluded was stated as a separate item.

The subject of exemptions and deductions is treated in Regulations 51 (Sec. 320.64).

When an article subject to federal excise, state, or local sales tax is sold direct to the United States, any state, or other political subdivision for its exclusive use, the tax does not apply. In our previous examples the sale price would be $2.00 regardless of the 20 per cent excise and 5 per cent state or local sales taxes.

A retailer may be allowed a credit or refund of a tax paid on an article when the price on which the tax was based is later

readjusted as a result of return or repossession of the article, or by a bona fide discount, rebate, or allowance. The allowable credit or refund is limited to the overpayment of the tax when calculated on the adjusted price. For example, if a $2.00 article subject to the 20 per cent federal excise tax is sold for $2.40 and later a discount or allowance of $1.00 is made (plus $0.20 excise tax), the retailer is allowed this $0.20 tax refunded as a credit or refund.

If in a business the owner will be liable for the collection of excise taxes, it will be necessary for him to make provision in his accounting setup for an adequate record of taxable sales or of the actual amount of tax collected from customers so that his records will be in order for inspection by federal officials at any time.

Miscellaneous Records

A small retail lumber dealer has for many years maintained records of contractors and of carpenters in his area in such a way as to be able to tell at any time what each one is doing. For example, he knows that contractor Smith has just started construction on a duplex apartment house and will be needing eight or ten carpenters in about two weeks. From past experience he knows that Smith will soon be asking him where he can find them. When this time comes, he can immediately refer to his carpenter file and learn which ones are ready to start to work at once and when each employed man will be available. Most of the men now take the initiative in informing him of their status. By making his office a clearing house for employment, this service has built up good will with both groups; and by keeping construction moving forward at a more regular rate, it has helped to increase sales.

A job printer who has several presses and employees but is still a small businessman solved many of his problems by maintaining efficiency and activity records of each machine and of each employee. In this way he has instituted a miniature

production control and costing system which enables him to plan jobs well in advance, make more accurate bids on competitive jobs, go after additional work whenever needed to keep his plant busy, and thus maintain greater stability of output and employment.

A small wholesale grocer secures published crop forecasts and prepares his own charts to help in planning and timing his buying. From his sales records he prepares a daily commodity breakdown to show buying trends. By analyzing past sales to each customer, many of whom are large farmers and poultry and stock growers, he has a record of the seasonal buying habits of each regular customer. These records are used in buying, sales promotion, and inventory control.

A small dress factory selling through agents to retail stores maintains a customer record card for each store showing the date and types and quantities of each purchase. These records are useful in planning production, in checking on the agents' solicitation of repeat business, and as a follow-up on the success of styles previously made and sold.

An insurance agent keeps records of all customers' policies, present and lapsed, showing renewal dates, reasons for changes, and similar data. By watching current news items, he sometimes secures reinstatement of a lapsed policy when circumstances have changed for a former customer. Naturally, customers are reminded of renewal dates, but this agent also studies each client's current needs and suggests changes to provide policy coverage better suited to present conditions. He also maintains records on prospective customers that are used for solicitation of new business.

These are just a few examples of particular small businessmen who have made effective use of records other than the standard accounting ones. In any small business a judiciously selected set of records will make possible increased sales, more regular and improved operations, and better customer and public relations.

Paper work and office procedures

When the small businessman first starts his own business, he will always have some paper work, whether his office is merely a table top and a letter file or a separate, well-equipped room. It is necessary to have some organization of the paper work to be performed, such as the writing of business letters, filing of records, opening and sending out of mail, and filling out of orders and invoices. Perhaps the owner-manager will do all of this work himself. If so, he will need to have this paper work so organized that it will not interfere with his obligation to serve his customers. The small businessman who sits back at his desk in the rear of the store checking invoices, writing orders, and so forth during business hours while his customers stand around waiting is sacrificing good will for the sake of work that should be done either during slack periods of the day or after business hours.

In the organization of office procedures, no single important activity that should be performed daily can safely be neglected. Letters must be answered promptly, accounting records must be kept up to date, and all the records necessary for the carrying on of the business should be filed daily.

Records must be arranged so that they will be available when they are needed for reference. The plan for filing each kind of record will depend upon the needs of the business. Correspondence, for example, may be filed alphabetically by name, location, or subject; the most practical method for the small businessman would probably be alphabetically by name. Equipment houses supply standard sets of alphabetical guides that will probably serve the needs of a small business if used with manila folders.

Printed or typed material containing useful information from trade journals, trade associations, or suppliers should be kept for future reference. This material should not be piled on a desk or in a drawer in hopes that it can be found when needed, but should be filed by subject or name in an alphabetical file, for this method might save hours of searching some busy day.

Sales records should be filed at first by customer's name and later, when the business is large enough, by territories. Purchase and pricing records, as well as quotations, could be filed alphabetically by commodity. Catalog indexes can be filed by commodity for easy reference. Mailing lists for advertising pieces should be filed by location.

Personnel records should be kept whether employees number one or fifty. These should be filed alphabetically by name with such material as application letters, letters of reference, social security records, and the like in each employee's folder. When an employee leaves, a notation of his reason for leaving should be made. This information will serve to jog the memory of the owner in case he is asked for a letter of recommendation or the employee again applies for a position with the business.

When a letter or paper might be filed in one of several possible places, the material should be filed in the most likely place and cross reference sheets like the sample one shown below prepared for the other locations. By this simple method of cross referencing, the location of papers can be greatly facilitated.

CROSS REFERENCE SHEET

Name or
Subject: Joe Doakes Date: 8/25/–

Regarding: Complaint

SEE

Name or
Subject: New Supply Company

After the small businessman has been in business for a year or two, his files will begin to grow out of bounds. For the small business, once a year will be often enough to transfer records to inactive files. The decision to retain all records may

be expensive over a period of years, for adequate storage boxes and storage space must be made available. The more general practice for small business firms is to destroy certain material every year. Some general factors have an influence in determining what material should be immediately destroyed and what should be stored. State and federal regulatory bodies have handed down complete instructions regarding the length of time that correspondence and records shall be kept by insurance companies. The Commissioner of Internal Revenue has ruled that, in general, records bearing on income taxes must be kept five years. The statutes of limitations in the various states, relating to the period during which suits may be brought, have much to do with deciding how long to keep records and correspondence concerned with contractual relations. Any record that may be involved in a case of fraud should not be destroyed. Generally speaking, the test of the advisability of transferring or destroying material is the number of references to past material and the need of protection in legal and tax matters.[8]

No discussion of office procedures for the small business would be complete without some mention of office furniture and equipment. If the owner plans to do his own office work, one all-purpose desk will be satisfactory. A double pedestal[9] flat-top desk made from either wood or metal would probably be satisfactory. This desk would have drawers for storing supplies and the flat top could be used for bookkeeping. A suitable office chair should also be provided.

In a small business some type of calculating machine will probably be a good investment, depending upon the amount and complexity of the bookkeeping system used. By talking with experienced men in the business and with suppliers, a

[8] Neuner, John J. W., and Haynes, Benjamin R., *Office Management and Practices,* pages 170–171. Cincinnati, Ohio: South-Western Publishing Co., 1947.

[9] The term "pedestal" used in describing desks refers to whether or not the desk contains drawers on one side of the desk (single pedestal) or on both sides (double pedestal).

suitable machine can be selected. Whether or not the purchase of a typewriter will be necessary will depend on the type of business.

In a small office it is often advisable to send certain work out to agencies, particularly duplication work that cannot be performed economically by the small office staff. There are so-called letter service companies that specialize in typing letters or in mimeographing, multigraphing, or printing material for small concerns that do not have the necessary equipment to do their own work. Prices for a particular type of service can be obtained from several agencies and may then be compared with the probable cost of doing the work in one's own office.

Conclusions

Modern business must be operated on the basis of adequate records. Financial records are necessary to determine *profit or loss, return on investment, owner's equity, assets, liabilities, and other pertinent facts. In addition, good accounting is an important tool of management.* Information obtained from records furnishes the basis for managerial decisions ranging in scope and importance from policy formation or revision down to day-to-day decisions regarding routine operations.

Both financial and closely related records are required for many tax uses. Often federal or state laws require that certain records be kept and that reports based on these records be made. Penalties are imposed for failure to comply with these statutes.

Although financial (or accounting) and tax records were emphasized in this chapter, additional records are desirable in many cases, even in the small business. The more important of these are treated elsewhere in the text in connection with the particular management functions to which they are related.

In the next chapter will be presented illustrations of simplified record systems that include, in addition to the regular accounting records, some used for other activities.

Review and Discussion Questions

1. Why is record keeping not merely desirable but absolutely necessary in modern business?

2. At what point is it desirable to stop increasing the number of records or the amount of detailed information being recorded? Explain.

3. How is the material of this chapter related to that of Chapter XVI, Business Expenses? Discuss.

4. Granting that both are useful, which is more important, the profit and loss statement or the balance sheet? Explain.

5. Why is so little published material available on record keeping for the small factory or service establishment?

6. Look through the trade journals in any of the fields of small business and notice the relative amount of space given to discussions of record keeping. Comment on your findings.

7. In what ways do standard operating ratios of the type referred to in this chapter resemble or differ from other (non-financial) standard operating ratios? Are both types used for the same or for different purposes? How does their use vary among the three major fields of small business? Discuss.

8. What information could be obtained from the balance sheets of a business drawn up at the end of each of ten consecutive years? Could the same information be obtained from the profit and loss statements for these years? Discuss.

9. What records would be most useful to you in deciding whether or not to buy a particular business that is offered for sale? How, if at all, could you verify the accuracy of these records? Discuss.

10. If a business has adequate records, what advantages are there in having an audit of the books made annually by a public accountant?

11. In what ways did the contents of this chapter show the influence of federal and state laws upon the records a business must keep? Would all these records be made unnecessary if the laws you thought of were eliminated? Explain and discuss.

12. How would you use the contents of this chapter in starting a

new business? In justifying a business opportunity? In refinancing a going business?

13. Do all businessmen keep all the records they know they need? Explain.

14. In general, which small businessman is more likely to keep adequate records, the one whose background was primarily in production or the one whose background was in selling? Are you sure? Explain.

15. Investigate several small businesses in each of the three fields —merchandising, manufacturing, and service—to determine the adequacy of their records. Analyze and report your findings and conclusions.

16. In what ways, if any, are the following people interested in the records kept by a particular business: its customers, its suppliers, its creditors, and its competitors?

17. If you were called in to assist a small business that was getting into financial difficulties, explain how you would use records and record keeping.

18. Select a particular kind of small manufacturing or service business and set up a complete system of adequate records for it. Compare your results with material presented in the next chapter.

19. What important records are needed in the small factory but not in the retail store? In the retail store but not in the factory? In either of these but not for the service business, and vice versa?

20. In what respects do the records needed for the proprietorship, partnership, and corporation differ? Discuss.

21. How would customer control be affected by a retail store's using the spring clip method of filing sales checks for charge transactions instead of customer ledgers? Discuss.

Chapter XXI

SIMPLIFIED RECORDS SYSTEMS

When the necessity of keeping a set of accurate records is understood, the question immediately arises, "What type of forms and record books will I need and where shall I get them?" Most businessmen know that stationery stores carry a large variety of material for bookkeeping purposes. The beginner will be perplexed to find bound cash receipt books, cash payment books, cash record books, bound ledgers, bound journals, loose-leaf journal sheets, loose-leaf ledger sheets, and all other kinds of fiscal and accounting records that are used by various firms, from the smallest individual business to the largest corporation. Forms that have been developed by manufacturers for use by dealers in certain fields will be discussed later. By carefully studying the needs of his particular business and comparing them with results obtainable from the various record books available, one can choose without much trouble the set of books that will most nearly fill his needs.

Since the advent of social security taxes and a more exacting income tax, stationery and accounting record designers have devoted a great deal of research toward the perfection of simple bookkeeping record systems that enable the small business manager to maintain an accurate set of books containing all of the information needed for various tax purposes. As a result he will probably find in the nearest stationery store several different kinds of so-called "one-book" records in which all the normal transactions of the typical small business can be recorded. These systems vary somewhat in detail but are similar in principle, and all are rather inexpensive.

A commonly found example of these systems is known as

the "All-Facts Improved Bookkeeping System."[1] This is a one-book system that conforms to approved bookkeeping principles but is so simplified in form that bookkeeping experience is not required to use it. Specimen entries, accompanied by detailed instructions, demonstrate the use of the columnar journal. The journal columns are numbered in such a manner that they may be easily transferred to similarly numbered summary forms from which the amounts used in the profit and loss statement are taken. The book, which may be obtained in either loose-leaf or bound form, contains 50 double-page cash journal forms; four pages of summaries, including profit and loss statement and balance sheet; one page for asset and depreciation record and mortgage and loan record; and four pages for savings records for eight employees. It is a complete cash-journal plan, designed to assist the operator of a small business in keeping accurate records of every transaction and to have available information to simplify the making of income tax returns. Although the system was designed for the small business, it is based on the procedure used by all large companies. It is complete because it can be balanced without any adjustments and can be used for either cash or accrual basis bookkeeping.

On pages 699 through 704 are reproduced specimen pages taken from the "All-Facts" system, showing typical daily transactions and the proper method of making entries to record these transactions. It will be noticed that the journal pages are divided into four divisions: cash received, cash paid out, merchandise sales, and purchases and expenses. The cash received section is designed to show the total amount of cash received from all sources and, likewise, to show a distribution of this cash by source of receipt. For example:[2]

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[1] Distributed by the Wilson Jones Company, 3300 Franklin Blvd., Chicago 24, Illinois. Plates for Figures XIII through XVIII in this chapter were provided by Wilson Jones Company.

[2] The first person plural is used in this section to make the examples clearer to the reader.

Cash sale receipts. On January 2, our receipts from cash sales were $41.00. This amount is entered in Net Amount, column (1), and also in Cash Sales, column (2).

Charge sale receipts. On January 2, Hill Bros. paid us $5.00 for merchandise purchased on December 5. This amount is entered in Net Amount, column (1), and also in Charge Sales, column (3). The date of sale is entered in the Memo column.

Interest received. On January 6, Mr. C. J. Clark paid us $1.50 interest on his note of November 6. This amount is entered in column (1) and in Interest Received, column (4).

Other receipts. On January 6, we made a loan of $250.00 at the National Bank. This item is entered in column (1) and in Other Receipts, column (6).

Other income. On January 7, we received $1.20 from the sale of paper and rags. This amount is entered in column (1) and in Other Income, column (5).

Discount allowed. On January 8, John Jones paid us for merchandise amounting to $10.00 and took advantage of a 2 per cent discount for payment in 10 days. The amount of the original charge of $10.00 is entered in column (1) and the discount of $0.20 is entered in Discount Allowed Customers, column (7).

The total of columns (1) and (7) will balance with the total of columns (2) to (6) when entries have been made correctly.

A column to keep a record of bank deposits is provided to the right of the cash received section. The day on which the deposit is made should be written in the date column and the amount of deposit entered in Amount, column (8).

The cash paid out section is designed for the entry of all cash disbursements and shows the total amount paid, whether by cash or check. In the case of payment by check, the check number is entered in the designated column.

No entry can be properly made in this section unless the amount and its distribution have been previously entered in the sales, purchases, and expenses section, although this requirement does not apply to personal drawings and other payments not provided for in the latter section. When payment is made, the full amount of the purchase or expense is

entered in By Cash, column (9), or By Check, column (10); and the discount, if any, is entered in Discount Allowed Us, column (12).

Personal drawing. The income tax law does not permit salary of the proprietor or partners of an unincorporated concern to be considered as salary or wages. Therefore, such payments should be recorded as personal drawings. On January 16, Mr. A. Smith, one of the proprietors, drew $42.00. This amount is entered in By Check, column (10), and Personal Drawings, column (14) or (15).

Payment on note. On January 16, a payment of $50.00 on a note was made by us to the National Bank. This amount is entered in By Check, column (10), and Other Payments, column (13).

The total of columns (9), (10), and (12) will balance with the totals of columns (11), (13), (14), and (15) when entries have been made correctly.

We now come to the sales, purchases, and expenses section of the cash journal forms. The merchandise sales division provides columns for entering cash sales in column (16), charge sales in column (17), and returns or allowances in column (18). When payment is received on a charge sale entered in this section, an entry is made in the cash received section. Bad debts written off should be recorded in the same manner as allowances in column (18) and earmarked as bad debts for use in preparation of income tax returns.

In order to have readily available information as to the unpaid balance of individual customer's charge accounts, it is advisable to keep a simple file of duplicate charge sales slips. When the amounts on these slips have been fully paid, they should be removed from the active file.

All purchases and expenses are entered in Total Amount of Purchase, column (19). When these amounts are paid, the date is entered in the date paid column. This will indicate the amount of unpaid bills outstanding at any time. When payment is made, an entry is made in the cash paid out section.

The distribution division provides columns for the distribu-

tion of all purchases and expenses under their proper headings in columns (20) to (31). For example:

Merchandise for resale. On January 2, we purchased merchandise from Blank Mfg. Co. amounting to $45.00. This amount is entered in column (19) and in Merchandise for Resale, column (20).

Desk for office. On January 2, we purchased a desk from General Fixture Co. for $50.00. This amount is entered in column (19) and Equipment, column (30).

Express charges. On January 2, we paid the Star Express Co. $1.00 for express charges. This amount is entered in column (19) and Express, Freight, and Cartage, column (21).

Returns or allowances. On January 6, we received a credit for $5.00 from Blank Mfg. Co. for merchandise we had returned. This amount is entered in Returns or Allowances, column (31).

Interest. On January 8, interest amounting to $6.00 was paid by us to the National Bank. This amount is entered in column (19) and Interest Paid, column (28).

Payroll payment. On January 15, our payroll amounted to $175.00, but $15.20 for Withholding Tax and $1.75 for Old Age Benefit Tax were withheld. Therefore, the payroll requires three entries as follows: $158.05 as payroll to employees, $15.20 as Withholding Tax, and $1.75 as O.A.B. Tax. These items are entered in column (19) and Salary and Wages, column (22). Another entry of $1.75 as the employer's O.A.B. Tax is made in column (19) and Tax, column (26). If desired, the Withholding and O.A.B. Taxes may be accumulated and one entry made at the end of each month for all deductions made from that month's payrolls.

Sales tax. On January 15, we made a payment to the State Treasurer of $19.65 for sales tax. This amount is entered in column (19) and in Tax, column (26).

The totals of columns (20) to (30) will balance with the total of column (19) when entries have been made correctly.

The totals for each column in the journal should be carried forward from page to page until the end of the month. A new page should then be opened for the beginning of the next succeeding month. The monthly totals are entered in the summary sheet provided at the back of the book.

These summary sheets are for the most part self-explanatory. Their purpose is to provide yearly totals of income and expense and, likewise, monthly balances of certain assets and liabilities. The amounts to be entered under these summaries are readily obtainable from the monthly totals of the cash journal pages. Each column in the cash journal pages and summary sheet is identified with a column number to facilitate the transfer of amounts.

A profit and loss statement is set up in conjunction with the summaries. The amounts to be entered on this form are obtained from the summaries of "sales" and "expenses." The proper column for entering the amount of each account is indicated by an (X). The profit and loss statement is arranged in such a manner as to simplify the transfer of amounts to the income tax return. The amounts to be transferred are indicated by a star.

A form of balance sheet will be found with the profit and loss statement. The amounts are readily obtainable from the monthly summaries or analysis of the accounts. The difference between total assets and total liabilities equals the "proprietary interest" or "net worth" of the business. Net worth at the beginning and at the end of any one year must be consistent with the results recorded on the Income Account as shown in the following example:

Net Worth, beginning of year		$4,542.80
Net Income, for the year	$3,924.12	
Deduct Capital Withdrawals	3,000.00	$924.12
Net Worth, end of year		$5,466.92

Although the "All-Facts" system of records would probably be sufficiently flexible for most small businesses, a certain business might be of such a special nature or might have such characteristics that it would require additional accounts or a special type of report for which the information needed would not be readily obtainable unless provided for in the accounting

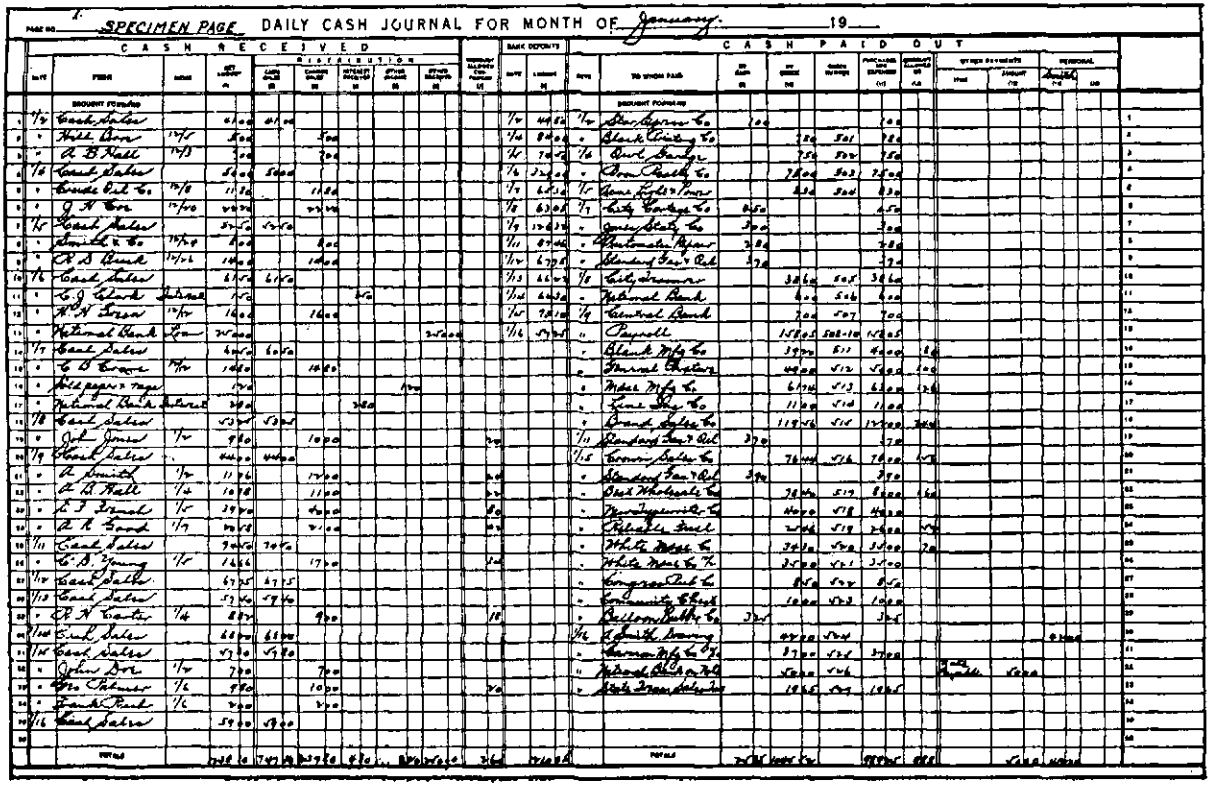
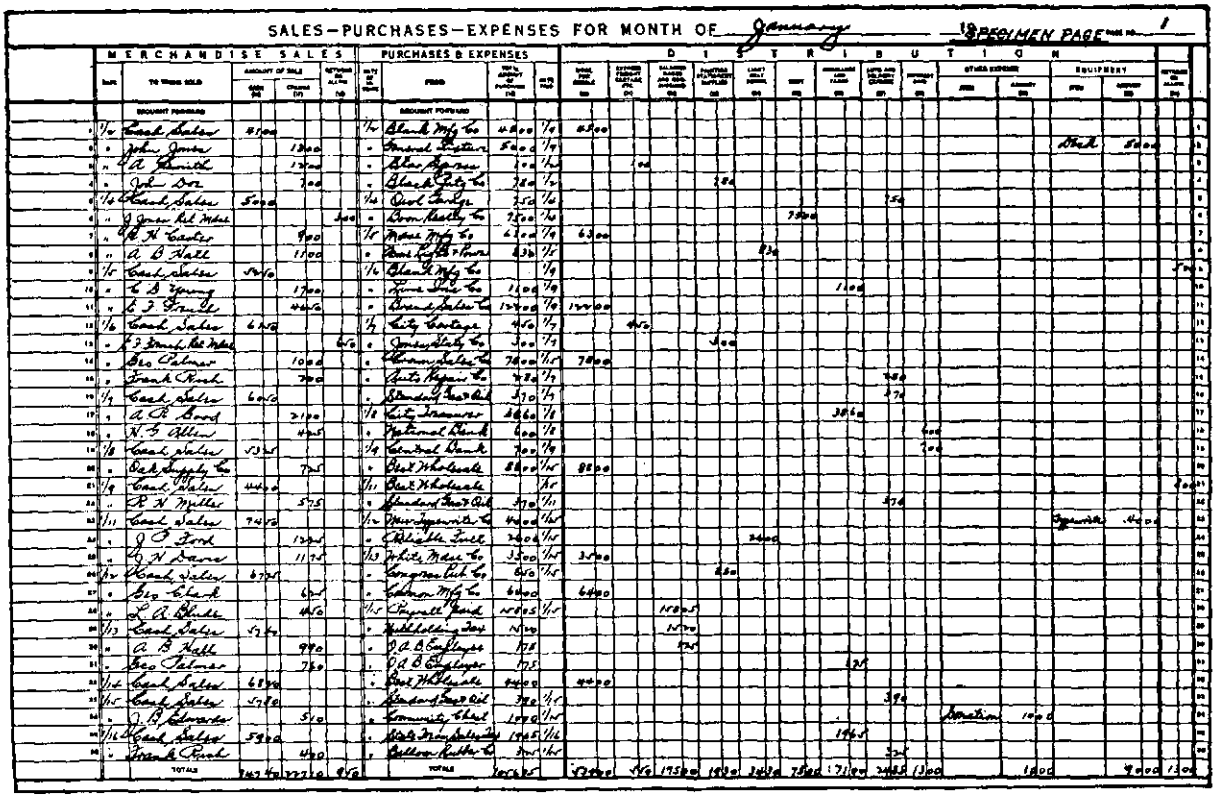

PAGE NO. 1.
SPECIMEN PAGE
DAILY CASH JOURNAL FOR MONTH OF January 19
CASH RECEIVED
Distribution
CASH PAID OUT
Bank Deposits
Purchases and Expenses
Merchandise Returned
Office Salaries
Personal
Drawings
Sundry Accounts
Cash Sales
Charge Sales
Interest Received
Other Sales
Other Receipts
Discount Allowed
Amount
To Whom Paid
Check No.
Bank Charges
Discount
Amount Forwarded
Totals

Figure XIII.


SALES—PURCHASES—EXPENSES FOR MONTH OF January 19 SPECIMEN PAGE PAGE NO. 1

MERCHANDISE SALES

	DATE	TO WHOM SOLD	AMOUNT OF SALE CASH	AMOUNT OF SALE CHARGE	RETURNS AND ALLOWANCES
		AMOUNT FORWARD			
1	1/2	Cash Sales	1100		
2	"	John Jones		1300	
3	"	A Smith		1700	
4	"	Jol Doe		700	
5	1/6	Cash Sales	5000		
6	"	J Jones Ad Misc			400
7	"	W H Castle		900	
8	"	A B Hall		1100	
9	1/8	Cash Sales	5476		
10	"	G B Young		1300	
11	"	E J Fowler		4476	
12	1/6	Cash Sales	6476		
13	"	E J Smith Ad Misc			676
14	"	Geo Palmer		1000	
15	"	Frank Hunt		700	
16	1/7	Cash Sales	6476		
17	"	A R Bond		2100	
18	"	N F Allen		425	
19	1/8	Cash Sales	5376		
20	"	Park Supply Co		725	
21	1/9	Cash Sales	4476		
22	"	F N Miller		575	
23	1/11	Cash Sales	7476		
24	"	J C Ford		1325	
25	"	J N Davis		1176	
26	1/12	Cash Sales	6725		
27	"	Geo Clark		625	
28	"	L A Blake		476	
29	1/13	Cash Sales	5776		
30	"	A B Hall		990	
31	"	Geo Palmer		789	
32	1/14	Cash Sales	6876		
33	1/15	Cash Sales	5776		
34	"	J B Edwards		576	
35	1/16	Cash Sales	5900		
36	"	Frank Hunt		490	
		TOTALS	143476	77776	876

PURCHASES & EXPENSES

	DATE	PAID	TOTAL AMOUNT OF CHECK	DISC'T
		AMOUNT FORWARD		
1	1/2	Black Mfg Co	4800	1/2
2	"	Standard Position	500	1/2
3	"	Allen Express	100	1/2
4	"	Black & City Co	700	1/2
5	1/3	Quick Cartage	250	1/2
6	"	Crown Realty Co	7200	1/2
7	1/5	Mains Mfg Co	6300	1/2
8	"	Penn Light & Power	836	1/2
9	1/6	Black & Mfg Co		1/2
10	"	Home Store Co	1100	1/2
11	"	Grand Sales Co	13700	1/2
12	1/7	City Cartage	450	1/2
13	"	Independent Co	300	1/2
14	"	Crown Sales Co	7000	1/2
15	"	Quick Repair Co	450	1/2
16	"	Standard Trust Co	370	1/2
17	1/8	City Insurance	3860	1/2
18	"	National Bank	600	1/2
19	1/9	Central Bank	700	1/2
20	"	Best Wholesale	8800	1/2
21	1/11	Best Wholesale		1/2
22	"	Standard Trust Co	370	1/2
23	1/12	New Ingersoll Co	4400	1/2
24	"	Eastside Fuel	3400	1/2
25	1/13	Atlas Mfg Co	3300	1/2
26	"	Longview Oil Co	650	1/2
27	"	Carlson Mfg Co	6400	
28	1/5	Cornell Bank	11805	1/2
29	"	Middleton Box	1170	
30	"	O A B Employes	975	
31	"	O A B Employes	975	
32	"	Best Wholesale	8400	
33	"	Standard Trust Co	370	1/2
34	"	Community Store	1270	1/2
35	1/14	A&B Manufacturing	1965	1/2
36	"	Bellows Rubber Co	370	1/2
		TOTALS	107685	

DISTRIBUTION

	WAGES PAID OFFICE	EXPENSES DIRECT & ELECTRIC	SALARIES SALES AND DEL.	PURCHASES MATERIAL SUPPLIES	LIGHT GAS & POWER	RENT	INSURANCE TAXES & LICENSES	REPAIRS AND MAINTENANCE	INTEREST	OTHER EXPENSE ITEM	OTHER EXPENSE AMOUNT	EQUIPMENT ITEM	EQUIPMENT AMOUNT	RETURNS & ALLOW.
1	6300											Desk	5000	
2														
3		100												
4				700										
5									150					
6						7900								
7	6300													
8					836									
9														500
10							1100							
11	12700													
12		450												
13				300										
14	7000													
15								750						
16								370						
17							3860							
18									600					
19									700					
20	8800													
21														700
22								370						
23												Typewriter	4400	
24					3400									
25	3300													
26				650										
27	6400													
28		11805												
29		1170												
30		975												
31		975					1275							
32	8400													
33								370						
34										Janitor	1200			
35							1965							
36								370						
	132700	4500	1950	1950	2436	7900	7100	2480	1300		1800		4900	1200

Figure XIV.

SUMMARIES
CASH RECEIVED
MERCHANDISE SALES
EXPENSES
PERSONAL
PROFIT AND LOSS STATEMENT
BALANCE SHEET
ASSETS (OWNED)
LIABILITIES (OWED)
TOTAL RECEIPTS FOR THE YEAR
LESS ALLOWANCES AND RETURNS ON SALES
TOTAL NET RECEIPTS
MERCHANDISE INVENTORY BEGINNING OF YEAR
MERCHANDISE BOUGHT FOR SALE
TOTAL
LESS MERCHANDISE INVENTORY AT END OF YEAR
NET COST OF GOODS SOLD
GROSS PROFIT
Business Deductions
SALARIES, WAGES, COMMISSIONS, ETC.
INTEREST ON BUSINESS INDEBTEDNESS
INSURANCE AND TAXES
LOSSES
BAD DEBTS
DEPRECIATION
RENT, REPAIRS, ETC.
EXPRESS AND FREIGHT
PRINTING AND STATIONERY SUPPLIES
LIGHT, HEAT AND POWER
AUTO AND DELIVERY EXPENSE
OTHER EXPENSE
TOTAL RENT, REPAIRS AND OTHER EXPENSES
TOTAL BUSINESS DEDUCTIONS
NET PROFIT AND LOSS
THESE AMOUNTS ARE USED FOR INCOME TAX RETURNS
Cash on Hand
Cash in Bank
Merchandise Inventory
Accounts Receivable
Real Estate—Land
Buildings
Furniture and Fixtures
Delivery Equipment
Other Assets (Specify)
TOTAL ASSETS
Notes Payable
Accounts Payable
Mortgages, etc.
Other Liabilities (Specify)
TOTAL LIABILITIES, ETC.
Proprietor's Interest or Net Worth

Figure XV.

SUMMARIES
CASH ACCOUNT
JANUARY
FEBRUARY
MARCH
APRIL
MAY
JUNE
JULY
AUGUST
SEPTEMBER
OCTOBER
NOVEMBER
DECEMBER
BALANCE
BANK ACCOUNT
RECEIVABLES
PAYABLES
LOANS & MORTGAGES
EQUIPMENT
INVENTORY—SET WORTH

Figure XVI.

Figure XVII.

Figure XVIII.

and records system. If the owner failed to find the type of record that would meet his needs in such a case, it would be a relatively easy matter to purchase ruled columnar sheets in blank and supply his own headings. By doing this, he could make his records as simple or as complex as desired. For instance, the following form represents utter simplicity:

Date	*Remarks*	Cash Receipts		Cash Payments			
		Cash Sales and Rec'd on Acc't	*Other Income*	*Mdse. for Resale*	*Operating Expenses*	*Other Payments*	
						Account	*Am't*
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)

These columns would be used as follows:

(a) Enter the date on which the transaction took place.

(b) Write a brief description of the transaction.

(c) Enter total cash receipts from cash sales and customers' payments on account. This could be entered as one total for the day's transactions on one line, or, if desired, individual entries could be made on separate lines under the same date.

(d) Enter any other cash receipts in this column.

(e) Enter total amount (or individual amounts) spent during the day by cash or by bank check for merchandise for resale.

(f) Enter total payments (cash or check) for expenses.

(g) Write in this column the nature of any other payment made which could not be classified under (e) or (f).

(h) Enter amounts of items listed in column (g).

This simple record, if well kept, would provide the small operator with general information and would be better than no records at all. However, it has serious limitations, for it lacks columns that an owner will need from time to time to record other transactions. For example, if he extends credit, it will

be almost necessary for him to have two columns in the journal for customers' accounts, one for charges and one for credits. Otherwise, this information will have to be laboriously scheduled from the customers' tickets each time he needs to know his total accounts receivable. Similarly, a column should be provided for creditors' accounts payable—that is, accounts representing bills owed but not yet paid by the firm.

If he is operating a business with several departments (such as grocery and meat, grocery and filling station, and the like), it will be almost necessary for the owner to set up in the column for sales a subcolumn for each department. Similar subcolumns for purchases of merchandise for resale would also be needed. Dividing the operating expense column (f) illustrated on the simple record into a dozen or more frequently recurring expense accounts would eliminate the necessity of spending weary hours in separating and tabulating the expenses for income tax return or other purposes. Some of these expense accounts would be: wages of sales clerks, owner's salary, office supplies (postage, stationery, blank forms, and so on), advertising, donations, store supplies (wrapping paper, twine, soap, towels, and so forth), telephone and telegraph, delivery expense, rent, repairs, utilities, insurance, taxes, interest expense, cash shortages, licenses, social security taxes, sales taxes, and various items not definitely classified that will be placed in the miscellaneous account. At the end of the accounting period, such expenses as depreciation and bad debts are closed off as expenses even though they do not represent actual cash disbursements.

In deciding what type of records system to use, certain points should be taken into consideration regardless of whether it is a simplified system already designed and printed or a system designed by the owner for use in his own particular business. These will vary with the type of business, possibly with the location, and with other factors, but the following discussion should bring to mind some points of general applicability:

A storekeeper in Pittsburgh had what he described as "the world's best accounting system"—a roll of money in his pocket. If it shrank, he figured that he was losing money; if it grew, he believed that his business was profitable. That was all he thought he needed to know. That merchant was in business. He is not in it now!

Why does only one in six merchants make a satisfactory profit? Why do most of them fail within the first five years?

Studies by competent authorities show that one thing common to most retail failures is poor record-keeping. One thing that is common to successful stores is a system of adequate records.

What the proper set of records should do—The type and number of records needed and the methods to use to get and keep them present a problem. Two factors must be kept in mind:

(1) The record system must be simple, workable, and practical.
(2) The time required to maintain the system must not be so great as to disrupt or disturb the merchant's main duty—that of buying and selling merchandise.

Information should be ample and correct, with records legible. The system should be orderly, with records at hand when needed.

Records that provide the right information will make the running of your store a pleasure. Lost time, mistakes, forgetfulness, carelessness, and many past troubles will disappear. When your bank and your wholesaler realize that you have things in hand, they will have a higher regard for you. Nothing adds so much to a merchant's rating as an efficient record-keeping system.

Records needed for profitable management:

1. Cash:
   - Cash sales
   - Cash received on account from customers
   - Cash paid out
   - Cash on hand and in bank
   - Cash deposited in bank
   - Cash withdrawn from bank

2. Sales:
   - Cash
   - C.O.D.
   - Charge
   - Outstanding accounts

Margins required
Sales by departments
Sales by salespeople
Average sale

3. Departments:
   Sales
   Inventory
   Expenses
   Margins required
   Customers served
   Average sale per customer
   Average cost per customer

4. Employees:
   Sales by each salesperson
   Customers served by each
   Average sale per customer per salesperson
   Average cost per customer per salesperson

5. Customers:
   Total customers served in store and in each department
   Customers served by each salesperson
   Average sale per customer for the store
   Average sale per customer per department
   Average sale per customer per salesperson
   Average sale cost per customer for the store
   Average cost per customer per department and per salesperson

6. Purchases:
   Cash purchases
   Purchases on account
   Invoices received
   Bills paid
7. Assets which the business owns
8. Liabilities which the business owes
9. Expenses:
   For the store
   By departments.[3]

[3] Small Business Aids, No. 302, U. S. Department of Commerce, "Profit from Store Records." Condensed from "Profit from Store Records." One of 17 booklets making up the handbook *Better Retailing*, 1941, Dayton, Ohio, National Cash Register Company.

Many small business managers keep their own books. If the business is small and the owner does not have to spend all his time in managerial duties, he may find that he can economize on office salaries by recording his business transactions daily and keeping his records posted up to date. At the end of the year it is a small matter to have a local accountant prepare the financial statements and income tax returns. There are small accounting establishments in almost every community that specialize in the preparation of periodic reports from the books of small business enterprises.

If the owner does not have the time to take care of his own accounting and record keeping or if he feels that it would be better to have it done by someone who is more familiar with accounting problems, it is usually possible to secure the services of a local bookkeeper on a part-time basis for a nominal fee. This bookkeeper will keep all transactions entered and books posted and will render periodic reports that reflect the operations of the business for the period and the condition of the business at the end of the period. Subscribing to the part-time services of local bookkeepers or public accountants is many times to the advantage of an owner, for they keep up to date on the latest tax information and requirements as a service to their clients and are therefore in a position to save money for them through the benefit of deductions and exemptions of which the manager may be unaware. Many such instances have occurred in connection with the preparation of income tax returns by accountants who specialize in tax work.

Retail Method of Inventory

A widely used method common in department and specialty stores for determining the cost value of the inventory without taking a *physical* count is the retail method of inventory valuation. This technique has been approved by the Treasury Department for income tax purposes.

The retail method is suitable for use by any store or department that has as its primary function the selling of merchandise

without processing or alteration. In addition to providing a closing inventory at "cost or market whichever is lower," it is a means of maintaining a perpetual merchandise inventory and of keeping records of markdowns, additional markups, and employee discounts. It also discloses stock shortages when the physical inventory is compared with the book inventory. However, our concern here is with its use for inventory valuation.

The beginning inventory and all subsequent purchases are recorded at both cost and retail prices (see Table 17). Freight and express charges are added to the cost column and net markups are added to the retail column. The resultant column totals are the cost and retail prices of goods available for sale during the period. The *cost* value of this merchandise is then deducted from the *retail* value to get the markup in dollars. Dividing the markup in dollars by the *retail* value of the merchandise available for sale and multiplying by 100 will result in the markup as a percentage.

TABLE 17

THE RETAIL METHOD OF INVENTORY VALUATION

		Cost	*Retail*
Beginning Inventory		$27,000	$ 45,000
Purchases		49,400	76,000
Add Freight and Express (cost column only)		460	
Add Net Markups (retail column only)			1,000
Goods Available for Sale (at cost and at retail)		$76,860	$122,000
Markup (retail minus cost)	$45,140		
Markup of $45,140 divided by merchandise at retail of $122,000 = 37 per cent markup			
Net Sales	$50,000		
Add Markdowns, Discounts to Employees, and Shortages	3,000		
Goods Sold or Disposed of (at retail)			53,000
Retail Value of Goods on Our Shelves			69,000

Cost percentage (100 per cent minus 37 per cent)		.63
Inventory at Cost	43,470	
Cost of Goods Sold (cost of goods available for sale minus inventory at cost)	$33,390	
Net Sales	$50,000	
Deduct Cost of Goods	33,390	
Gross Margin	$16,610	

Our next step is to add markdowns, discounts to employees, and shortages, in dollars, to net sales in dollars for the period. This sum, representing the retail price of the goods we have sold or disposed of otherwise, is then deducted from the total retail price of the goods available for sale to give us the *retail* price of goods still on our shelves. The *cost* price of these goods is our objective. The retail price is multiplied by the cost complement of the markup per cent (100 minus per cent markup) to give us the figure for this ending inventory at cost.

Cost of goods sold is easily calculated by deducting the inventory at cost from the cost of goods available for sale. The explanation is that from the total cost of goods available for sale we have deducted the cost of goods still on our shelves, the resulting figure being the cost of goods we have sold or disposed of.

It will be noticed that the markup percentage used (37 per cent) was calculated without including markdowns, discounts, and (estimated) shortages, but these were added to sales as recorded to get the total value at retail of goods disposed of. Therefore, the calculated cost value of the closing inventory is less than actual cost, and this is proper because some of the goods were marked down. If, however, the price trend had been upward and additional markups (rather than markdowns) had been taken, these *would* be included in calculating

the markup percentage and the calculated cost would more closely approximate actual cost.

Service Records

A third type of record system not properly classified elsewhere may be illustrated by the records needed for a repair service.

Certain kinds of business in each of the three main fields must meet the repair problem. Manufacturers may have their products returned to the factory for repair or in certain cases may furnish repair service at the customers' locations. Merchants handling items like household appliances, radios, furniture, and jewelry must make provisions for necessary repairs after the product has been sold. The need may arise either before or after a guarantee period has expired. If the former, repair costs will be borne by the merchant or charged to the manufacturer. Where and by whom such repairs are made is a matter of policy and agreement with the manufacturer.[4] In any case, records are needed to handle the transactions efficiently, to prevent loss of goods, and to assure collection from the customer or manufacturer. Finally, an important segment of the service field is that concerned with repair services of various kinds.

The simplified system described here is adapted from the Westinghouse "Accurate Service Record System"[5] but could be used with proper alterations by other types of business.

Sale and installation dates usually determine the status of a guarantee and this in turn determines who is to bear the cost of repairs. This information is also useful to a merchant who may be called upon to repair or service goods purchased from him without any specific guarantee. Most retailers want to

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[4] Lawyer, Kenneth, *Manual of Small Business Operation*, Chapter XXXIX. New York: Prentice-Hall, Inc., 1946.

[5] *Service Operating Manual for Westinghouse Dealers*, pages 7–10. Mansfield, Ohio: Westinghouse Electric and Manufacturing Company, 1942.

make good any merchandise defects but should not be expected to provide maintenance against normal wear and tear.

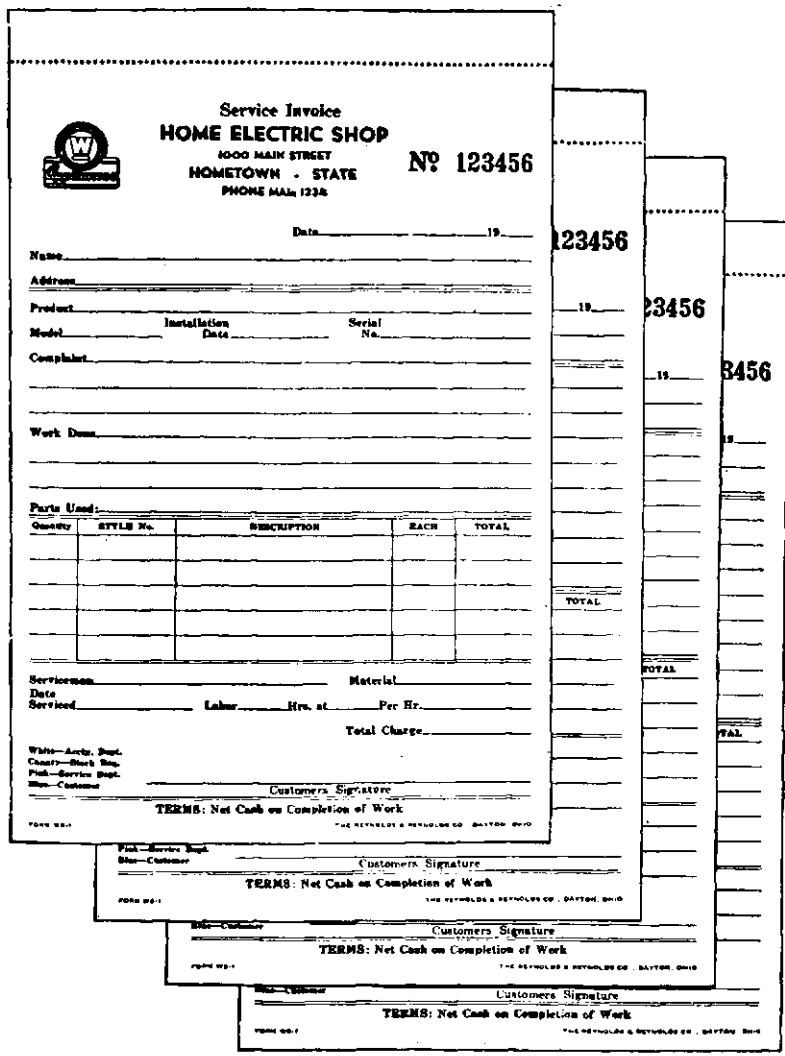


Figure XIX. Service orders and parts sales.

A complete record should be kept of each service call or of all work done on articles brought in for repair. Figure XIX

shows a combination work sheet, internal order sheet, invoice form, and customer acceptance. It is prepared to keep accounting and other record keeping simple. By using four copies—one each for the bookkeeper, the service man, stock control, and the customer—the same record serves four purposes. Procedures for using this record are explained in the Westinghouse manual, page 9, as follows:

General—A serially numbered, snap-out form (see figure XIX) should be used to handle service orders and part sales from the stockroom. It should be a four part set with interleaved, one time carbons. The ultimate disposition of each copy should be:

Original—Bookkeeping department.
1st copy—Parts requisition.
2nd copy—Service department.
3rd copy—Customer's copy.

Service Orders—The service order should be partially filled out at the time the service call is received. The information to be recorded at that time should include:

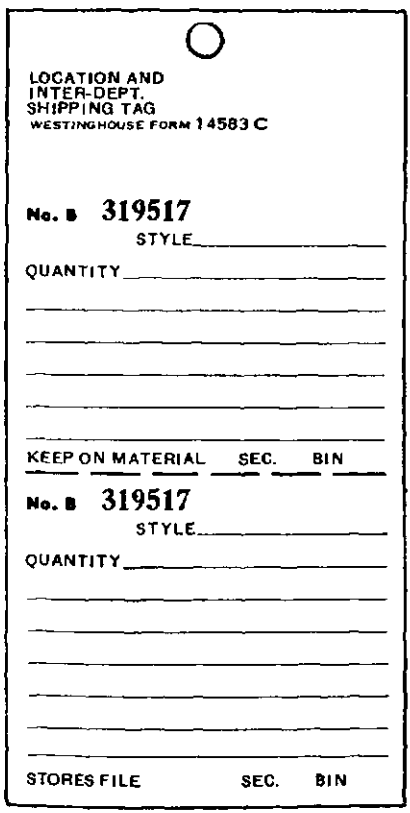
1. Date call received.
2. Customer's name and address.
3. Name and address of party to be charged.
4. Product to be serviced.
5. Installation date, model and serial number.
6. Nature of the complaint.
7. When free service, mark no-charge (NC) on line provided for total charge.

The order numbers should be recorded on a check sheet, prepared in duplicate, and all copies of the orders and a copy of the check sheet obtained of each service order and the date it was forwarded to the service department.

The service department records the name of the service man to whom the order has been assigned in the column "Charge To" in their copy of the check sheet.

When the call has been completed by the service man, he notes on the order the work done, lists any parts used, signs in the space

provided, marks the date service was rendered, inserts the number of hours, and obtains the customer's signature. If it is a charge call, he marks the price of parts used, inserts labor rate per hour, calculates labor charge and figures total charge. Before giving the customer a copy of the order, the service man marks the orders on charge calls either, (a) by initialing in the columns provided if cash is received, or (b) by marking in the same space "Bill Above" when cash is not collected.


LOCATION AND
INTER-DEPT.
SHIPPING TAG
WESTINGHOUSE FORM 14583 C

No. B 319517
STYLE
QUANTITY

KEEP ON MATERIAL SEC. BIN

No. B 319517
STYLE
QUANTITY

STORES FILE SEC. BIN

Figure XX. Bin card.

The service man turns the original copy in, together with the cash collected. The stock requisition copy of the order is turned in to the store room to replenish any parts that may have been used.

The service department records receipt of completed orders on the check sheet and issues an invoice on those orders marked "Bill Above." The date service was rendered and the order number are recorded on the user's card and orders are then filed in a binder by order number.

To Obtain Parts from Stock—The stock requisition copy of the order is turned in at the storeroom by the service man to replenish his car stock for any parts that were used.

An adequate supply of essential repair parts is necessary to render efficient service. Figure XX shows a simple bin card to help maintain this inventory. When parts are added to the bin

stock, the amount is added to the bin tag, and the process is reversed as parts are removed. Figure XXI illustrates a return material tag useful when returning parts or materials to the distributor or factory. This identifies the part and expedites repair, return, or credit.

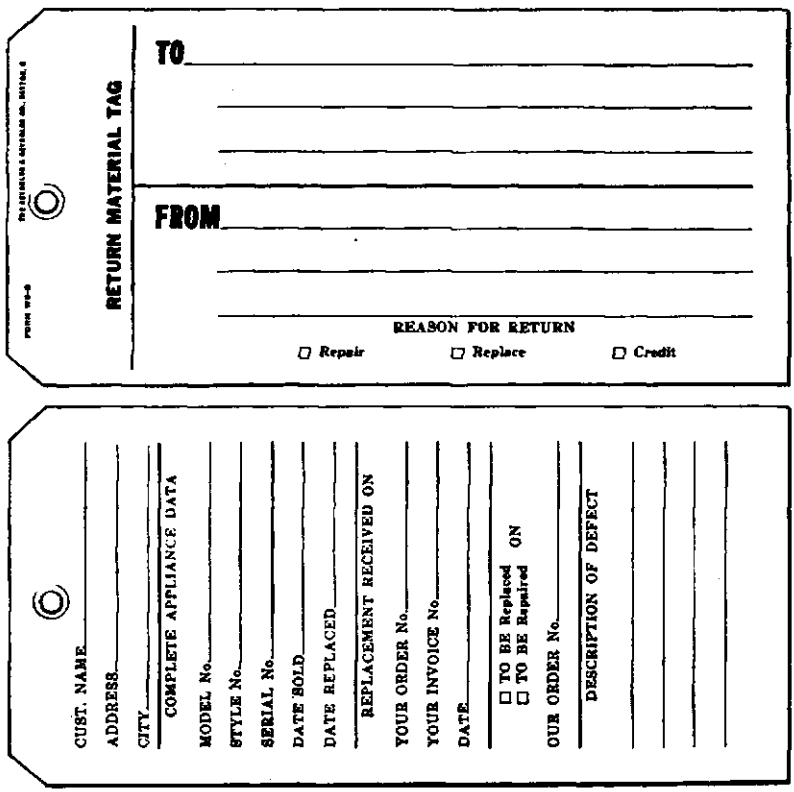


Figure XXI. Return material tag (front and back of form).

It is a good practice to establish standard appliance repair charges for as many run of the mine repairs jobs as possible. This will not only establish a fair profit basis for your repair work, but will help your bookkeeping department and increase customers' confidence in the fairness of your service charges.[6]

[6] *Service Operating Manual for Westinghouse Dealers,* page 8. Mansfield, Ohio: Westinghouse Electric and Manufacturing Company, 1942.

Dealers and merchants rendering repair service on most kinds of mechanical products may secure suggested customer charges for recurring types of repair jobs. Whether followed exactly or not, these lists are useful guides.

For each type of business certain additional records may be needed. Even though a situation in a particular business is out of the ordinary, sufficient thought given to planning the essential records will usually lead to the development of a simplified system like those illustrated throughout this chapter.

Conclusions

Keeping the necessary records for a small business need be neither complicated nor time-consuming. Simplified record systems have been developed for recording the essential accounting information needed, such as the one-book system described in the chapter. Whenever certain transactions occur frequently as do sales in a retail store or service calls in a repair shop, the necessary recording can be reduced to a simple system. When the transaction is common to other businesses in the field, prepared record keeping systems are usually available from either local stationers or suppliers.

Since a strong urge to keep accurate and complete records does not seem to be characteristic of most small businessmen, *the owner-manager should be on guard against neglect of this important function.* To make it easy to maintain essential records, the system installed should be as simple as possible, provided it does the job. At the start, at least, this may justify seeking competent advice or even employing a specialist to select the best system and get it started properly.

The owner should remember that *in the long run time spent in keeping adequate records actually saves time* that would otherwise be necessary to secure essential information required for measuring progress, paying taxes, or financing. The results will be more accurate and the efficiency and profitableness of the business will tend to increase when decisions are based on

reliable information that is available only through a system of adequate records.

Review and Discussion Questions

1. Select a particular business in each of the three major fields and list any accounting (financial) information that would not be available for each if only the one-book system were used. Discuss.

2. Visit a local stationery and office supply store to see what simplified record systems are available. What systems are designed for such special purposes as keeping certain tax records, production control in the factory, and identification of each customer's goods in the service establishment? What conclusions do you draw from your investigations?

3. Design a simplified record system that would provide for each of the following situations:

(1) Lay-aways of seasonal goods that would be of no value after the end of the season.

(2) A drawing account against commissions and bonuses earned for salesmen who are paid a weekly salary plus 5 per cent commission on all sales in excess of $50 per day, plus an additional bonus of 10 per cent on all sales in excess of $75 per day. Commissions are paid each Thursday for the preceding week, and bonuses are paid on the first Tuesday of each month for the preceding month's sales. In each case only the excess of commissions or bonuses earned above the amount already drawn by the salesmen is paid. Salesmen are limited to a maximum of two drawings per week.

(3) A sample expense survey to compare the actual markdowns as a percentage of the first price at which goods in a department are sold. Items are divided into two groups: (a) returned goods and (b) all other merchandise sold during the same six-month period.

(4) A summary report of all customer complaints received during a six-month period for:

(a) a retail clothing store (men's and women's apparel), (b) a laundry and dry cleaning establishment, and (c) a factory making a variety of non-seasonal toys.

4. Visit a grocer and a druggist each doing a credit business and

make a comparative study of their record systems. What conclusions do you draw?

5. Compare the Westinghouse service record system discussed in the chapter with the repair service record system used by a local service garage and the largest local furniture store. Comment on the results.

Chapter XXII

SMALL BUSINESS AND THE FUTURE

The future of American small business has never been more encouraging. Trends and problems discussed in the text have both contributed to this condition. The trend of expanding interest has been supplemented by a growing effort to secure more facts about independent enterprisers and their problems and needs.[1] One result of the findings of such investigations has been to expand training for owner-management. A second has been to make more and more agencies, such as schools of commerce and business administration, vocational education administrators, manufacturers, and other business organizations, aware of their responsibilities to present and prospective small businessmen.

Another significant development has been the high failure rate of many small concerns that were started during the post-World War II influx by inadequately prepared individuals. This has not only left those who survived the early "recession" on a sounder basis, but has also emphasized the importance of adequate preparation *before* undertaking business ownership. Accompanying the increase in failures of many ill-advised small businesses have been reports of the outstanding success achieved by other well-managed small enterprises.[2] Both the more

[1] For further study see Kelley, Pearce C., *What Commerce Majors Do After Graduation.* Special Studies Series, Bureau of Business Research, University of Mississippi, 1949.

[2] For further study see "Sales Going Up; Some Small Businesses Boom Merrily Along, Bucking the Downtrend; They Credit New Products, Special Service, Harder Selling and Promotion." *The Wall Street Journal,* July 1, 1949, Vol. 4, No. 1.

realistic approach to the field of small business and the increased appreciation of the fact that, although incompetent enterprisers are quickly eliminated, those who have what it takes can succeed in spite of adverse conditions have tended to place independent business ownership on a sound, enduring foundation.

Predictions are hazardous at best and are especially difficult in the relatively uncertain area of economic or international conditions for specific periods of time. It is not our intention in this chapter to forecast the position of small business for the next year or for any other particular time. We are concerned with long-time trends and with an examination of fundamental factors that will continue to influence the position of small business regardless of what conditions may develop.

The best approach to this problem seems to be to review briefly certain points about small business developed in the text and then to examine the probable effects on small business of different conditions that may appear at some time in the future. Finally, we hope to show that the surest way to insure an enduring place for small business is through continued study and application of the ideas and methods suggested throughout the book.

We have seen that small business occupies an important and unique place in our economy. Not only was every important big business of today started as a small enterprise, but also well over 90 per cent of all businesses are still properly classified as small. That this situation will continue in spite of conflicting and often confusing trends is the accepted belief of all well-informed observers.

Small business is unique in many respects. It has advantages, limitations, and problems that differ from those of large concerns. It is necessary to have a large number of small enterprises if true competition is to exist, if freedom of initiative and business enterprise is to be maintained, and if we are to continue our progress in extending more goods and services to an

ever increasing number of people. Big business alone cannot provide these things.

Many limitations and problems accrue to certain enterprises merely because of their small size. Inability to operate in the fields of mass production where heavy investment in machinery is required is one of these. Particularly in the field of manufacturing, a given industry usually achieves maturity only by developing machinery and the subdivision of labor to an extent that seriously limits the opportunities for small-scale enterprise.

In general, the fields of natural monopolies are not for the small enterprise. The so-called "heavy industries" are represented by large concerns, although many small firms operate in service and facilitating capacities as well as in the distribution of some of these industries' products. Although a small enterprise can operate successfully in the vast majority of business areas, in most of these fields branches of large concerns may also be operated. It is principally when the potential volume is too small to be of interest to big business that the little fellow has the field to himself.

Of the many problems of small business, probably the most important are: (1) limited time of the owner-manager, (2) wide range of managerial ability demanded of one or a few men, (3) difficulty in making effective use of research, and (4) the problem of securing access to adequate financial resources. Some of the other problems, as we have seen, arise principally because of the type of individual normally attracted to business ownership; others plague a business of any size but seem to bear more heavily on the little fellow.

One advantage of a study of *small* business is that the recognition of its special problems stimulates efforts to solve them. We have seen many ways in which the independent businessman can conserve his precious time for important matters by adapting to his needs well-developed managerial aids, including policies, organization, modern personnel practices, and the fundamentals of modern management. He may share

managerial duties with a partner or a few well-chosen members of a closed corporation. In certain retail fields he may affiliate with one of the voluntaries and thus economize his own time as well as secure the benefit of additional managerial abilities. And finally, for certain functions of management he may utilize the outside staff discussed in the text.

The increasing number of suggestions in the trade press concerning how small business can meet its needs for technical and market research is an indication that workable solutions to this problem may be found soon. Already several groups of small firms are reported to have made satisfactory progress in meeting their research needs. In some cases the research facilities of governmental agencies are aiding; in others, by pooling research efforts the facilities of private research agencies have been employed; and in a few cases large companies may make their research departments available to small firms. It also seems reasonable to expect that experience during World War II, when know-how was furnished to subcontractors, will be utilized more and more in helping to solve this problem. The basic fact that all industry is interdependent suggests that it is entirely logical to expect efforts in this direction even within the framework of a competitive economy.

Following World War II, a large number of veterans emphasized market research in their college training. With new data made available from postwar censuses by the Bureau of the Census, U. S. Department of Commerce, we may expect to see many free-lance operators in the field of market and marketing research offering their services to small businessmen. Because even fairly large concerns need the services of market research specialists only on a part-time basis, they are free to engage in professional practice for themselves some of the time.

Financing, which was mentioned as the fourth important problem, is at least in part a corollary of the more basic management problem. As noted on several occasions in the text, the agreement seems to be pretty general among bankers

and others concerned with the financial needs of small business that the real need is for management counsel. Given good management, most of the financial problems of small business become of minor importance, because (1) good management includes efficient handling of finances and (2) lenders are usually anxious to invest money in the well-managed business.

There are, however, three other types of financial problems confronting small business for which it is not so easy to suggest solutions. Most important is the fact that small-scale financing is always more expensive per dollar than large-scale financing. Whether the lending or investing process can be analyzed, simplified, and organized in such a way as to overcome this inherent handicap remains to be seen.

Several interesting but as yet untried proposals have been made. One approach involves separating the various cost elements, such as risk-bearing, investigation, negotiation, paper work, and contact, to mention a few for purposes of illustration. The cost of each of these elements would be reduced to a minimum through use of whatever plan is appropriate; for example, the principles of underwriting and insurance might be applied to risk-bearing. This has been done in reducing the cost of financing homeownership through the F.H.A. as well as the cost of temporary unemployment to the worker through unemployment insurance. The principle of guided self-declaration used in American income tax procedure with appropriate penalties for falsification might be applied to reduce the cost of investigation. Costs of paper work and of contact could probably be reduced greatly by centralization and use of machine methods. Harebrained as these proposals may sound to a person familiar with the difficulty and expense of small-scale financing, they are probably no more ridiculous and impractical than were the original ideas that started most of our large modern technical industries when first proposed. This does not mean that the particular proposals listed above represent a solution to the problem, but it does suggest that a solution

can be found no matter how impractical it seems to the "experts" at first. Such is progress!

The second type of problem relates to what small businesses should be financed through loan or investment capital. The principle is generally accepted under our system of free enterprise that any individual should be permitted to invest his own capital in any business venture no matter how unsound it may appear to others, provided he does not break the law or transgress the rights of others. However, creative imagination, or "brains," and adequate capital do not always go together, at least at the inception stage of a new idea. There may be ten to a hundred freak ideas launched by hopeful enterprisers that fail for one that succeeds, but who can pick the successful one at the start? In a given market that appears to be overcrowded with businesses of a particular kind, the right individual can succeed when scores around him are failing. The authors do not propose a solution to the problem of forecasting the winner out of hundreds of contestants beyond advice already given in the text. The chapter on justification is intended to offer helpful suggestions in regard to this type of problem.

Financial problems in a third and final group relate to building and maintaining adequate financial reserves. Not only is the first thousand (dollars)—that is, the initial capital to start business—usually the hardest to get, but the effects of both the business cycle and our current tax system lay additional financial burdens upon the beginning small business. Heavy taxes on personal incomes in the lower brackets affect the typical small business, which is usually a proprietorship or partnership, although they have no serious effect on larger corporate units. Also, whenever the tax system imposes heavy rates on low business profit brackets or penalizes the withholding of profits for reserves, the effects are more serious to small than to large business units. Both situations have existed in recent periods of our tax history.

The effects of the business cycle, especially on the downswing, bear more heavily on the capital structure of small than

of large businesses. However, small business has some compensating advantages, especially greater flexibility and relatively lower fixed overhead expenses. Also, the very nature of the recession period of the business cycle—a period of contracting overexpanded business facilities at current prices—may make this pressure on many small businesses desirable. Being more flexible than their large competitors, they may be able to reduce costs and prices to justify continuing operations. If this is not possible and ability to stay in business depends upon using accumulated capital, small business may actually take a lesser loss by retiring early in the recession period of a prolonged business depression. In some cases it may even be possible to make a second start later at bargain prices. This resembles the procedure of going through a reorganization of the capital structure as big firms sometimes do.

It is in connection with changing economic conditions that the two basic points discussed early in our text are of great value, namely, the importance of studying small business as such and of adapting methods developed in one field to use in other lines. The small business has special needs and problems that differ from those of big business when economic activity is changing, either for better or for worse. The fact that limited capital makes it harder for the little fellow to withstand a decline in business activity is not always an unmixed evil; but it also restricts his ability to expand rapidly to capitalize fully on opportunities resulting from an upswing of the business cycle. Once we appreciate this and other needs and problems characteristic of small business, we see the importance of profiting by the experience and methods of big business. Adequate reserves, well-formulated policies governing expansion and contraction, proper timing, the use of options instead of long-term commitments, and various other methods could be mentioned. The fundamental facts remain the same. Only the "dress" changes with different stages of the business cycle.

Permanence of Small Business Field

Our examination of small business in each of the three major fields—merchandising, manufacturing, and service—has established (1) that the field of independent business operation is important and distinctive enough to warrant special study of small business as such and (2) that any business, large or small, can profit by the experience and methods developed in other concerns regardless of their size or field of operations. The former is the justification, the latter the major thesis of this text. The two belong together. The interdependence of all business has been stressed and illustrated throughout the book. Our purpose has been to study the small enterprise, not as an isolated segment, but as a part of the entire interrelated and interdependent business structure. Not only is the little fellow a part of the whole economic system, but he learns from and contributes to the entire field of economic activity.

These two points are important when we consider the future of small business. Economic conditions change; attitudes and interests of the government, the public, and individuals shift; international conditions vary and influence national policies and business activities. In this respect change is the only constant factor. However, regardless of economic conditions, small business will continue as an important part of our economy. Each of the three types of changes mentioned affects both the immediate or temporary position of small business and its long-run or permanent position.

The number of small concerns tends to decrease during depression and increase during prosperity both absolutely and relatively, although the same tendency operates for employment, wages, profits, rents, and other economic elements. Offsetting the somewhat greater problems of small business during hard times are the many opportunities such conditions afford to buy or to start a business on a safe foundation. Also, were it not for these cyclical fluctuations in business activity, the study of small business would be much simpler but also less interesting.

The long-time trend in American business history has been favorable to small business, especially in terms of new opportunities and number of concerns. Each new industry, although it may soon be dominated by large concerns, brings in new opportunities for small firms and results in a great increase in the total number of establishments. In wholesaling the trend has been toward a larger number of small concerns. Nearly the entire field of service businesses was unknown a century ago. Only in farming has there been a decline in the number of small enterprisers relative to either population increase or total number of units in operation. In fact, it is primarily the rise of many large industries and a steady increase in the use of capital goods and modern technology that have made it possible for us to have an ever-increasing number of small business units in operation.

Probably one reason for confused thinking on this point is the failure to compare similar periods of the business cycle. Naturally the number of small businesses will be smaller during the depression stage than during the preceding boom stage, and usually small units represent a smaller percentage of the total number of firms in operation during hard times than during good times. However, if successive years of boom or of depression times are compared separately, the long-time upward swing in favor of small business will be evident.

Even during the years of World War II the number of small manufacturing firms showed a steady increase. From 1940 to 1945 small manufacturers also showed greater proportionate gains in net worth and net working capital than did large concerns. In addition to the enormous increase in our productive capacity that took place during the war period, we had 40,900 more manufacturers in June, 1946, than in June, 1945. About 60 per cent of the new manufacturers in business in 1946 had four or fewer employees.[3] We have noted earlier in the

[3] Sullivan, A. M., "Small Business—It Can Go Places—And Without a Free Ride." *Printers' Ink*, October 31, 1947, Vol. 221, No. 5, pages 94–108.

text that the vast majority of the nearly one million new firms starting business in all fields during the first two postwar years were small concerns. Economic conditions cause the number and kinds of small businesses needed at particular times to vary but do not change the long-run trends of the increasing number and importance of small independent operators.

Changing attitudes and interests on the part of the government and of the public are to be expected from time to time. These need not affect the position or permanence of small business and should not weigh too heavily in determining our interest in this field. During the closing years of World War II and the first postwar years, attention was naturally directed to problems of reconversion, including those relating to small business. Once the period of great influx into business has passed, it is reasonable to expect attention to shift to other fields. Also, it is always possible that propaganda campaigns in progress at any particular time will have undue influence on government attitudes and public interests. However, this very shifting of government and public attention to new "topics of the hour" should intensify rather than lessen our serious study of the needs and problems of the independent enterpriser.

More small firms are in operation today than ever before in a similar period of our history. Many of them were launched hastily during the postwar boom period, often by individuals none too well prepared for the inevitable competition to develop sooner or later. Certain fields appear to be overcrowded and readjustments will be needed. In previous postwar periods we had a similar heavy influx of new business enterprises, followed before long by heavy casualties among those least able to stand the competitive struggle. The more obvious opportunities for starting a small business have been taken up. Prospecting and seeking out new and justifiable opportunities will require increasing attention by entrepreneurs of the future. These conditions all point to the ever greater importance of a careful study of small business organization and operation such as that suggested in the text.

Since the rise of our industrial economy, developments in the international situation have always affected small business as well as the rest of our economic activity. However, they have never lessened the ultimate importance of the individual enterpriser nor invalidated the fundamental principles relating to small business. Merely the emphasis as to type of needs and problems is shifted. Consider the shift of emphasis during the war to procurement, working within government regulations, and closer interbusiness coördination such as sub-contracting or closer vendor relationships, and compare with this the peacetime emphasis on sales promotional activities and cost reduction. The example might be cited of certain individuals who wanted to enter foreign trade at the close of World War II but who decided after investigation to defer entering the field on their own until the international situation was more stabilized.

The point of emphasis here is that the study of small business is justifiable in its own right at all times. It should not be viewed opportunistically as something of importance only during a period of rapid business expansion or "easy going." Small business has certain advantages, limitations, problems, and opportunities that shift in emphasis with changing conditions but remain surprisingly constant in fundamentals throughout all types of economic conditions.

And finally, if certain economic or international situations enforce a delay in starting the kind of business an individual ultimately hopes to own, the result may be actually to strengthen the business when it is finally started. Several examples of such semi-voluntary delay have been cited in the text; it has been pointed out, for instance, that prospective retailers often work for years to secure a particular location before starting on their own. In other cases individuals with one type of knowhow, such as technical training, have deliberately planned several years of business experience or training in management before launching their own enterprises. Usually the interval between deciding to enter business and starting the enterprise can be used profitably in planning, accumu-

lating capital, and developing trade connections.

A long-range view of any type of business should include consideration of its probable status under changing conditions. In the past, at least, during a 20- or 30-year period a particular business went through all the varieties of conditions discussed in the preceding paragraphs. Small business, in spite of ups and downs, has stood the test of operating under every variety of economic conditions and is stronger today than ever before. The long-range future prospects seem bright, regardless of temporary setbacks that will probably appear from time to time.

Improving the Outlook

That the future prospects of small business can be improved is implied in every effort to study the field, in every proposal to solve some of the problems of the little fellow, and in the growing recognition of the importance of this segment of our economy. Self-improvement is usually the most desirable. In general, the plan recommended in this text stresses self-improvement by present and prospective small businessmen as the surest road to future progress.

We have suggested that a potential business owner should first determine if he is better suited to being his own boss than someone else's employee. After selecting the kind of business to enter, he should determine the requisites for success in the chosen field and acquire as many of the ones he lacks as possible before actually starting the business. Questions of when to launch, where to locate, and how to formulate sound policies complete the "getting started" stage. Once safely launched, the new business can be reasonably sure of success if the modern management methods discussed throughout the text are applied.

No better concluding advice could be given to the small businessman, present or prospective, than to keep in close touch with information provided through his trade association, trade press, suppliers, mercantile agencies, and local banker.

APPENDIXES

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APPENDIX B

UNITED STATES DEPARTMENT OF COMMERCE
William C. Foster, Acting Secretary

OFFICE OF DOMESTIC COMMERCE
H. B. McCoy, Director

MARKETING DIVISION
Nelson A. Miller, Chief

SHOE STORE

WORK SHEET FOR ESTIMATING INITIAL CAPITAL REQUIREMENTS FOR ESTABLISHING A SHOE STORE*

This work sheet is designed to assist the prospective shoe merchant in estimating his total initial capital requirements. The estimate should be completed in full before any commitments are made. It is not advisable to establish any business unless available capital exceeds the initial requirements by a safe margin.

The required investment in furniture, fixtures and equipment constitutes one of the most variable and significant items, and should be carefully estimated on the form below. The total for these items (last column) should be transferred to the form on page two for inclusion in computing the estimate of total capital requirements. (Explanatory notes are provided on page three.)

SCHEDULE OF FURNITURE, FIXTURES AND EQUIPMENT

ITEM (SUGGESTED LIST - ADD OR ADD ITEMS AS REQUIRED. USE SEPARATE SHEETS TO LIST DETAILS UNDER EACH MAIN HEADING)	IF CASH PURCHASE (NEW OR USED) ENTER FULL AMOUNT BELOW AND IN THE LAST COLUMN	IF INSTALLMENT PURCHASE (NEW OR USED) ENTER IN THE LAST COLUMN DOWN PAYMENT PLUS AT LEAST ONE INSTALLMENT			ESTIMATE OF YOUR INITIAL CASH REQUIREMENTS FOR FURNITURE, FIXTURES AND EQUIPMENT
		PRICE	DOWN PAYMENT	AMOUNT OF EACH INSTALLMENT	
SHELVING					
DISPLAY STANDS					
DISPLAY CASES					
WRAPPING COUNTER					
SEATS					
FITTING STOOLS					
FITTING DEVICES					
MIRRORS					
WINDOW DISPLAY FIXTURES					
SAFE					
CASH REGISTER					
TYPEWRITER					
ADDING MACHINE					
LIGHTING					
FLOOR COVERING					
OUTSIDE SIGN					
OTHER STORE EQUIPMENT					
TOTAL FURNITURE, FIXTURES AND EQUIPMENT (Enter total on page 2 under "nonrecurring initial capital requirements.")					$

*For a detailed description of the problems involved in organizing and managing a shoe store see the Commerce Publication, "Establishing and Operating a Retail Shoe Store, Industrial (Small Business) Series." Superintendent of Documents, Government Printing Office, Washington 25, D.C. Price, 25 cents.

Department of Commerce

WORK SHEET FOR ESTIMATING INITIAL CAPITAL REQUIREMENTS FOR ESTABLISHING A SHOE STORE

ESTIMATED OPERATING RATIOS EXPRESSED AS A PERCENT OF NET SALES, WITH EXAMPLES SHOWING THEIR APPLICATION TO VARIOUS ANNUAL SALES VOLUMES
(See note 1, page 3)

	PERCENT	ANNUAL SALES VOLUME		
Net sales	100.0	$30,000	$60,000	$80,000
Cost of goods sold	65.0	19,500	39,000	52,000
Gross margin	35.0	10,500	21,000	28,000
Operating expenses	29.0	8,700	17,400	23,200
Net profit	6.0	1,800	3,600	4,800
Average inventory (See note B, page 3)	-	7,800	15,600	20,800
Stock turn: 2.5 times per year				

MONTHLY SALES AND OPERATING EXPENSES *(See note 2, page 3)*				INSTRUCTIONS FOR COLUMNS 3 AND 4	
ITEM	ESTIMATED RATIOS PERCENT OF SALES	DOLLARS PER MONTH BASED ON ANNUAL VOLUME OF $60,000	YOUR ESTIMATE OF MONTHLY SALES AND EXPENSES BASED ON ANNUAL VOLUME OF $ _____	Enter your monthly operating expenses in column 3 based on percentages of sales in column 1, as illustrated in column 2. Enter your initial cash requirements in column 4 based on amounts shown in column 3. For several items a period of months is suggested.	YOUR ESTIMATE OF INITIAL CASH REQUIREMENTS
	COL. 1	COL. 2	COL. 3		COL. 4
NET SALES 1/12TH OF ANNUAL ESTIMATE	100.0	$ 5,000.00	$	*(See note 3, page 3)*	$ [illegible]
OPERATING EXPENSES SALARIES OF OFFICERS, PROPRIETORS OR PARTNERS	6.0	400.00		Enter 1 month or more *(Note 4, page 3)*	
ALL OTHER SALARIES AND WAGES	7.0	350.00		Enter 1 months or more	
OCCUPANCY *(Including rent, light, heat and building service)*	6.0	300.00		Enter 1 months or more *(Note 5, page 3)*	
ADVERTISING	2.0	100.00		Enter one-fourth annual advertising budget	
DEPRECIATION *(except buildings)*	1.0	50.00		No entry in column 4 *(Note 6, page 3)*	
ALL OTHER EXPENSES				Make your own estimate for other expenses	
TELEPHONE AND TELEGRAPH			est. monthly sales	Check local rates	$
WRAPPING MATERIALS AND MISCELLANEOUS SUPPLIES				Include stationery for 6 months	
UNEMPLOYMENT INSURANCE				Consult your State director of unemployment insurance	
OLD AGE AND SURVIVORS INSURANCE				Consult nearest Social Security Adm. Field Office *(located in all the larger cities)*	

OTHER INSURANCE	5.0	250.00	Total of these items should amount to 3%	May have to pay premiums for 1 year or more (Note 7, page 3)	
DONATIONS AND DUES					
LICENSES AND TAXES (other than income)				Consult city and state taxing authorities	
BAD DEBTS				No entry in column 4	
MISCELLANEOUS				List any item not mentioned above	
					$
AVERAGE MONTHLY OPERATING EXPENSES	20.0	$ 1,450.00	$	No entry in column 4	

NONRECURRING INITIAL CAPITAL REQUIREMENTS		
PURCHASE OF REAL ESTATE	(See note 9, second paragraph, page 3)	$
INITIAL INVENTORY	Estimate and enter initial inventory from instructions in note 8, page 8.	
FIXTURES AND EQUIPMENT	Enter total of list on page 1.	
INSTALLATION OF FIXTURES AND EQUIPMENT	Enter cost of installing all fixtures and equipment.	
DECORATING AND REMODELING	Enter total estimated cost	
DEPOSITS WITH PUBLIC UTILITIES	Enter full amount to be deposited	
CASH	For unforeseen requirements, special purchases, etc., and for absorbing any initial losses.	
OTHER	List any item not mentioned above	
		$
TOTAL ESTIMATED INITIAL CAPITAL REQUIREMENTS (Add all items entered in column 4)		$

EXPLANATORY NOTES

1. The operating ratios illustrated on page 2 may be briefly defined as follows:

   NET SALES - Gross sales less all returns and allowances, and exclusive of sales tax revenue.

   COST OF GOODS SOLD - Beginning inventory, at cost, plus net purchases (gross purchases less returns and allowances, plus freight in), less ending inventory, at cost. (Percent of net sales).

   GROSS MARGIN - Net sales less cost of goods sold. (Percent of net sales).

   OPERATING EXPENSES - All expenses incurred in business operations - see breakdown in table on page 2. (Percent of net sales).

   NET PROFIT - Gross margin less operating expenses. (Percent of net sales).

   STOCK TURNS (Number of times per year) - Cost of goods sold divided by average inventory.

   The operating ratios shown are for an independent shoe store and were estimated on the basis of current and prewar conditions. In general they assume conditions more favorable than those of prewar years and less favorable than those which prevailed throughout 1946-47. It should be noted that the operations of an individual shoe store may vary widely from the averages for the trade, these variations depending upon location, size, number and variety of lines of merchandise carried, and services offered. However, the estimated ratios above may be used as a rough guide in determining how much to spend for an initial inventory and what provision to make for initial operating expenses in relation to anticipated sales.

2. Monthly sales and operating expenses as listed on page 2 should be determined as follows:

   (1) Estimate annual sales volume (see note 3 below.)

   (2) Divide by 12 to obtain estimated monthly sales volume.

   (3) Multiply monthly sales volume by each operating ratio to determine dollar amount for each operating expense for 1 month.

   (4) Monthly expenses for the items for which separate ratios are not shown should be individually estimated. The total of these expenses should be approximately the percent of estimated net sales shown opposite the bracket across "all other expenses" (Column 1, page 2).

3. Your actual sales volume cannot be accurately determined in advance since this will depend upon the amount of business in the area, the number of competitors already sharing this business, and the amount which you may be able to obtain. However, assistance in making a careful estimate can be obtained from representatives of shoe manufacturers and wholesalers, the trade associations, your banker, the Chamber of Commerce, and other business men who may be familiar with local conditions and the opportunity for a new store in the area in which you plan to enter business.

   Do not be over-enthusiastic in estimating your potential sales. A new business generally grows slowly, especially at the start. If you overestimate your potential sales you are likely to invest too much capital in equipment and initial inventory, and to commit yourself to heavier operating expenses than the actual sales volume attained will justify. If you under-estimate your potential sales, you can always expand. Too much caution, however, may result in inadequate facilities to handle the business which does develop.

4. The amount which should be allowed for owner's salary will depend on the extent to which you draw on the business income for personal expenses. Some proprietors draw a regular monthly salary and the remainder of net profits irregularly or at the end of each year. Others reinvest a part of net profits in the business. The method of withdrawal of net profits, if the business is unincorporated, does not affect your income tax since salary, withdrawals, or profits retained in the business are all taxable and at the same rates.

   The amount of salary as a percent of net sales will generally decline with increases in sales volume. However, all other salaries and wages, as a percent of net sales, will generally increase. The two items together generally constitute a somewhat constant percentage of sales volume.

5. Occupancy, as used here, applies either to the expenses of renting business property or to ownership expenses. For rented quarters the ratio covers, besides rent, repairs for which the tenant is responsible, janitorial services, light and heat, and in some cases a monthly write-off of improvements paid for by the tenant, such as a store front or remodeling. For owned premises the ratio covers such ownership expenses as property taxes, mortgage interest, insurance, depreciation, maintenance costs, janitorial services, and utilities.

   If real estate is acquired for the business, enter under nonrecurring initial capital requirements on page 2 the total price if purchased outright. If the purchase is to be partially financed by a mortgage, enter the total cash payment. If business property is to be constructed enter the total cost of construction. In each case full provision must be made for all of the initial costs incident to the purchase or construction. This requirement should be discussed thoroughly with the real estate agent, contractor, financing agency, or others whose services are employed in this connection.

6. Allowance should be made for depreciation of all fixtures and equipment in the determination of profits. The monthly depreciation rate should be entered in column 3 in the estimate of monthly operating expenses and profits. However, no provision for depreciation need be included in column 4 in the estimate of initial capital requirements.

7. Types of insurance for which provision may be made include fire, lightning and windstorm, use and occupancy, public liability, compensation, and robbery and burglary. Consult a reputable insurance company for full details of cost and coverage.

8. To estimate average inventory by using the operating ratios shown at the top of page 2 take 65 percent of your anticipated annual sales volume. This figure will represent "cost of goods sold," or the annual sales at cost value. Divide this amount by the number of stock turns per year (2.5) and the resulting amount will be the estimated inventory value at cost. (For estimated sales of $60,000: $60,000 X .65 = $39,000 ÷ 2.5 = $15,600).

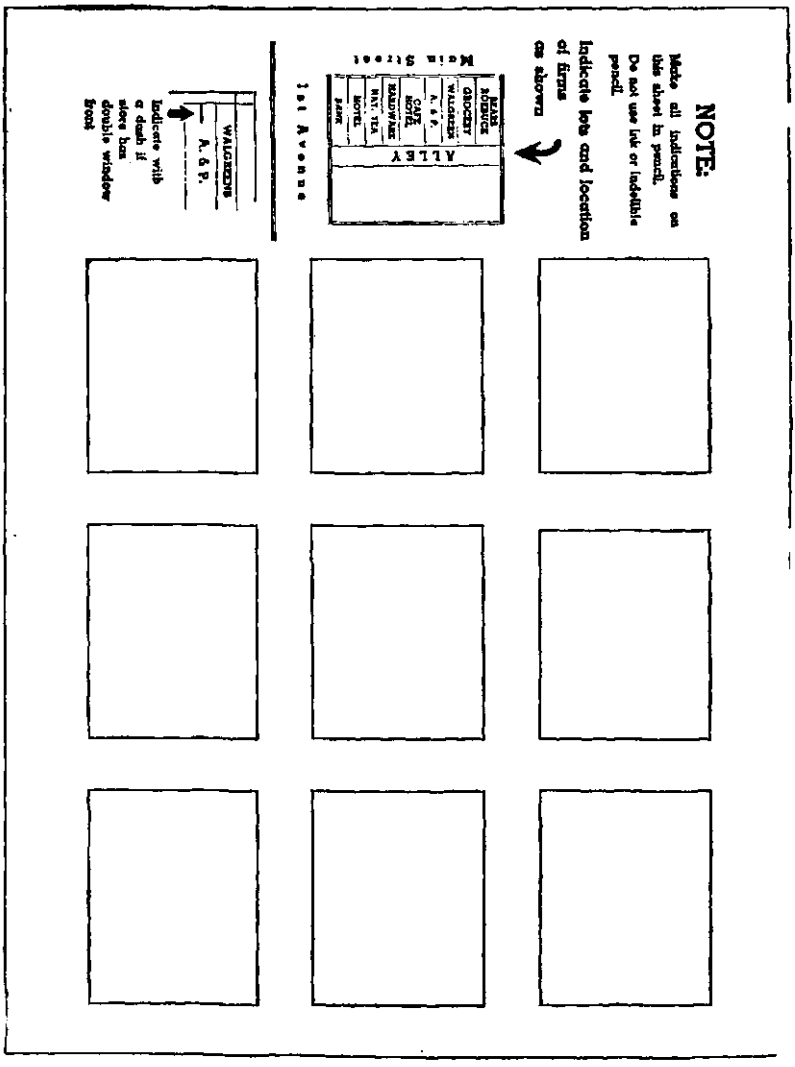
   NOTE that when average inventory is computed on the basis of operating ratios it applies to the store already in operation, which maintains a somewhat larger stock than is essential for a new retailer. Your initial inventory may be reduced by (1) stocking a reasonable supply of major lines and filling in variation and specialties as demand develops. (Suppliers frequently will recommend such a "skeleton" stock), and (2) securing a part of your inventory on credit; although this is not a recommended policy for a new business, since it may be difficult to meet such commitments if sales volume develops slowly.

ACKNOWLEDGMENT IS MADE OF THE ASSISTANCE OF THE NATIONAL SHOE RETAILERS' ASSOCIATION IN REVIEWING THIS WORK SHEET

APPENDIX C[1]



[1] Courtesy, Western Auto Supply Company of Los Angeles.


NOTE:
Make all indications on this sheet in pencil.
Do not use ink or indelible pencil.
Indicate lots and location of firms as shown
Main Street
1st Avenue
ALLEY
MEAT SERVICE
GROCERY
WALGREENS
A. & P.
CAFE
BOOKWARE
RAT. TEA
MOTEL
BANK
WALGREENS
A. & P.
Indicate with a dash if store has double window front

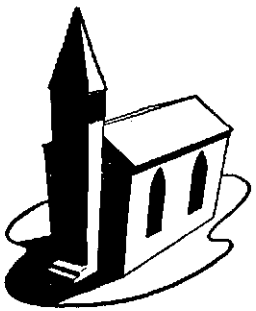
GENERAL INFORMATION

PREDOMINANT NATIONALITIES IN COMMUNITY

1_____ 2_____ 3_____

4_____ 5_____ 6_____

7_____ 8_____ 9_____



CHURCHES

_____ _____

_____ _____

_____ _____

_____ _____

_____ _____

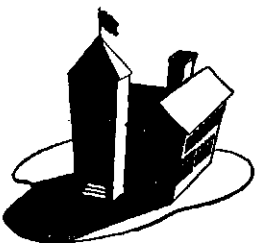
SCHOOLS

Grammar_____

High Schools_____

College_____

Parochial_____





RECREATION

Theatres_____

Parks_____

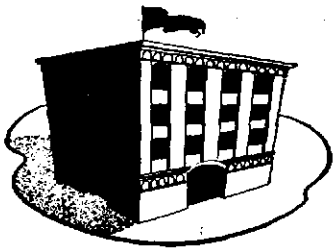
Golf Courses_____

This area is not a Summer Resort

This area is not a Winter Resort

(Black-Out Words Not Applicable)

BUSINESS SURVEY



BANKS

Name	Deposits

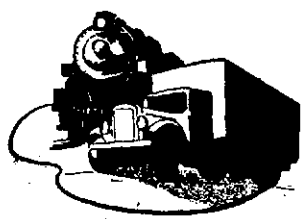
NEWSPAPERS

D. or W.	Name	Circulation	Local Inch Rate

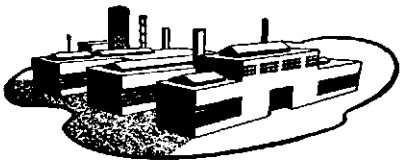
TRANSPORTATION

Railroads	Truck Lines

Bus Lines



BUSINESS SURVEY — (Cont.)



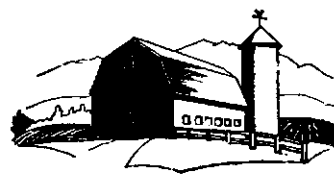
LEADING INDUSTRIES

Company Name	Products	Employees	Mo. Payroll

AGRICULTURE

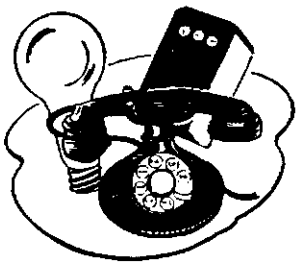
_____% Dry Farming _____% Irrigation

Principal Products



TOWNS IN TRADING AREA

Town	Population	Town	Population



UTILITIES

Telephones

Electric Meters

Gas Meters

PRESENT RETAIL ESTABLISHMENTS

Auto Dealers	Doctors	Florists	Gen. Mdse.
Barbers	Drug Stores	Food Stores	Hardware
Clothing	Feed Stores	Furniture	Restaurants
Dentists	Filling Sta.	Garage	Others

CHAIN STORES REPRESENTED

AVERAGE RENTAL PER FRONT FOOT

Most Desirable Secondary Dist.

Comment:

PROJECTED EXPENSES and PROFITS

ITEM	%			
Total Sales	100.			
Cost of Sales	74.2			
Gross Profit	25.8			
EXPENSES				
Salaries. Clerks	3.7			
Salaries. Owners	5.5			
Rent	3.			
Heat and Light	.5			
Transportation	.1			
Advertising	1.1			
Taxes	.6			
Insurance	.3			
Tel. and Tel.	.4			
Installation Store Expense	.1			
Interest	.1			
Repairs	.2			
Depreciation	.3			
Miscellaneous	.3			
TOTAL EXPENSES	16.2			
Operating Profit	9.6			
Bonus	.7			
Total Profits	10.3			

D. WORK SHEETS FOR A COMMUNITY INDUSTRIAL SURVEY

This Work Sheet has been prepared for use in connection with the U. S. Department of Commerce publication, BASIC INDUSTRIAL LOCATION FACTORS. The thirteen Roman numerals which follow refer to the thirteen Basic Industrial Location Factors in this booklet.

COMMUNITY—Unless otherwise identified, it is understood that the community is a single city or village.

AREA—Some questions call for information on the area surrounding the community. The area covered by this information should be defined at the outset and any exception should be clearly shown.

....

(community) (its population) (county)

Survey started..... Survey completed.....

LOCATION OF COMMUNITY: .....

.....

WHERE AREA IS REFERRED TO it means the territory within radius of ..... miles. A further description of the area, including the names of its other towns, follows: .....

.....

.....

I. LOCATION OF PRODUCTION MATERIALS

1. *What production materials exist in area?*

   a. Minerals, metallic (list kinds; estimated minimum quantities) .....

   .....

   b. Minerals, non-metallic (list kinds; estimated minimum quantities) .....

   .....

   c. Forest products (list timber species & est. minimum quantities of each) .....

   .....

d. What are chief farm crops?.....
Which of these farm crops are now processed in area?.....

e. Do you have commercial fishing? (List kinds of fish caught.) .....

f. What materials are partly processed (meaning those whose manufacture is completed elsewhere) and to what extent?

2. *Remarks:* .....

II. LABOR

1. *Labor force in area*

a. Population 1940 ..... 1943..... 1947.....
Percent: urban..... rural non-farm..... farm.....
Population over 14 yrs. of age within trade or employment area in 1940.....
Persons in labor force, 1947 M..... F..... Total.....
Persons employed M..... F..... Total.....
How many persons are available for employment expansion M..... F..... Total.....

2. *Occupational characteristics of the labor force*

a. Percent of the workers in each of the principal industries skilled and semi-skilled:

Industry	*% Skilled*	*% Semi-skilled*

b. What are the principal occupations? (be as specific as possible) .....

c. What occupations have been most frequently in demand in the area? .....

d. Of the persons now employed, what percent are skilled?..... unskilled?..... What occupational skills are most common among those now employed?.....

e. Average hourly pay rates for:

Skilled workers	Men $.....	Women $.....
Semi-skilled workers	Men $.....	Women $.....
Unskilled workers	Men $.....	Women $.....

3. *Other labor factors*
   a. Degree of seasonal fluctuation in employment: Large.....slight.....months of peak employment.....months of lowest employment.....
   b. Extent of labor organization in manufacturing industries: Complete.....partial.....none.....
   c. Number of work suspensions due to management-labor disagreement during past 12 months.....total workers involved.....
   d. Estimated net gain or loss of labor force due to migration during the past 12 months.....
4. *Source of data on labor supply* (local survey, State Employment Service, etc.) .....
5. *Remarks:* .....

.....

III. SITES

1. *Land available for industrial expansion*
   a. Acres of improved land (served by utilities).....
   b. Acres unimproved.....How much of this is cleared?

   .....
2. *At what cost and terms can land be purchased or leased?*
   a. Improved (give range of cost, in acres or square feet).....

   .....
   b. Unimproved .....
3. *What industrial floor space is or will be available in existing buildings?*

   ....
   (Type of building) (Square feet)

   ....
   (Type of building) (Square feet)

   ....
   (Type of building) (Square feet)

   Could two or more of these buildings be utilized by a single manufacturer without undue cost? .....
4. *Remarks:* .....

.....

IV. INDUSTRIAL FUELS

1. *Coal*
   a. Is coal delivered by rail, truck or water?.....
   b. Wholesale prices per ton range from $..... to $.....

2. *Gas*
   a. Is natural.....or artificial.....gas available?
   b. Who is the supplier? .....
   c. What is the quality of the gas? (thermal unit of BTU) .....
   d. Maximum supply is.....cu. ft. per day
      Maximum demand is.....cu. ft. per day
   e. Price of gas in a typical industrial installation $.....
3. *Fuel Oil*
   a. How is oil delivered? (Water, rail, truck or pipe line).....
   b. What storage facilities exist?.....capacity?.....
   c. Price of industrial grade fuel oil?.....
4. *What is the prevailing industrial fuel used?*
   a. Kind.....
   b. Is it adequate for industrial expansion?.....
5. *Remarks:* .....

V. TRANSPORTATION FACILITIES

1. *Railroads*

Company	*Type of line*	*Number trains daily*	
		Passenger	*Freight*
.....	..... (*branch, main*)	.....	.....
.....	..... (*branch, main*)	.....	.....
.....	..... (*branch, main*)	.....	.....

Express service?..... (yes or no) Is there pick up service?..... (yes or no)
Terminal facilities available.....
Time distance to St. Paul—Minneapolis..... Chicago.....
Other cities .....

2. *Motor Carriers*
   a. State and Federal highways through city (highway numbers) .....
   b. City bus service?..... (yes or no)
   c. Through bus service (names of systems).....
      Number buses daily: North–South?.....;
      East–West?.....

d. Trucking facilities

Company	*Area served*

e. Some large cities reached on an overnight truck haul?.....

3. *Waterways*
   a. If on a waterway describe terminal and dock facilities.....
   b. Navigation opens..... (date) Closes..... (date)
4. *Airport*
   a. What is nearest airport? (name)..... Distance from city.....
   b. Municipal, county or private ownership? (which).....
   c. Describe briefly airport facilities (no. hangars, length of runways, size of field, etc.).....
5. *Mail service* (ordinary first class)
   a. Time to some principal cities.....
   b. Hours of mail arrivals and departures.....
6. *Remarks:* .....

VI. MARKET

1. *Information on the community's markets*
   a. Where do existing local industries market their products; give some specific examples.....
   b. Radius.....mi. and population.....of retail trading area.
   c. Radius.....mi. and population.....of wholesale trading area
2. *Remarks:* .....

VII. DISTRIBUTION FACILITIES

1. *What distribution agencies and services are available?*
   a. Indicate the degree of availability and capacity of each of the following facilities for efficient movement of goods and transfer of ownership.

(Add to this list any other services believed significant aids to selling, financing, and moving products to and from the area.)

Packing and crating service.....
Weighing service.....
Grading and inspection service.....
Freight warehousing .....
Cold storage warehousing .....
Farm product warehousing .....

b. What financing services are available for industry?.....

.....

.....

Banks	*Capital*	*Surplus*	*Deposits*
.....	.....	.....	.....
.....	.....	.....	.....
.....	.....	.....	.....
Total	.....	.....	.....

2. *Remarks:* .....

.....

VIII. POWER

1. *Name of electric power supplier*.....
   a. Is electricity AC or DC?.....
   b. Is electricity generated by steam, water or Diesel?.....
   c. What is the total capacity?.....KW
      The present maximum demand?.....KW
   d. Industrial rates vary from.....per KWH/month for .....KW to.....per KWH/month for.....KW
      (Attach schedule showing residential, commercial and industrial rates)
2. *Do seasonal factors affect the power supply?*.....
   If so, how? .....
3. *Can existing facilities be expanded?*.....
   If so, how much?.....
4. *Remarks:* .....

.....

IX. WATER

1. *Water available for additional industry*
   a. Source of water supply.....If wells, give depth.....
   b. Pumping capacity is.....gallons per day.
      Present maximum demand is.....gallons per day.

c. Rates vary from.....to.....per 1,000 gal. per mo.
(Attach schedule showing various rates)

2. *Quality of the water supply*

a. Is water clear?.....

b. Hardness in parts per million.....
(Bureau of Engineering of State Health Dept. has this information for every public water supply in the state)

c. Has chemical analysis of water been made?.....(If so, attach copy)

d. How is the water treated?.....

3. *Remarks:* .....

.....

X. LIVING CONDITIONS

1. *Housing facilities*

a. Total dwelling units.....Percent occupied.....

b. Average monthly rental of 6-room house.....
3-room.....

c. Average selling price of 6-room house.....

d. What percent of houses are owner-occupied?.....

e. Is housing crowded at the present time?.....

f. How many new homes are under construction at the present time?.....
How many have been built since 1940?.....
Is new building concentrated in the town or in outlying areas?.....
Is additional suitable space available for residential building?.....

2. *Community facilities and services*

a. *Facility*	*Number*	*Capacity or size*
Hotels	.....	.....rooms
Tourist cabins	.....	.....beds
Eating places	.....	.....seats
Hospitals	.....	.....beds
Churches	.....	.....members
Theatres	.....	.....seats
Public libraries	.....	.....volumes
Public parks	.....	.....acres
Newspapers	.....	.....circulation
Elementary schools	.....	.....students
High schools	.....	.....students
Jr. colleges & colleges	.....	.....students

b. The community has:.....physicians,.....dentists,.....full-time firemen,.....policemen,.....grocery stores,.....hardware stores,.....drug stores,.....department stores,.....furniture stores,.....apparel stores,.....variety stores,.....appliance stores,.....laundries,.....dry cleaning establishments.

3. *Remarks:* .....

.....

XI. LAWS AND REGULATIONS

1. *Zoning and related information*
   a. Does municipality have a zoning ordinance?....., building code?....., smoke abatement ordinance?.....
   b. Does municipality have a planning commission?.....
   c. Does municipality have a building inspector?....., engineer?.....
2. *Relation of local sewerage facilities to industrial expansion*
   a. Is sewer system adequate to receive additional industrial waste?.....
   (yes or no)
   b. Do you have a municipal treatment plant?.....
   (yes or no)
   Is it adequate to receive additional flows?.....
   (yes or no)
   If not, are early additions contemplated?.....
   (yes or no)
   c. Do you have a municipal policy regarding accommodation of industrial wastes in the municipal system?.....
   (yes or no)
   If by ordinance, please attach copy; otherwise explain below:
   .....
   .....
   .....
3. *Remarks:* .....
   .....

XII. TAX STRUCTURE

1. *How favorable is the tax structure to industry?*
   a. City or village: current tax rate.....average tax rate for 5 years.....Property is assessed at what percent of actual value.....Total valuation as equalized.....
   Net bonded debt.....

b. County: current tax rate.....average tax rate for 5 years.....Property is assessed at what percent of actual value.....Total valuation as equalized..... Net bonded debt.....

c. School district: current tax rate.....average tax rate for 5 years.....Net bonded debt.....

d. Township: (to be filled out in case of a village or township) current tax rate.....average tax rate for 5 years.....Property is assessed at what percent of actual value.....Total valuation as equalized..... Net bonded debt.....

e. Total tax rate.....

2. *Remarks:* .....

.....

XIII. CLIMATE

1. *What are the climatic characteristics of the area?*

a. Temperature.....winter low..... summer (average for.....yrs.)
high.....

b. Precipitation.....low.....high.....
(average for.....yrs.) (month, amt.) (month, amt.)

c. Humidity (low, moderate or high).....
(Anything below 50% is low—above 88% is high)

d. Snowfall (annual average in inches).....

e. Length of growing season.....

f. Average date of earliest frost.....latest.....
(Over period of.....years.)

g. How frequently do floods occur? (best local judgment)

h. Altitude (feet above sea level).....

2. *Remarks:* .....

.....

MISCELLANEOUS INFORMATION

1. *Existing industries*

(If more space is needed than is provided below, attach a separate sheet with this information.)

Name of plant	Product	Has operated here since	Av. no. employed (if seasonal so indicate) (male)	(female)

			(male)	(female)
			(male)	(female)
			(male)	(female)
			(male)	(female)
			(male)	(female)

2. *Telephone service*
   a. Name of company servicing area.....
   b. Total number of subscribers: urban.....rural.....
3. *Telegraph service*
   a. During what hours is service available on week days?.....
   On Sundays and holidays?.....
4. *Local maps*
   a. Circle those available: regional, town, highway, nearest airport, railroad, water mains, trunk sewers, power lines, zoned areas.
5. *City streets*
   a. Total miles....., miles paved....., miles unpaved.....
   b. What percentage of streets are curbed?....., have sidewalks?.....
   c. Is there regular maintenance of all streets?.....
   What percentage of streets should be rebuilt or extensively repaired in the next five years?.....
6. *Construction and service facilities*
   a. Is there a general contractor in the community?.....
   b. Is there a surveyor or civil engineer in the community?.....
   c. Is there a machine shop?.....foundry?.....a mill supply house?.....; if not, where are the nearest?
   .....
7. *Civic organizations*
   (Organizations broadly representing the community, naming individuals to be contacted.)

	(individual and title)
	(individual and title)
	(individual and title)

8. *Brief description and historical sketch of the community*

.....

.....

.....

.....

.....

.....

.....

.....

9. *Remarks on community's attitude toward industry*

.....

.....

.....

.....

.....

Survey made by:

.....

.....

This Work Sheet was originally prepared by the Michigan Department of Economic Development, Lansing, Michigan.

E. CHECK LIST FOR ORGANIZING AND OPERATING A SMALL BUSINESS

The following check list should be completed satisfactorily before a person is ready to enter business for himself. It follows the general plan and recommended procedures of the text *How to Organize and Operate a Small Business.* An important consideration for any prospective business owner is to plan carefully and to work out every major requirement for success *before actually starting the business.* It is not enough merely to read the text and to have good intentions of applying its recommendations as each need arises. Not only is there danger that some important matters will be overlooked unless this check list is followed seriously, but once the business is in operation the pressure of daily work greatly reduces the likelihood that the best practices will be adopted and the best decisions made on all important questions.

The plan of the check list is simple. Each topic is presented as a question intended to stimulate analysis concerning some important point. An honest affirmative answer to most questions means that the topic has been considered and provided for to the best of the enterpriser's ability. When further attention to a topic is needed, an attempt to answer the question should convince the prospective businessman of this need and also suggest what further action is called for. Requirements thus discovered should be recorded and checked off as completed.

Topic Questions

I. *Place of Small Business*

1. What are the most serious problems for the small businessman?
2. How would these affect *you* as a business owner?

II. *Employment or Your Own Business*

1. Would you worry less as an employee or in business for yourself?
2. What is the principal reason why you want to enter business on your own?

III. *Factors in Business Success*

1. Have you rated yourself and had some acquaintances rate you on the qualities necessary for success as your own boss, using scales such as those presented in the text?

2. Have you taken steps to improve yourself in those qualities in which you are weak but which are needed for success?

3. Have you saved money, made business contacts, taken special courses, or read particular books for the purpose of preparing yourself for business ownership?

4. Have you had experience in your proposed line of business or in one similar to it?

5. Have you employed and supervised workers?

6. Are you: (a) good at managing your own time and energy? (b) easily discouraged? (c) willing to work harder in your own business than as an employee?

IV. *Appraising a Going Concern*

1. Have you checked the proposition against the lists of warnings issued by Better Business Bureaus and other authorities as discussed in Chapter IV?

2. Have you honestly compared what it would take to start a similar business of your own with the price asked for the business you are considering buying?

3. Has your lawyer checked to see that the title is good, that there are no liens against the business and no past due taxes or public utility bills?

4. If it is a bulk sale, has the Bulk Sales Law been complied with?

5. Have you earnestly investigated possible developments, such as those discussed in Chapter IV, that might affect the business adversely?

V. *Justifying the New Business*

1. If your new firm will be similar to established businesses, have you checked statistical data as recommended in Chapter V?

2. If your business will be based on an entirely new idea, have you attempted to secure actual contracts or commitments from potential customers instead of merely getting their polite approval of your idea?

3. Have you discussed your proposition with competent advisers who are in several different occupations or who have different, but important, viewpoints?

VI. *Financing and Organizing the Business*

1. Have you written down a complete, itemized list of all capital needs for starting your kind of business, including a fair allowance for operating expenses and your own living expenses until the business is able to support itself *and* a substantial reserve for the one serious error most businessmen make during their first year of operation?

2. Have you discussed this financial prospectus with a banker and a successful businessman in your proposed field?

3. If available for your kind of business, have you used as a guide: (a) the appropriate U. S. Department of Commerce *How to Establish and Operate* manual? (b) the standard operating ratios for your business in calculating your capital requirements? (c) the "Worksheet for Determining Capital Needs" prepared by the U. S. Department of Commerce?

4. Are you sure you have made ample provisions for your personal and family needs during the period when no funds should be withdrawn from the business?

5. Have you considered all the factors for and against each legal form of organization?

6. If you plan to secure much of your initial capital from friends or relatives, are you *certain* that your business will remain free of "friendly" domination?

VII. *Selecting the Profitable Location*

1. Have you compared several different possible locations before making your final choice?

2. Have you used one or more detailed check lists, such as the one presented in Chapter VII, to guide your selection?

3. Have you arranged for legal counsel before signing the lease and any similar contracts?

4. Are you, and the members of your family affected, satisfied that the community in which you plan to locate will be a desirable place to live and rear your children?

5. If your proposed location is not almost ideal, are there sound reasons (not merely your impatience to get started) why you should not wait and begin working to secure a more nearly ideal location?

VIII. *Building and Layout*

1. Have you studied your proposed building with function, construction, and modernization in mind?

2. Have you made a personal inspection of the physical plant of other successful businesses similar to the one you plan to start, including both independents and branches of large organizations?

3. Have you planned your proposed layout for the building to scale on paper?

4. If the proposed building does not meet all of your important needs, are there any *good* reasons for deciding to use it?

IX. *Establishing the Business Policies*

1. Have you made an honest, objective investigation of the probable success of your proposed policies?

2. Have you written down the main provisions of your general and major policies?

3. Have you discussed your proposed policies with competent advisors to counteract the beginner's tendency to offer what *he* likes and wants instead of what his potential *customers* like and want?

4. Have you written down an adequate statement of the reputation you want your business to acquire with customers, suppliers, and competitors?

5. Have you made adequate provisions to insure that your policies will be understood and enforced and that you will receive ample warning of the need for policy adjustments?

X. *Management and Leadership*

1. Have you planned the way you will organize duties and responsibilities?

2. Have you made up a tentative plan or schedule to guide the distribution of your own time and effort?

3. Have you planned ways to conserve your time and energy by using management aids such as policies, standards, budgets, schedules, and others discussed in the text?

4. Have you provided some check on your own actions to insure that you do adequate management planning before making commitments or important decisions covering future activities of the business, as illustrated by the cases in Chapter X?

5. Have you arranged to use periodically some check list (such as that presented in Chapter X) covering detailed activities regarding customer relations, maintenance, safety, or whatever type of activity will require close attention to details in your particular business?

XI. *Employee Relations*

1. Have you investigated thoroughly the advisability of employing friends and relatives as compared to employing persons only on the basis of objectively determined qualifications?

2. Have you planned working conditions to be as desirable and practical as possible? Are you sure that what *you* think will be pleasant to your employees?

3. Are you certain the employee incentives you plan to use represent the workers' viewpoint rather than what *you* think they want?

4. Have you planned your employment, induction, and follow-up procedures?

XII. *Relationships with Resources*

1. Have you considered each of the desirable objectives in choosing a particular supplier as discussed in Chapter XII before selecting the companies you plan to deal with?

2. Have you carefully analyzed the points for and against concentrating your purchases with one or a few vendors, taking into account your personal skill and ability as well as conditions in your line of business?

3. Have you given adequate attention to each of the fundamentals of buying discussed in Chapter XII in making your plans for this function?

4. Have you investigated your field of business with reference to the presence and advantages of voluntaries or coöperative buying groups?

XIII. *Sales Promotion*

1. Have you analyzed your probable competition in connection with the direct and indirect sales promotional methods you plan to use?

2. Have you planned definite ways to build and maintain superior customer relations?

3. Have you defined your potential customers so precisely that you could describe them in writing?

4. Have you decided how you can measure and record the degree of success achieved with each sales promotion so that you can repeat the "hits" and avoid the "duds"?

5. Have you made provisions to secure a sales promotional calendar applicable to your kind of business?

6. Have you considered different features of your business that would be appropriate for special promotions timed to your customers' needs and interests?

XIV. *Advertising for Profit*

1. Have you put in writing your own list of "do"s and "don't"s to guide your advertising?

2. Have you made a list of all the media suitable for use in *your* business with some evaluation of each?

3. Have you selected the most promising reasons why people should patronize your business and incorporated them in plans for your opening advertising?

4. Have you made use of all appropriate sources in the preparation of a good initial mailing list?

5. Have you given careful thought to the advertising value of the proposed names for your firm, products, and services?

6. Have you made plans for some unusual gesture of welcome and appreciation for all customers during the opening days of your business?

7. Have you planned how you can measure the effectiveness of your advertising?

8. Have you arranged to use an advertising check list, such as the one presented in Chapter XIV?

XV. *Pricing for Turnover and Profit*

1. Have you thought through the desirability of and difficulties connected with acquiring the price reputation you plan for your business?

2. Have you considered the probable reaction of competitors to your pricing practices?

3. Have you compared the relative importance in your business of each major marketing instrument, including price?

4. Have you investigated possible legal limitations on your pricing plans?

5. Have you considered possible applications of price lining and brand lining to your business?

6. Have you decided on the formula or method you will use in pricing each class of goods and services?

7. Have you decided how and to what extent you will meet probable price competition?

XVI. *Expense Control*

1. Have you investigated the standard systems of expense classifications used in your field and selected the most appropriate one for your use?

2. Have you determined what are usually the largest items of expense for your type of business and made definite plans for controlling these expenses from the very beginning of the business?

3. Have you determined which, if any, expense items, though normally small for your type of business, very easily become excessively large unless carefully controlled *at all times?*

4. Have you prepared on paper a *flexible* expense budget for two or three different probable amounts of volume of business, including provisions for frequent operating expense reports to be compared with planned figures in your budget?

5. Have you determined the standard operating ratios for your field that you plan to use as guides?

6. Have you compared the expense of "farming out," or having certain activities of the business done by outside agencies, with what it would cost you to do the work yourself?

XVII. *Inventory or Stores Control*

1. Have you determined carefully what constitutes a *balanced* inventory for your business?
2. Have you recorded on paper the exact information you will need for effective inventory control?
3. Have you planned the best methods for securing this information?
4. Have you selected the most appropriate inventory control *system* to use?
5. Have you planned the best procedures to use for stock or stores-keeping?
6. Have you listed the purposes and uses of information you plan to secure from your inventory or stores control system?

XVIII. *Regulations and Taxes*

1. Have you ascertained from reliable sources all regulations that must be complied with for your business?
2. Have you provided for an adequate system of record keeping that will furnish essential information for all taxation purposes?
3. Have you checked the police, health, fire, and other safety regulations that apply to your business?
4. Have you provided for securing all information from employees required by law?
5. Have you obtained a social security number?
6. Have you checked with competent advisors systems you plan to use in paying sales, excise, and similar taxes?
7. Have you complied with regulations governing the use of a firm or trade name, brand names, or trade-marks?

XIX. *Credit and Collections*

1. Have you carefully investigated the need for credit extension by your business?
2. Have you planned specifically the various ways you will secure and use information obtainable from your charge account customers?
3. Have you made a personal investigation of the services and costs of affiliating with the local credit bureau?
4. Have you planned the basic procedures you will *always* follow before extending credit to any applicant?
5. Have you formulated plans to *control* all credit accounts?

XX and XXI. *Records*

1. Have you decided what records will be adequate for each division and need of your business?

2. Have you secured the necessary forms to enable you to start keeping adequate records from the first day of operation of the business?

3. Have you planned your record system so that appropriate use will be made of standard operating ratios?

4. Have you investigated the possibilities of using simplified record keeping systems for some of your needs?

5. Have you considered applications of the "one-book" system to your business?

6. Have you decided when and by whom each record needed will be kept?

7. Have you investigated the advantages and cost of using some outside agency, such as the "Mail Me Monday" system?

8. Have you made plans for keeping essential records in addition to your accounting records?

9. Have you investigated the record keeping system recommended by the trade association in your field?

INDEX

INDEX

A

Acceptances, 598–599
Accidents, causes of, 366
Accountant, capital requirements of, 145–146
Accounting records, 664–677
Accounts receivable, analyzing according to age, 677
Achievement tests, as employment procedure, 345
Adapting the building, 238–247
Advertisability (*see* Expansibility)
Advertising, 450–484
  agencies, 456–461
  as expense, 189–191
  basic factors, 452
  by mail, 470–473
  check list, 453–454
  classified, 462–463
  determining the right amount, 455–459
  direct, 470–473
  do's and don'ts, 484
  effect on profits (*table*), 489
  expense control, 528
  expenses, 524
  for the service business, 480–484
  for the small factory, 478–480
  for the small retailer, 473–476
  for the small wholesaler, 476–478
  groundwork, 454–455
  handbill, 469–470
  mailing lists, 688
  mat services, 460–461
  means of testing, 451
  media, 461–473
  newspaper, 462–463
Advertising (*Cont.*):
  outdoor, 228
  percentage of net sales (*table*), 456–457
  pretesting, 451
  principles, 450
  radio, 464–469
  regulations, 608
  relation to net sales volume, by industries (*table*), 458
  sign, 468–469
  split run testing, 451
  telephone-book classified, 463–464
  types, 451–452
  window, 475–476
Affinities of retail stores, 191–193
A. G. (*see* Associated Grocers)
Agency, as principle of law, 594–595
Agents (*see* Agency, as principle of law)
A. I. L. (*see* American Institute of Laundering)
Air conditioning, 246–247
Air travel:
  effect on wholesaling locations, 208, 211
"All-Facts Improved Bookkeeping System," 694–704
"Allied trade," as resources in laundry and dry cleaning fields, 377
American Foundry Institute, 91
American Institute of Laundering, 547
American Management Association, 58

Amos Parish's forecasting agency, 299
Anti-loss leader laws, 493, 499, 603–604
Anti-trust laws, 599–600
Application blank for employment, 340–341
Application for credit (*figure*), 644
Appraisal of going concern, 87–106
  advice to the novice, 103–106
  check list of considerations, 88–89
  factors:
    estimates, 101–103
    intangibles, 96–101
    profits, 90–93
    tangible assets, 93–96
  need for, 87
  qualifications, 88
  recommendations by Better Business Bureau, 105–106
Area Development Division, U. S. Department of Commerce, 215
  analysis of factors influencing industrial location, 220–221
Arthur Mincer Company, 406
Asset and Depreciation Record (*figure*), 703
Assets, tangible, 93–96
Associated Credit Bureaus of America, Inc., 629
Associated Grocers, 397
Association of Buying Offices, 405
Automobile repair shop, 307
  advertising, 481
  advertising ratio, 459
  buying, 416
Authority, assignment of, 328
Axioms of success and failure, 68–75

B

Backtrack flow:
  means of avoiding, 273–274
Bad debt losses, 646
Bad debts, 524
Balance-of-stores record (*figure*), 582
Balance sheet, 672–677, 698, 701
Banker's acceptances, 599
Bank loans (*see* Loans)
Banks (*see* Lending institutions)
Basic stock, 566
BAWI, Mississippi, 163
Beauty parlor (*see* Beauty shop)
Beauty shop:
  advertising ratio, 459
  buying, 421
  employee relations, 367–369
  location, 231
  methods of remuneration, 369
  pricing, 508–509
  specialized service, 306
Ben Franklin stores, 398
Bernstein and Wolff, 406–407
Better Business Bureau, 105
Better Retailing, 361
Big business:
  advantages, 14–15
  efficiency:
    in manufacturing, 62–63
    in merchandising, 63–67
    in service fields, 67–68
  fields in which superior to small business, 16–18
  limitations, 15
  problems, 28
Bill of lading, 658
Bills of exchange, 597–598
Bin card (*figure*), 715
Bookkeeping (*see* Records)
Bookkeeping service, capital requirements of, 145–146
Borrowing (*see* Capital: methods of obtaining)
Brokers, 379
  merchandise, 405–407
Brown Derby, Hollywood, 245
Bryant Radio Company, 439–440
Budget policies, 289
Budgets, 521–522

Building (*see* Physical plant)
Bulk Sales Law, 103, 596
Burr Stores, 398
Business cycles, effect of, 725–726
Business opportunities (*see* Survey of business opportunities)
"Business opportunities racket," 22
Business ownership (*see* Small business: ownership)
Business policies (*see* Policies)
Butler Brothers, 91, 250, 394, 397–399
Buying, fundamentals of:
  determining needs, 382–383
  follow-up, 387
  locating suppliers, 384–385
  maintaining favorable relations, 385–386
  negotiating terms, 385
  receiving, checking, and marking, 386
Buying a business:
  arguments pro and con, 89–90
Buying habits of women in Fayetteville, Arkansas, 112–114
Buying motives, 116–117

C

Calculating machine, 689–690
Candymaking:
  advertising, 478
  capital requirements, 142–143
Capital:
  amount needed, 132–148
    for manufacturing, 139–144
    for service establishment, 144–147
    in merchandising, 133–139
    summary, 147
  borrowed, 148–149
  equity, 148–149
  fixed, 131–132, 288
  initial, 287–288
    sources (*tables*), 151, 154
Capital (*Cont.*):
  initial (*Cont.*):
    work sheet for estimating requirements for shoe store, 753–756
  intermediate, 132
  methods of obtaining, 149–166
    friends and relatives, 154–155
    lending institutions, 156–161
    miscellaneous, 162–165
    partnership or incorporation, 155–156
    trade financing, 161–162
  owner's equity, 130–131
  policies, 287–288
  sources, 148–165
  types needed, 148
  working, 132, 288
  work sheet for estimating initial requirements for shoe store, 753–756
Cashiering facilities, 258
Cashing personal checks, 641
Cash journal (*figure*), 699
Cash payments, 669–670
"Cats and dogs" (*see* Shelf-warmers)
Celotex, 123
Chain discount system, 500–501
Chain-sponsored agency or franchise stores, 394
Chain stores, 63–65
  absence in small towns, 184
Charga-Plates, 647
Charge account list, 622
Charge accounts, special services, 634
Chase Company, 355–356
Chattel mortgage, 625–626
Checking account, 669–670
Checking goods, 386
Check list for organizing and operating a small business, 775–782
"Checklist of Work Conditions," 358
Checks, 598–599

Chelton Company, 406
Classified advertising, 462–463
Class of trade, policies regarding, 295–296
Clayton Act, 593, 600
Clerk tabulation system of unit control, 564
Clover Farm Stores plan, 395–397
C.O.D. basis of sale, 658
Collateral, 159
Collections, 636–640
  by credit bureaus, 632–633
Color conditioning, 246
Commercial credit (*see* Mercantile credit)
Commission buying officers (*see* Merchandise brokers)
Common law, 593
Community industrial survey, 764–774
Competition, 101–102
  as factor in selecting location, 179
  plotting competitive outlets (*figure*), 195
  regulations, 599–601
Complaints:
  causes, 432–433
  handling, 438–439
Conditional sales contract, 625–626
Constitutional provisions, 593
Consumer credit, definition of, 625
Consumer surveys, 112–114
  used to determine customer wants, 389
Contracts, 595
Controlled credit system, 642–647
  application for credit, 642–645
Convenience goods, 193
Coöperative chains, 392–403
Coöperative groups, 392–403
Corporate chains, 185
Corporation, 168–170
Correspondence, 687
Cost accounting, 503, 530, 533, 542
Cost of goods sold, how to compute, 673
Coupon books, 625
Court decisions, 593
Credit, 621–659
  advantages, 621, 623–624, 670
  application, 642–645
  Charga-Plates, 647
  collections, 636–640
  cost, 641
  customer analysis, 651–654
  customer control analysis, 633–640
  definition, 623
  delinquent accounts, 646–647
  disadvantages, 623–624
  from resources, 162
  in manufacturing, 655–658
  in merchandising, 640–650
  instalment, 625–626
  insurance, 654–655
  in the service business, 658–659
  in wholesaling, 650–655
  limit, 645
  policies regarding, 297
  ratings, 654
  terms, 645, 656–658
  types, 625–627
Credit bureaus, 627–633
  collection services, 632–633
  policies, 305
  Personnel-Employment Credit Character Form (*figure*), 344
Credit Manual of Commercial Laws, 656
Cross flow, 273–274
Cross referencing, 688
Current ratio, 676
Customer analysis, 651–654
"Customer bait," 254
Customer complaints, causes of, 432–433
Customer control analysis, 633–635
Customer relations, 426–427
  check list for grocery store, 322–324

Customer relations (*Cont.*):
guides, 429–431
Customer service, policies regarding, 296–297
Customers' ledger, 668–669
Customer's Order Card, 583
Customer wants, 431–432

D

D. E. (*see* Distributive Education)
"Declaration of Estimated Tax," 681
Dehydration, 123
Delivery, 641
Delivery Record, 584
Demand forecasting, 542–543
Demand goods, 255–256
Departmentizing, 559
Department stores, 65–66
customers' reasons for preference (*table*), 113
Depreciation, 671–672, 678
Desks, 689
Developmental training, 348
Diamond Cleaner, 353–355
Diaper service, 233–234
Differential pricing, 505–506
Direct advertising, 470–473
Direct production costs, 543–544
Discounts, 506, 657
as incentives, to personnel, 362
importance of, 81–82
in wholesaling, 500–501
policies, 289–290
Distribution costs (*see* Marketing costs)
Distribution establishments, number of (*table*), 9
Distribution unit cost studies, 539
Distributive Education, 348–349, 360, 370, 428
Distributor Store program (Butler Brothers), 398–399
Diversified Occupations, 348–349
D. O. (*see* Diversified Occupations)
Dollar control system (*see* Inventory control: systems)
Drafts, 598–599
Drayage (*see* Trucking business)
Dress factory, records in, 686
Drive-ins, 229–230
Drug stores:
customers' reasons for preference (*table*), 113
Walgreen Agency Plan, 394, 395, 402–403
Dry cleaning plant:
advertising, 481
capital requirements, 145
expense control, 548
improving internal accessibility, 240–241
personnel problems, 371–372
pricing, 509–510
sales promotion, 441
Dun & Bradstreet, Inc., 91, 656

E

Elasticity of demand, 489–492, 495, 504
Electrical appliance shop:
advertising ratio, 459
buying, 417–419
Electrical hazards, 321
Electrical wholesaling, layout for, 263–264
Electricity, expense control of, 528
Eli Lilly and Company, 91
Employee relations (*see also* Personnel), 336–372
Employees:
placement, 346–347
promotions, 351–352
remuneration, 353–357
selection, 340–346
training, 347–351
transfers, 351–352
Employee's Earning Record, 704
Employment, advantages of, 30–31
Employment policies, 292–293

Employment procedures, 340–346
application blank, 340–341
Credit Bureau report, 342–344
interview, 345–346
references, 341–342
tests, 344–345
Employment records, 364–365
E.O.M. terms, 657
Equipment, office, 689–690
Equipment and fixtures, 95
Equipment records, 671–672
Excise taxes, 683–685
Expense control, 517–549
advertising, 528
budgets, 521–522
classification, 522–525, 529–530
electricity, 528
for the small factory, 540–547
in merchandising, 526–538
in the service business, 547–549
in wholesaling, 538–540
labor, 526–527
method studies, 525–526
operating ratios, 530–538
rent, 527–528
requirements, 521–522
Expense ratios (*see* Operating ratios)
Expenses:
advertising, 524
operating, 523–524
types, 517
Expansibility, 489–492
Expansion policies, 286–290
Extra dating, 657

F

"Facilitating industries," 213
Factory layout, 265–271
Failure:
causes, 80–81
statistics, 82–83
Fair Labor Standards Act, 610
Fair Trade laws, 493, 494, 501, 604–606
Fashion goods:
inventory control, 564
pricing, 497–498
Fayetteville, Arkansas, women of, buying habits of, 112–114
Federal Housing Administration, 163
Federal Mediation and Conciliation Service, 609
Federal Reserve System, 157
Federal Revenue Act, 683
Federal Trade Commission, 593, 600–601, 608
Federal Trade Commission Act, 600
Federal Unemployment Tax Act, 614–615
Federated stores, 398
Filing, 687–688
Films, training, 350
Finance companies, for small loans, 161
Finance policies, 286–290
Financial needs (*see* Capital: amount needed)
Financial reserves, 725
Financial statements, 672–677
Financing (*see also* Capital: methods of obtaining), 723–725
problems of, 27
Firestone Tire Company, dealer plan, 400
Flat rate pricing, 507–508
Flow chart, 273–274
Flow of goods and records (*figure*), 573
Food, Drug and Cosmetic Act, 606–607
Ford, Henry, 279
Former occupations of small business owner-managers, 12
Forms of organizations, 165–171
corporation, 168–170
partnership, 167–168
single proprietorship, 166–167
Franchises, 99–100

Frozen food lockers, sales promotion for, 441
Frozen food packaging, 123
Furniture, office, 689–690

G

Gamble-Skogmo, Inc., 400
Gamble Stores, 400
Gary, Indiana:
  fund to finance industries, 163
  Industrial Foundation, 217
General merchandise store, capital requirements of, 137–139
George-Deen Act, 294, 349
G. I.:
  loans, 163
  on-the-job training, 349
Goodrich Tire Company, 395
  dealer plan, 400
Good will, 97–99, 426
Goodyear Tire Company, 395
  dealer plan, 400–401
Goss Brothers Frozen Food Lockers, 441
Government control over business, 27
Grocery store:
  check list for good customer relations, 322–324
  credit policy, 636–638
  example of price lining, 495–497
Grocery wholesaling:
  inventory control, 573–574
  records, 686
Gross margin, 517
"Gross profit," 517
Guiding store traffic, 256

H

Handbill advertising, 469–470
Harco Toys, Inc., 302–303
Hardware wholesaling:
  customer analysis, 651–654
  inventory control, 570–571, 574, 575
Heart of the Ozarks Products Company, 279
H. G. F. stores, 397
Hopkins, C. C. (case study), 312–315
Hotels, expense control in, 548–549

I

I. G. A. (*see* Independent Grocers Alliance)
Impulse goods, 255–256
Incentive wage plans, 353–355
Income tax (*see also* Withholding tax):
  records, 678
Incorporation, as source of capital, 155–156
Independent Grocers Alliance, 397
Indirect production costs, 544
Industrial survey, community, 764–774
Ingersoll, Robert H., 279
Inherited businesses, 23
Initial retail price, 498–499
Instalment credit, 625–626
  principles to observe, 650
Instalment sales, financing of, 648–650
Insurance, credit, 654–655
Insurance agent, records for, 686
Intelligence tests, as employment procedure, 344–345
Inter-Bureau Report No. 1 (*figure*), 629
Interdependence of all business, 13–14, 68
International situation, effect of, on small business, 730
Interviews, as employment procedure, 345–346
Inventory, 88, 93–95
  relation to purchasing, 383
  retail method, 709–712
Inventory control, 554–588
  as means of increasing turnover, 558–559

Inventory control (*Cont.*):
by observation, 559–560
by on hand—on order—sold record, 560–562
by perpetual inventory record, 562
by physical check, 560
in manufacturing, 577–586
in merchandising, 557–570
in the service business, 586–588
inventory taking, 566–567
in wholesaling, 570–577
methods, 559–562
scope, 555–557
systems, 562–565
Inventory taking, 556–557, 560, 566–567
Invoice file, 670
IOU not a negotiable instrument, 597–598

J

Jack Sprat Food Stores, 397
Job analysis, 293, 338–339
Job description, 338–339
Job evaluation, 339–340
Job Instructor Training plan, 348
Job Methods Training program, 361–362
Job printer, records for, 685–686
J. S. Phelon and Company, 406
Justifying a new business, 109–126
if similar to established ones, 110–114
if unique, 114–121

K

Kentucky Chamber of Commerce:
inquiry form for location-seeking industry, 218–219
"What an Industry Employing 150 Men Means to a Community" (*figure*), 226

L

Labels, as sales promoters, 437
Labor, expense control regarding, 526–527
Labor legislation, 608–616
regulation of wages, hours, and working conditions, 610
settlement of labor disputes, 608–610
social security, 611–616
Labor - Management Committees, 363
in small factory, 365–366
Lanham Act, 607
Laundry:
advertising, 481
capital requirements, 145
expense control, 547
inventory control, 586–587
location, 232–233
modern methods, 78
personnel problems, 371–372
sales promotion, 441
standard accounting system, 547
Laws, 591–618
civil, 593
criminal, 593
labor (*see* Labor legislation)
objectives, 592
origins, 592
principles, 594–599
agency, 594–595
contracts, 595
negotiable instruments, 597–599
sales, 595–597
Lay-away sales, 625
Layout, 241, 250–274
factors to consider, 251–252
factory, 265–271
process or job, 265
product or straight line, 265–266
how to plan, 253–255
manufacturing (*see* Layout: factory)
merchandising, 252–259
poor layout, indications of, 319–320

Layout (*Cont.*):
relative value of space (*diagram*), 254
service establishment, 271–274
merchandising type, 271–272
processing type, 272
wholesaling, 259–265
Leaders, 499
Leadership, 331
"Lead time" in buying, 412–413
Leases, 197, 200
Lee Skirt Company, 301
Lending institutions, 156–161
Letter service companies, 690
Licenses, 616–617
Lighting, 245–246
List prices, advantages of using, 506
Loans:
character, 157
collateral, 157
equipment, 158
finance company, 161
instalment, 157–158
mortgage, 158
proper ratio to owner equity, 160
secured by accounts receivable, 158
secured by warehouse stocks, 158
standards, 158
Location, 173–235
advantages where one is well known, 174
agencies assisting, 218–219
beauty shop, 231
check list, 176–178
competition as factor in selection, 179
diaper service, 233–234
factory, 212–228
advantages of agricultural community, 225–228
agencies assisting, 215–228
factors influencing, 220–221
questions to consider, 224–225
Location (*Cont.*):
factory (*Cont.*):
reasons for selecting a particular community, 221–224
selection of site, 228
work sheet for analyzing basic factors, 221
laundry, 232–233
manufacturing (*see* Location: factory)
personal factors, 174
photographic supply store, 233
radio service business, 234–235
retail, 179–204
selecting district, 185–189
selecting site, 189–204
size of town, 183–185
restaurant, 231–232
selecting district, 208–209
class of trade desired as factor, 187–188
nature of merchandise as factor, 187
volume size of store as factor, 188–189
selecting region, 173
selecting site, 209–212
accessibility as factor, 194
check list, 201–203
environment as factor, 191–194
rent as factor, 197–200
site history as factor, 200
store building as factor, 196–200
traffic analysis as factor, 194, 196
selecting town, 173–179, 205–208
service business, 228–235
beauty shop, 231
diaper service, 233–234
laundry, 232–233
photographic supply store, 233
radio service business, 234–235
restaurant, 231–232

Location (*Cont.*):
wholesaling, 204–212
selecting district, 208–209
selecting site, 209–212
selecting town, 205–208
Location system, 586
Louisville, Kentucky, fund to finance industries, 163
Lumber dealer, records for, 685

M

Machine hazards, 321
Machine tool factory, modern methods in, 78–79
Mailing lists, filing of, 688
"Mail Me Monday" service, 666
Mail order competition, 500
Mail order houses, 66
Management, 312–333
seven "m's" of, 62
Management functions:
control, 326–327
coördination, 327
direction, 325
supervision, 325–326
Managerial aids, 722
Manpower, 102–103
Manufacturers' voluntary chains, 393–394
Manufacturing:
advantages of big business in some kinds of, 16–19
advertising, 478–480
buying, 411–414
capital requirements, 139–144
credit, 655–658
definition, 50
efficiency of big business, 62–63
expense control, 540–547
factory building, special requirements, 248
inventory control, 577–586
layout, 265–271
modern methods, 78–79
personnel, 363–367
policies, 300–305
Manufacturing (*Cont.*):
pricing, 502–507
salesmen, 366–367
sales promotion, 436–439
superiority over other types of business activity, 225–227
trends, 58–60
"What an Industry Employing 150 Men Means to a Community" (*figure*), 226
Market analysis, 117–121
getting the facts, 119
importance to small businessman, 117–118
organizing the facts, 120
reviewing the possibilities, 120–121
trying out the plans, 121
Marketing:
direct, 489–490
indirect, 487–489
Marketing costs, 487–493
Marketing instruments, 492
Market promotion costs, 546
Market representatives, 403–407
merchandise brokers, 405–407
paid buying officers, 404–405
Market research, 723
Market trends, means of determining, 391–392
Marking goods, 386
Markon, 498–499
Markup, policies regarding, 298
Material costs, 545
Mat services, 460-461
Maximum stock standards, 575–576
Mercantile credit:
definition, 625
insurance, 654–655
ratings, 654
Merchandise brokers, 405–407
Merchandise control (*see* Inventory control)
Merchandise regulation, 606–608
Food, Drug and Cosmetic Act, 606–607

Merchandise regulation (*Cont.*):
patents and trade-marks, 607–608
Wool Products Labeling Act, 607
Merchandise tag system of unit control, 564
Merchandising (*see also* Retailing; Wholesaling):
advantages of small unit in, 18–20
buying, 388–412
capital requirements, 133–139
cost accounting, 530
credit, 640–650
definition, 50
efficiency of big business, 63–67
example of successful policy, 285–286
expense classification, 529–530
expense control, 526–538
inventory control, 557–570
layout, 252–259
operating ratios, 530–538
personnel, 359–362
policies, 285–286
pricing, 493–500
sales promotion, 427–434
store building, special requirements, 247
trends, 60–61
Merchandising ratios (*see* Operating ratios)
Merchants Service Bureaus, 250
Metal-working shop:
inventory control, 587–588
layout, 268–271
Method studies (*see also* Distribution unit cost studies), 339, 525–526, 542
Michigan Department of Economic Development, work sheets for a community industrial survey, 221, 764–774
Middlemen:
functional, 379–380
merchant, 377–379
Miller-Tydings Act, 604
Millwork, inventory control, 583–585
Mincer (*see* Arthur Mincer Company)
Minimum stock standards, 575–576
Minneapolis Field Office, U. S. Department of Commerce, work sheet for analyzing industrial location factors, 221
Mississippi Agricultural and Industrial Board, 216
Mississippi BAWI, 163
Model stock, 566
Model stock plan, 390
Model stock system, 563
M. O. M. terms, 657
Morale:
building by means of non-financial incentives, 357, 359
function of Labor-Management Committees, 365–366
ways to build, 332–333
Mortgage, chattel, 625–626
Mortgage and Loan Record (*figure*), 703
Movable fixture units, 259

N

National Association of Dyers and Cleaners, 91
National Association of Retail Grocers, 91
National Cash Register Company, 250
National Institute of Credit, 648
National Labor Relations Act, 593, 608–609
National Labor Relations Board, 593, 608–609
National Resources Committee, 212
National Retail Credit Association, 643, 647–648

National Retail Hardware Association, 91, 250
Natural monopolies, advantages of big business in field of, 16–17
Negotiable instruments, 597–599
Net profit, 517
Net worth, definition of, 674
New ideas (*see* Justifying a new business: if unique)
Newspaper advertising, 462–463
New York University, School of Retailing, 361
Novelties, pricing of, 499

O

Oakland, California, encouragement of industry, 217
Office furniture, 689–690
Office of Price Administration, 604
Office procedures, 687–690
Old-age and survivors insurance, 611–614
Old Age and Survivors Insurance Tax, 678–679
"One-book" record system, 667, 693–704
One-price policy, 298, 502
On hand—on order—sold record, 560–562
On-the-job training, 349
Open account credit, cost of, 641
Open display, 256–257
Operating expenses:
  fixed, 523–524
  variable, 524
Operating ratios, 91–93, 139, 455, 525, 530–538, 673–674
Opportunities, business (*see* Survey of business opportunities)
Order points, 575–576
Organization, as aid to management, 327–330
Organization policies (*see* Policies: personnel)
Outdoor advertising, 228
Out-of-town buying, 113–114, 500
"Outs," 558, 563
Outside staff (*see also* Advertising agencies), 722
Overcapitalization, 164
Overhead expenses, 88
Overstocks, 556, 563
Owner's equity, 130–131, 287

P

Paid buying officers, 404–405
Paper work, 687–690
Partnership, 167–168
  as source of capital, 155–156
Patents, 607–608
  issued to small businesses, 10
Payment of bills, policies regarding, 289–290
Permits, 616–617
Perpetual Inventory Card, 587
Perpetual inventory record, 556, 557, 562, 563, 568–569
  in manufacturing, 578
Personnel (*see also* Employee relations; Employees):
  employment records, 364–365
  incentives, 362
  in manufacturing, 363–367
  in merchandising, 359–362
  in service business, 367–374
  Job Methods Training program, 361–362
  Labor-Management Committees, 365–366
  safety, 366
  study recommended, 74
  training program, 365
Personnel-Employment Credit Character Form (*figure*), 344
Personnel policies, 290–295
Personnel records, filing of, 688
Petty cash fund, 670
Phelon (*see* J. S. Phelon and Company)

Phonograph records, inventory control of, 568–569
Photographic supply store, location of, 233
Physical examination, as employment procedure, 345
Physical plant, 238–250
  accessibility, 239–241
  adapting building formerly used for special purpose, 243
  adapting the building, 238–247
  air conditioning, 246–247
  as advertising medium, 244
  as indication of type of business, 244–256
  color conditioning, 246
  constructing, 242–244
  cost, 239
  current trends in management, 242
  factory building, special requirements, 248
  floor coverings, 243
  function, 239–242
  human factors, 241–242
  internal transportation, 241
  layout, 241
  lighting, 245–246
  modernization, 244–247
  safety, 242
  service building, special requirements, 248–250
  store building, special requirements, 247
  suitability, 239
Piggly Wiggly store fronts, 245
Pittsburgh, University of, Research Bureau for Retail Training, 361
Placement of employees, 346–347
Plumbing and heating contractors, buying for, 415–416
P. M. (*see* Premium merchandise)
Policies, 173, 277–308
  credit, 297
  dangers, 280–281
Policies (*Cont.*):
  definition, 277–278
  departmental (*see* Policies: minor)
  employment, 292–293
  expansion, 286–290
  finance, 286–290
  general, 279
  importance, 282
  major, 279–280
  manufacturing, 300–305
  merchandising, 285–286
  minor, 280
  organization (*see* Policies: personnel)
  personnel, 290–295
  price, 298–299
  product, 283–286
  regarding class of trade, 295–296
  regarding contributions, 330
  regarding customer service, 296–297
  regarding employment of relatives, 330
  regarding markup, 298
  regarding sales promotion, 296
  retailing, 295–299
  service business, 305–308
  wholesaler's price, 502
  written and unwritten, 278–279
Portland, Oregon, Chamber of Commerce, 1947 Annual Report, 215
Power of attorney, 594
Premium merchandise, 362
Previous Residence Report No. 5 (*figure*), 630
Price cutting, 603–604
Price discrimination, 601–603
Price fixing, 601
Price lining, 298–299, 494, 495–497
  wholesale, 506
Price regulation, 601–606
  price cutting, 603–604
  price discrimination, 601–603
  price fixing, 601

Price regulation (*Cont.*):
resale price maintenance, 604–606
wartime, 604
Prices, policies regarding, 298–299
Price strategy, 487, 495, 499
Pricing, 486–511
differential, 505–506
factors, 489–490
for the service business, 507–511
initial retail price, 498–499
in manufacturing, 502–507
in merchandising, 493–500
in wholesaling, 500–502
legal regulation, 493
Pricing records, filing of, 688
Problems of big business, 28
Problems of small business, 20–28, 722
Producers, 377
Product identification, 304
Production costs, 543–544
Production credit (*see* Mercantile credit)
Product policies, 283–286
Profit and loss statement, 518–521, 672–677, 698, 701
examples (*tables*), 519, 520
Profit ratio, 88
Profit sharing, 356–357
Promissory notes, 597–599
Promotions, 351–352
policies, 292
Property, 595
Proprietorship, single, 166–167
Publicity, 442–443
Purchase records, 670–671
Purchasing agents (*see* Market representatives)
Purchasing records, filing of, 688
Pure Food and Drug Act, 606

R

Radio advertising, 464–469
best hours, 466
cost, 464
Radio advertising (*Cont.*):
public service features, 466–467
"spot" announcements, 464–466
"station break" commercials, 466
Radio service business:
advertising ratio, 459
buying, 417–419
location, 234–235
sales promotion, 439–440
Receiving goods, 386
Reconstruction Finance Corporation, 163
Record keeping, 663–690
Records, 663–690
accounting, 664–677
cash payments, 669–670
customers' ledger, 668–669
dress factory, 686
employment, 364–365
equipment, 671–672
grocer, wholesale, 686
how long to keep, 689
importance stressed, 74
insurance agent, 686
in the service business, 712–717
job printer, 685–686
lumber dealer, 685
miscellaneous, 685–690
need for information concerning, 23–24
needs met by adequate records, 666–667
"one-book" system, 667
personnel, 688
pricing, 688
purchase, 670–671
purchasing, 688
sales, 667–669
tax, 677–685
which ones necessary, 707–708
References for employment, 341–342
Regulations, 591–618
advertising, 608
permits, 616–617

Regulations (*Cont.*):
pertaining to competition, 599–601
price (*see* Price regulation)
restrictions, 616–617
Relations with resources (*see* Resources)
Relatives, employment of, policies regarding, 330
Remedial training, 348
Remuneration of employees, 353–357
Rent, 197–200
as expense, 189–191
expense control, 527–528
Rent ratios:
factors influencing (*table*), 187
for retail stores (*table*), 198–199
in wholesaling, 210
Repair business:
capital requirements, 145
personnel problems, 371
records, 712–717
Reputation, 277
importance in service business, 306
Requirements for business ownership, 38–47
abilities and skills, 43–44
general business attitudes, 39
personality traits, 40–43
rating list, 42–43
Requisition system of inventory control, 563
Resale price maintenance, 604–606
Resale price maintenance laws (*see* Fair Trade laws)
Research, 723
Research Bureau for Retail Training, University of Pittsburgh, 361
Resident buying officers (*see* Market representatives)
Resources, 376–422
buying from (*see* Buying, fundamentals of)
Resources (*Cont.*):
types:
functional middlemen, 379–380
merchant middlemen, 377–379
producers, 377
"Resources file," 387
Responsibility, assignment of, 328
Restaurants:
advertising, 481–482
advertising ratio, 458–459
buying, 419–421
location, 231–232
personnel problems, 369–371
Restrictions, 616–617
Retailer coöperatives, 393
Retailing (*see also* Merchandising):
advertising, 473–476
buying, 388–407
layout (*see* Layout: merchandising)
location (*see* Location: retail)
modern methods, 76–77
policies, 295–299
suitability of small business for, 19
Retail Method, 562, 567–568, 709–712
"Retail reductions," 498
Retail store—population relationships (*table*), 181
Return material tag (*figure*), 716
Reverse demand curve (*see* Price lining)
R. F. C. (*see* Reconstruction Finance Corporation)
Rice-Stix Manufacturing Wholesalers, 250
Roadside stores, trend toward, 122
Robert Morris and Associates, 91
Robinson-Patman Act, 65, 505, 593, 601–602, 657
R.O.G. terms, 657
Roswell Laundry and Dry Cleaning Company, 441

S

Safety, 318–321, 366
  electrical hazards, 321
  handling of materials, 320
  housekeeping, 320
  layout, 319–320
  machine hazards, 321
  maintenance, 320
Sales, 444–445, 595–597
Sales finance companies, 648–649
Sales force, guide for checking, 434
Salesmanship, 428, 442
Salesmen, importance of careful selection, 366–367
Sales promotion (*see also* Advertising), 425–447
  check list, 445
  definition, 425
  direct, 425–426
  indirect, 425–426
  in manufacturing, 436–439
  in merchandising, 427–434
  in the service business, 439–442
  in wholesaling, 434–436
  policies regarding, 296
  special aspects, 442–447
  special methods, 446–447
  use of charge account records, 634–635
Sales—Purchases (*figure*), 700
Sales records, 667–669
  analyzing to determine customer wants, 388–389
  filing, 688
Sales tax, 682–683
Sawmill, capital requirements of, 143–144
School of Retailing, New York University, 361
Schulte-United, 185
"Scientific management" movement, 58–59
Scott Stores, 398
Seasonal goods, pricing of, 497–498
Season dating, 657
Selection of employees, 340–346
Service business:
  advantages of small unit, 18–20
  advertising, 480–484
  amount, 50–51
  buying, 411–412, 414–422
  capital requirements, 144–147
  credit, 658–659
  definition, 50–54
  efficiency of big business, 67–68
  expense control, 547–549
  inventory control, 586–588
  layout, 271–274
  location (*see* Location: service business)
  modern methods, 78
  personnel, 367–374
  policies, 305–308
  pricing, 507–511
  records, 712–717
  sales promotion, 439–442
  service building, special requirements, 248–250
  trends, 61
Service station:
  advertising, 481
  buying, 416–417
  personnel problems, 369–370
  special requirements, 249–250
Seven "m's" of management, 62
Sheet metal shop, buying for, 413–414
Shelf-warmers, how to sell, 446–447
Sherman Anti-Trust Act, 599
Shoe store, work sheet for estimating initial capital requirements, 753–756
Shopping goods, 494
  inventory control, 564
"Shorts," 556
Showmanship, 429, 446
  in direct mail advertising, 472
Sight drafts, 599, 658
Sign advertising, 468–469

Single-price policy, 298
Single proprietorship, 166–167
"Sleepers," 558
Slow accounts, 636
Small business:
  amount (*table*), 9
  causes of failure, 80–81
  classification, 49–54
  compared with big business, 6
  definition, 1–8
    by characteristics, 1–3
    by statistics, 3–4
  distribution of, by fields (*table*), 5
  fields in which superior to big business, 19–20
  importance, 7–14
    to develop self-reliance, 11
    to improve working conditions, 10
    to link big business to markets, 13
    to maintain free, competitive economy, 8, 10
    to provide new ideas, 10
  numbers of important types, 49–50
  ownership:
    advantages, 31–36
    disadvantages, 36–38
    extent, 44–47
    reasons, 35
  prerequisites, 69–71
    ability, 71
    capital, 71
    experience, 70
    opportunity, 69–70
  problems, 20–28, 722
    caused by "business opportunities racket," 22
    due to existing conditions, 26–28
    due to the individual, 21–26
    financing, 27
    lack of liquid reserves, 24
Small business (*Cont.*):
  problems (*Cont.*):
    lack of time, 24
    requirements, 38–47
    successful principles and practices, 76–79
    suggestions, 72–75
Small-scale financing, problems concerning, 724
Small town markets, 183
Smith-Hughes Act, 294, 349
Social controls, 617
Social security, 611–616
Social security taxes, 678–679
Society for the Advancement of Management, 58
Soundness of new business (*see* Justifying a new business)
Specialties, pricing of, 499
Split run testing, of advertising, 451
Standard Consumer Credit Report (*figure*), 629
Statutes, 593
Statutes of limitations, 689
"Stock envelope" system of inventory control for phonograph records, 569
Stock standards, 575–576
Stone Engineering Company (case study), 316–318
"Store" business, in wholesaling, 210
Store front, design of, 247
Store layout (*see* Layout: merchandising)
Stores control (*see* Inventory control)
Storeskeeping, 556
Straight line flow, means of achieving, 273–274
Suburbs, movement of population toward, 122
Suggestions for prospective small businessmen, 72–75
Suppliers (*see* Resources)

Supply costs, 545
Supply houses, comparable to wholesalers, 377
Survey of business opportunities, 121–126
  by analyzing markets, 124
  by analyzing trends, 122–124
  by capitalizing on new industries, 126
  by noting consumer complaints, 124–125
  by observing habits of living, 125–126
  by starting with what you have, 121
  by studying present offerings, 125

T

Taft-Hartley Act, 609
T. & I. (*see* Trade and Industrial Education)
Tangible assets, 93–96
Taxes, 591–618
  excise, 683–685
  Old Age and Survivors Insurance, 678–679
  sales, 682–683
  social security, 678–679
  Unemployment Insurance, 678–679
  withholding, 679–682
Tax records, 677–685
Taylor, Frederick W., 58
Telephone-book classified advertising, 463–464
Terms available to small buyer, 385
Tests, as employment procedure, 344–345
3033 Retailing Ideas, 445
Time studies, 525
Trade acceptance, 598
Trade and Industrial Education, 348–349
Trade Clearance Report, 628
Trade financing, 161–162
Trade information, as means of determining customer wants, 389–390
Trade-Mark Act, 607
Trade-marks, 607–608
Traffic analysis, 194, 196
Training films, 350
Training of employees, 347–351
  developmental, 348
  remedial, 348
  use of training films, 350
Transfer of Record Report, 630
Transfers, 351–352
Transportation costs, 545
Travelers Cheques, 598–599
Trends in business management, 57–61
  in manufacturing, 58–60
  in merchandising, 60–61
  in service fields, 61
Trends in small business, 720–721
Trucking business, capital requirements of, 146–147
Turnover, 556
  effect on profits, 486, 492
  increasing by means of inventory control, 558–559

U

Undercapitalization, 164
Unemployment insurance, 614–616
Unemployment Insurance Tax, 678–679
Unfair practice laws, 499, 603–604
Unfair trade practice, 600
Uniform Negotiable Instruments Law, 597
Uniform Sales Act, 596
Unions:
  contribution to personnel management, 363
  representation on Labor-Management Committees, 365–366
Unit control systems (*see* Inventory control: systems)
United Cigar—Whelan Stores, 394

V

Variety stores, operating ratios of (*table*), 532
Vendors (*see* Resources)
Veterans Administration, as aid in financing small business, 163
Vocational education, 348–350
"Volume-itis," 542
Voluntary groups, 392–403

W

Wages, 353–357
  regulation, 610
Wagner Act (see National Labor Relations Act)
Walgreen's, 185
  Walgreen Agency Plan, 394, 395, 402–403
Want slips, 391
Western Auto Supply Company of Los Angeles, 185, 399–402
  Western Dealer Plan, 394, 399–402
  Western's Dealer Location Survey, 757–763
Westinghouse, 91
  "Accurate Service Record System," 712–716
Wheeler-Lea Act, 600, 608
Wholesalers:
  cash-and-carry, 377–378
  service, 377–378
Wholesaler-sponsored voluntary chains, 393
  Clover Farm Stores, 395–397
Wholesaling (*see also* Merchandising):
Wholesaling: (*Cont.*)
  advertising, 476–478
  buying, 407–411
  credit, 650–655
  decline in importance, 60–61
  developments leading to new locations, 208
  expense control, 538–540
  inventory control, 570–577
  layout, 259–265
  methods for determining cost of goods, 502
  price lining, 506
  pricing, 500–502
  reasons for patronizing particular wholesaler, 212
  sales promotion, 434–436
  unsuitability of small business for, 19
Wilson Jones Company, 694–704
Window advertising, 475–476
Withholding tax, 679–682
Women, buying habits of, in Fayetteville, Arkansas, 112–114
Wool Products Labeling Act, 607
Woolworth, Frank W., 279
Working conditions, regulation of, 610
Working hours, regulation of, 610
Work sheet for estimating initial capital requirements for establishing a shoe store, 753–756
Work sheets for a community industrial survey, 764–774
Wrapping facilities, location of, 258

Z

Zoning restrictions, 617