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Title Introduction to Modern Busin

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# INTRODUCTION
# TO
# Modern Business

# INTRODUCTION TO Modern Business

BY

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# FOREWORD

MANY STUDENTS who enroll in collegiate schools of business or departments of business in liberal-arts colleges have a broad concept of occupational opportunities in business and industry, gained through their contacts with secondary-school guidance programs and society in general. The recent emphasis on guidance in the secondary schools has done much to help students make plans for their adult lives, although the area cannot be covered thoroughly because of the immaturity of the students and the limited amount of time that these schools have to devote to it.

Approximately one-third of the high-school graduates in this country continue with some type of advanced education, and a large percentage of these decide upon a career in business. Few students entering college know enough about the specific kinds of jobs available. Their limited knowledge prohibits them from making an exploration of their individual interests and aptitudes, although this is obviously a prerequisite to the selection of a sound educational program of preparation. Successful individual achievement in any kind of business enterprise is greatly dependent upon interest, aptitude, and preparation. When these elements are present, the possibility of maladjustment in business occupations is decreased.

Colleges preparing students for business careers can no longer justify a program that gives only formal information. In addition to providing a foundation of broad, technical courses, they must make available an educational program that will aid youth in selecting, preparing for, entering upon, and succeeding in the proper vocation or profession.

The authors of this book are business educators whose experience in education have provided them with a broad knowledge of business and a complete understanding of the problems of students. In developing the material for the book, they have provided information useful for orientation courses and necessary as a foundation for further study in economics and business. By describing the advantages and disadvantages of different kinds of occupations, the kind of educational background necessary to succeed, and the possibilities for advancement, they have included additional information to aid students in exploring

various job opportunities. Equipped with the information and guidance provided by this book, the student may avoid frustration and discouragement in the important task of selecting and preparing for his life work.

CECIL PUCKETT, *Dean*

*College of Business Administration*
*University of Denver*

# PREFACE

As its title suggests, this book is written for use in an introductory course in business training. The authors have endeavored to present a complete one-volume textbook describing how business is organized, managed, and controlled. To this end the interrelationships among the various departments of a business are made clear, and the way each department contributes to the operation of the organization as a unit is emphasized.

One distinctive feature is the inclusion of occupational-guidance material about careers in business. The authors believe that providing accurate information about business occupations in a course of this kind will help students to make an intelligent choice of their major field of specialization. For example, the chapter on accounting as a tool in business also presents occupational facts about the work of the accountant, including his education, employment opportunities, and professional standards. Similar occupational information is offered in connection with the study of such other business functions as advertising, banking, marketing, and personnel management, to mention only a few.

This book may be used in an introductory course in business that is to be followed by more advanced courses in specialized fields such as accounting, advertising, banking, economics, finance, marketing, insurance, and retailing. Its scope is broad enough to recommend its use also in terminal courses in general business administration in institutions that offer fewer specialized advanced courses in the business curriculum.

The authors have purposely avoided lengthy discussions of economic theories. Instead, the material presented is functional. Actual business practices are emphasized, as are practical illustrations. Since this book is designed as a general introduction to business, the accent is on practices rather than theories.

A second feature is the presentation of a wide choice of carefully selected instructional aids to complement the basic text. These aids are in the form of terms for study, questions, problems and projects, and lists of selected readings at the end of each chapter. A workbook for student use and a manual for teachers are available.

The authors are indebted to many business organizations for their generosity in supplying tables, charts, graphs, photographs, and statistical data. More specific acknowledgments are made in the appropriate places. The authors wish to acknowledge and express their appreciation for the help of colleagues who served as critics in reading portions of the manuscript and who offered suggestions for its improvement. Among those who furnished helpful suggestions are: Professors Jerome M. Peschke, Rolland G. Crouch, John P. Owen, and Jay Lonnie Grisham of the College of Business Administration, University of Houston; Professors Theodore Cutler, Wayne Shroyer, and F. L. Carmichael, and Dean Cecil Puckett of the College of Business Administration, University of Denver; Professor Margaret Bell Humphreys of the College of Commerce, University of Kentucky; Dean Ellis M. Sowell and Professors Herbert R. Mundhenke, Troy Crenshaw, and Estus C. Polk of Texas Christian University; and Professor Tom Rose of North Texas State College.

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# CONTENTS


PAGE

FOREWORD, by Dean Cecil Puckett . . . . . v
PREFACE . . . . . vii

## PART I: BUSINESS AND YOU

CHAPTER

I. YOUR BUSINESS CAREER . . . . . 1
Surveying the Field . . . . . 2
Measuring Your Qualifications . . . 5
Finding Employment . . . 12
Going into Business for Yourself 16
Looking Ahead 17

II. THE CONSUMERSHIP APPROACH TO BUSINESS TRAINING 24
Consumer Characteristics 24
The Student as a Consumer 37

## PART II: ECONOMICS OF BUSINESS

III. ECONOMIC ASPECTS OF BUSINESS 47
An Appreciation for Our Economic History . 47
The Capitalistic System 50
American Economic Factors . 53
Cyclical Behavior Patterns of Our Economy . . . 64

IV. FORMS OF BUSINESS ORGANIZATION . 73
Individual Proprietorship . . 74
General Partnership . . . . 77
Limited Partnership . . . . . 81
Joint-Stock Company . . . . 82
Corporation . . . . . 82
Massachusetts Trust . . 96

## PART III: BUSINESS MANAGEMENT

V. BUSINESS MANAGEMENT AND INTERNAL ORGANIZATION . . . 101
What Is Management? . . . . . 101
Departments in Business . . . . . 108
Nature and Purpose of Organization . . . . . 112

CHAPTER PAGE

Types of Organization Plans . . . . . 114
Organization Charts . . . . . 120
Other Methods of Control . . . . . 120
Management Courses in Business Administration . . . 122
Opportunities in Management . . . . . 123

VI. The Small Business . . . . . 127
What Is Small Business? . . . . . 128
Organizing a Small Business . . . . . 130
Management . . . . . 134
Sources of Business Information . . . . . 135
Management for Specialized Business Enterprises . . . 137

PART IV: MANAGERIAL CONTROLS

VII. Accounting in Business . . . . . 149
The Importance of Accounting in Business . . . . . 149
The Nature of Accounting Work in Business . . . . . 152
Financial Statements . . . . . 160
Accounting as a Career . . . . . 168

VIII. Statistics and Research in Business . . . . . 175
Significance of Statistics and Research in Business . . . 175
The Nature of Statistics and Research . . . . . 177
Methods of Measurement . . . . . 181
Presentation of Statistical Data . . . . . 188
Statistics as a Career . . . . . 195

IX. Office Management and Secretaryship . . . . . 200
Major Areas of Office-Management Problems . . . . . 202
Qualifications of the Office Manager . . . . . 218
Secretaryship in Business . . . . . 219

PART V: PERSONNEL AND LABOR RELATIONS

X. Personnel Management . . . . . 226
The Significance of Personnel Management . . . . . 226
The Nature of Personnel Work in Business . . . . . 228
Personnel Management as a Career . . . . . 249

XI. Labor-Management Relations . . . . . 256
Importance of Labor-Management Relations . . . . . 256
Labor Organizations . . . . . 258
Collective Bargaining . . . . . 260
Settlement of Labor Disputes . . . . . 268

## PART VI: FINANCE AND BUSINESS RISKS


| CHAPTER | | PAGE |
|---|---|---|
| XII. | BANKING AND FINANCE | 276 |
| | Banking | 276 |
| | Long-Term Financing | 290 |
| | Stock Exchanges | 293 |
| | Financial Planning | 294 |
| | Other Financial Institutions | 296 |
| | Careers in Banking and Finance | 299 |
| XIII. | BUSINESS RISKS AND INSURANCE | 304 |
| | Kinds of Business Risk Insurance | 310 |
| | Social Security | 322 |
| | Careers in Insurance | 325 |


## PART VII: GOVERNMENT AND BUSINESS


| | | |
|---|---|---|
| XIV. | GOVERNMENT REGULATION OF BUSINESS | 331 |
| | Why Government Control of Business? | 331 |
| | Types of Regulations | 333 |


## PART VIII: PRODUCTION


| | | |
|---|---|---|
| XV. | PRODUCTION IN MODERN BUSINESS | 357 |
| | Production the Cornerstone of American Business | 357 |
| | Characteristics of Production | 358 |
| | The Nature of Production Processes | 365 |
| | Choice of Plant Location | 369 |
| | Plant Layout | 373 |
| | Materials Purchases and Inventory Control | 375 |
| | Production Control | 380 |
| | Careers in Production Work | 386 |


## PART IX: DISTRIBUTION


| | | |
|---|---|---|
| XVI. | MARKETING | 390 |
| | Functions of Marketing | 394 |
| | The Commodity Approach in Marketing | 405 |
| | Co-operative Agencies | 410 |
| | Foreign Trade | 416 |
| | Employment and Promotional Opportunities in Marketing | 418 |
| XVII. | DISTRIBUTION PROCESSES | 424 |
| | The Importance of Middlemen | 424 |

| CHAPTER | | PAGE |
|---|---|---|
| | Wholesalers | 426 |
| | Other Important Middlemen | 434 |
| | Warehousing Services | 435 |
| XVIII. | TRANSPORTATION | 450 |
| | Transportation the Keystone of Distribution | 450 |
| | Areas of Transportation | 453 |
| | The Traffic Manager | 472 |
| XIX. | RETAILING OUTLETS | 479 |
| | Retailing an Integral Part of Marketing | 479 |
| | Functions of Retail Stores | 481 |
| | Types of Retail Stores | 485 |
| | Organization Plans | 493 |
| | Retailing as a Career | 497 |
| XX. | THE SELLING FUNCTION | 503 |
| | Selling Processes | 503 |
| | Selling as a Career | 520 |
| XXI. | ADVERTISING | 525 |
| | Nature of Advertising | 525 |
| | Measuring the Effectiveness of Advertising | 527 |
| | Advertising Media | 530 |
| | The Advertising Agency | 540 |
| | Advertising as a Career | 542 |
| | INDEX | 549 |

## CHAPTER I

# YOUR BUSINESS CAREER

EVERY STUDENT should give serious thought to the problem of choosing his life work. There are so many different occupations, however, that it is sometimes difficult to make a wise choice. Every reader of this book has expressed an interest in learning more about business, and he probably wants to pursue a career in some business occupation. He wants to know the principles upon which business is founded and to learn about current business problems, practices, and procedures. Above all, he wants to know more about the different types of business occupations, and whether or not a particular phase of business is the correct occupational choice for him.

The large number of people who are dissatisfied with the occupations they have chosen or been arbitrarily assigned to should serve as a warning to the student who is inclined to give this choice less attention than it deserves. Almost one-third of the people who were asked the question, "If you had your life to live over again, what three things would you do differently?" listed a different occupation as one of the changes they would make.[1] *Fortune* found that 41 percent of the men and women questioned in one of its quarterly surveys would choose a different career if they could go back to the age of 18 and start life over again.[2]

One of the purposes of this book is to help the reader learn more about the business world in which he lives and works, to help him understand the functions of business and how the different departments of a business enterprise are related to one another. Another purpose is to aid him in learning about the various opportunities for specialization in business employment so that he may choose his career wisely. A third purpose is to prepare a foundation for the study of other business subjects and to present a preview of further work in the different fields.

---

[1] Starch, Daniel, "Most People Would Do Things Differently If They Could Make a Fresh Start." *Syracuse* (New York) *Post-Standard,* November 8, 1936.

[2] "The Fortune Quarterly Survey: XI." *Fortune,* January, 1938, Vol. 17, No. 1, p. 86.

## Surveying the Field

### Areas of employment

Some of the areas in business in which one might decide to earn his living are:

1. *Central*
   - Production
   - Marketing
   - Wholesaling
   - Retailing
2. *Auxiliary*
   - Accounting
   - Statistics
   - Secretarial Work
   - Transportation
   - Selling
   - Advertising
3. *Financial*
   - Finance
   - Banking
   - Insurance
4. *Managerial and Administrative*
   - Business Ownership
   - Business Management
   - Office Management
   - Personnel Management
   - Labor-Management Relations

This is intended to be, not a hard-and-fast classification, but a convenient grouping to guide the student's choice of a major subject.

### Reasons for studying various fields

People who go into business for themselves naturally are interested in learning all they can in order to be highly successful. It is just as necessary for those who choose to serve in the employ of others to be well schooled in all phases of business life and endeavor. Let us examine some of the reasons why *everyone interested in a business career should be interested in all phases of business.*

Probably most business-administration students can be grouped into three divisions:

1. Those who know quite definitely in what field they want to specialize.
2. Those who have an idea of the field in which they want to specialize but are not sure.
3. Those who do not know in which field they want to specialize.

Persons in this third group will naturally welcome an opportunity to explore the possible fields. The very fact that they possess but little knowledge interests them in gaining more. They are prompted to learn not only about the different types of jobs but also about the various relationships among jobs and the contribution each makes to the smooth operation of the business as a whole. Those in the second group will

be interested in looking at other possibilities because they are not certain that the fields they have chosen are the ones for which they are best fitted and in which they will be most satisfied. The study of other fields may be just the thing to convince them that they have made wise choices. But how about the first group, those who know quite definitely what they want to do? Should they be interested in studying other fields? Let us consider this question and look at some cases and possibilities.

*The Importance of Proper Choice of a Related Field.* Although many students correctly judge that they should specialize in certain fields in which they will do well, frequently they give little or no thought to choosing the best *related fields* in terms of their particular abilities and the possibilities of increased income and professional advancement. Of the several fields that would fit in well with the major each person has selected, there should be one or possibly two fields that would work best for him either because of his qualifications or because of his interests.

As an example, consider the student interested in accounting. He may learn in elementary and intermediate courses that he likes accounting and does well in it. He knows that economics, finance, and statistics are closely related to accounting. At the same time, his father may be a wholesaler of building materials, providing the student an excellent opportunity to begin work in this business. For him the building industry and marketing may be the best related fields that he could choose to study.

Five years after leaving school, many individuals are not in the fields of work for which they prepared as their first choices. In many instances they are doing work for which they were qualified because of their study in fields that were their second and third choices.

The student will be interested in studying about the various fields in business in order to understand what is going on in other departments of the business organization for which he works. A knowledge of how those departments tie into the organization as a whole will enable him to understand and appreciate the work being done by associates who are specialists in fields other than his own.

An individual's value to an organization is just as dependent upon his knowledge of the entire business as upon his ability in the field of his specialization. The more he knows about the general principles and procedures of business operation, the more easily and quickly he will be able to learn about the inner workings of any particular business. To possess at least some knowledge of the business as a whole will make

him more valuable to his company and will enhance the probabilities of his promotion.

*To Strengthen and Broaden the Major Field.* One more reason why the person who has already selected his major wisely will be interested in studying about other fields is that such study will strengthen him in his chosen field. Let us take a few examples:

1. Consider a student who has decided to major in accounting but does not want any economics. This may not be because he does not like economics, but rather because he does not see why he needs it or how it will help him. When he learns that accounting is actually applied economics—that it is, in other words, specialization in one phase of economics—his feeling about economics will change, and he will recognize it as a field of study that will correlate well with accounting.

2. Another accounting student may not have any desire to study business law, although he wishes to advance as far as possible in his chosen field. When that student learns that he must pass a three-hour examination in business law when he takes his C.P.A. examination, his interest in law will be immediately sharpened.

3. A student (male or female) who is highly proficient in typewriting and shorthand may have considered work as a stenographer or secretary but not as a teacher. Learning that, especially in years of unstable economic conditions, much better salaries can be earned in teaching than in secretarial work and that business experience of a secretarial nature will make it possible to secure a position in a larger school system and at a salary higher than those paid to teachers without such experience, this student may include sufficient courses in education to meet the state requirements for teaching, immediately doubling the avenues of employment. The same procedure would apply in the case of all fields of business.

4. Some subjects, such as statistics, should be studied by every business student. A picture is frequently better than a thousand words; some information can be shown more clearly in a chart than in paragraph form. Everyone will of necessity find himself using pictorial charts and other methods for presenting facts, and he may also need to carry on research investigations as well. Since many investigations are statistical, being able to use statistics will prove invaluable, if not absolutely necessary. It would probably be impossible to read professional journals intelligently without understanding the use of index numbers, a principle that, though not at all complicated, is entirely foreign to those who have not mastered the technique. It is difficult to visualize a

single responsible job in business that does not require the use of statistical information.

There is no end to the number of illustrations that could be used to emphasize the need for understanding various related fields in business.

## Measuring Your Qualifications

### What is required

It is impossible to set down specific data that describe *all* employers as a general class. Those in one industry seek one qualification that has special application to their organization, and others seek different qualifications. Preferences are explained by differences in organization structure, responsibilities of the job assigned, product sold, type of customer served, and company precedent.

There is strong agreement among employers, however, about some qualifications that are important to many jobs—personal qualifications, for example. The National Industrial Conference Board [3] recently published an illuminating report on this point for 126 representative manufacturing and nonmanufacturing business organizations in the United States that employ more than two and one-half million people. These companies were asked to rank the personal qualities they looked for in selecting their personnel. The following is an adaptation of the Board's report:

| *Rank Trait* | *Companies* | *Percent of Group* |
|---|---|---|
| 1. Character | 49 | 38.8% |
| 2. Intellect | 25 | 19.8 |
| 3. Attitude | 23 | 18.3 |
| 4. Personality | 19 | 15.1 |
| 5. Physical condition | 6 | 4.8 |
| 6. Appearance | 4 | 3.2 |
| | 126 | 100.0% |

From the same study the student of business can get a good idea of the personnel specifications asked for by employers in contacting employment agencies. This report, based on 142 companies, was as follows:

---

[3] National Industrial Conference Board, *College Graduates in Industry*, p. 5. Studies in Personnel Policy, No. 89, 247 Park Avenue, New York.

| | *Number of Companies* | *Percent of Group* |
|---|---|---|
| College degree required * | 119 | 83 |
| Degree not required | 5 | 4 |
| No statement about degree | 18 | 13 |
| | 142 | 100 |
| Age range limited † | 59 | 42 |
| Age range not limited | 55 | 38 |
| No statement about age range | 28 | 20 |
| | 142 | 100 |
| Single men preferred ‡ | 26 | 18 |
| Marital status immaterial | 86 | 61 |
| No statement about marital status | 30 | 21 |
| | 142 | 100 |
| Travel requirements specified | 42 | 30 |
| Travel not required | 71 | 50 |
| No statement about travel | 29 | 20 |
| | 142 | 100 |

* Sometimes a certain degree was specified, such as Mechanical Engineering.
† Such as 20 to 28 years, to promote homogeneity of training group.
‡ In many cases a temporary situation due to housing shortage.

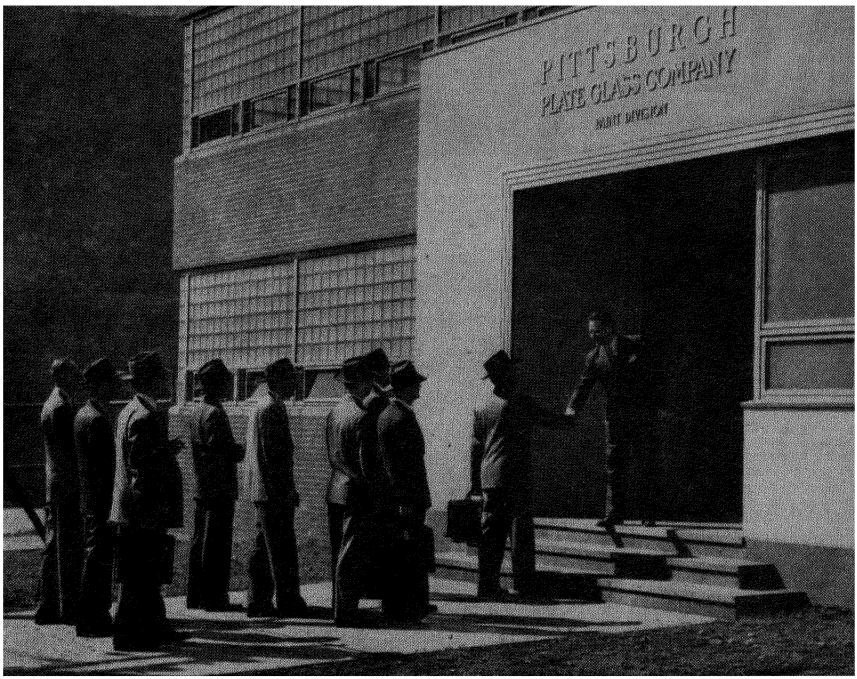
Ordinarily employees offer their employers some specific skill or specialty training, but such is not always true. For example, in various sections of the country employers have insisted on selecting people who do not have specific skills or specialized training. Many oil companies, retail stores, chain food stores, and clothing establishments prefer to give employees their *own type* of company training.[4] It is understood, however, that applicants must possess high intelligence, a broad educational background, and enthusiasm for the job. Thus, the business student should be impressed with the idea that specific training is important, but that one may expect to enter employment near the bottom of an organization and work up as rapidly as he is capable of grasping the company's way of doing business.

## What you have to offer

Many occupations and professional careers are evaluated superficially by students, and frequently too much is taken for granted about their aptitude for a particular career. Too many careers are selected simply because they strike the fancy of the person concerned. Actually, every-

[4] An exhaustive study dealing with types of training programs used on the job by employers of college graduates has been reported by B. J. Koehler for the National Office Management Association, *Survey Summary No. 5*, p. 4. N.O.M.A., 12 E. Chelten Avenue, Philadelphia, Pa.

one has certain talents that may seem almost unlimited at times, yet limitations place ceilings on individual aptitudes for different types of work. Fortunately, patterns are now being perfected for evaluating individual potentialities.




*Courtesy Pittsburgh Plate Glass Company*

*Figure 1-1. Company Training Schools.* In addition to formal business training in schools, many young people now take advantage of special training sessions offered by most large companies. These range from short orientation periods to formal classes in skills and techniques peculiar to the work involved.

*Self-Evaluation.* Evaluations may be made on a purely subjective basis or by applying certain standard objective tests. Certain questions, for example, bear directly upon an individual's aptitude for a business career:

1. Am I willing to work the hours required?
2. Am I willing to make personal sacrifices for the job?
3. Am I interested in people?
4. Am I able to get things done through people?
5. Am I financially minded?
6. Am I looking for a business career or a steppingstone to something else?

*SELF-RATING CHART*

1. Intelligence_____
   Excellent Good Fair Average Poor Very Poor
2. Initiative_____
   Excellent Good Fair Average Poor Very Poor
3. Industry_____
   Excellent Good Fair Average Poor Very Poor
4. Aggressiveness_____
   Excellent Good Fair Average Poor Very Poor
5. Perseverance_____
   Excellent Good Fair Average Poor Very Poor
6. Personality_____
   Excellent Good Fair Average Poor Very Poor
7. Tact_____
   Excellent Good Fair Average Poor Very Poor
8. Sincerity_____
   Excellent Good Fair Average Poor Very Poor
9. Enthusiasm_____
   Excellent Good Fair Average Poor Very Poor
10. Leadership_____
    Excellent Good Fair Average Poor Very Poor
11. Ability to organize work_____
    Excellent Good Fair Average Poor Very Poor
12. Ability to handle details_____
    Excellent Good Fair Average Poor Very Poor
13. Willingness to assume responsibility _____
    Excellent Good Fair Average Poor Very Poor

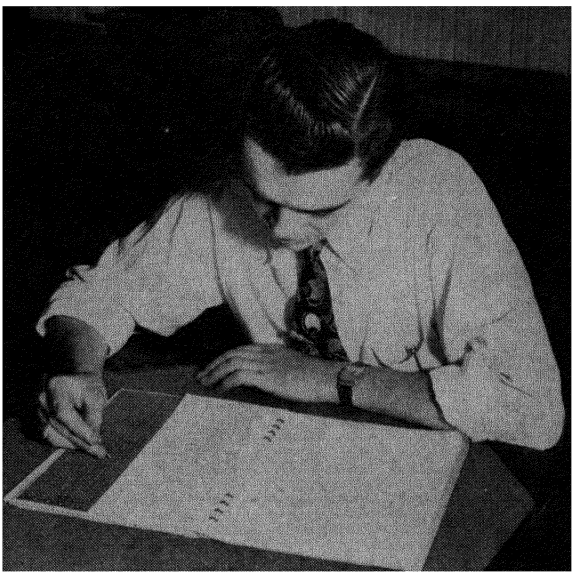
*Figure 1-2. Self-Rating Chart for Business Students.* (SOURCE: Converse, P. D., *Should I Start My Own Business,* p. 31. Urbana: University of Illinois, Bulletin No. 5, 1945.)

The value of self-rating scales depends upon our ability to overcome one weakness—our inability to be honest about ourselves. We possess a bias that distorts the true report; we tend to overestimate ourselves in desirable traits and underestimate ourselves in undesirable ones.

Possibly the most practical method of self-analysis is built around the simple procedure of using a check list of traits known to be important to successful business careers. Such a check list or rating scale as that

shown in Figure 1-2 has many possibilities for business students. The student may rate himself and have friends or disinterested people rate him as well.

Although a rating scale cannot be standardized for all employment, it is assumed that "Fair" to "Excellent" ratings on most points measured are desirable. In addition, every business student should collect as many objective data about himself as he can. Begin with a personal inventory of physical make-up, health, experience, interests, and competitive achievements in such fields as athletics, literature, and drama. These form a partial background for evaluating your qualifications for a business career.



*Courtesy Radio Corporation of America, RCA Victor Division*

*Figure 1-3. Screening Personnel for Jobs.* Tests are used to determine in what areas the subject's vocational interests lie.

Opinions held and impressions made are important, too. The impression you make on other people often determines whether or not more objective factors, such as education, skill, and physical qualifications, will gain an opportunity to be employed.

*Tests.* Self-evaluations are internal sources of information. To these one may add vital information secured from external sources—sources that measure one's potentialities.

Personnel specialists have been experimenting for years with tests they hoped would be error-proof in choosing people for jobs. Although

much valuable work has been done on this subject, no measuring devices are completely reliable in their predictive ability. Certain general techniques of measuring, however, do reflect pertinent data about qualifications for success in fields of business specialization.

Three kinds of tests reveal important inventories of knowledge, skills, and attitudes useful in choosing careers:

1. Interest tests
2. Aptitude or ability tests
3. Skill or achievement tests

Interest tests measure attitudes and reveal information about personal habits. The two most widely used interest tests are probably the Strong Vocational Interest Blank and the Kuder Preference Test. The Strong test covers several hundred items relating to different occupations, school topics, recreations, characteristics of people, and self-estimates of personal abilities and characteristics. Like other standard tests, these have interpretive scores that make it possible to measure the relative performance of individuals. For example, if 70 to 90 is an average interest score for a certain type of occupation, someone who scores 66 should obviously be discouraged from choosing that kind of work.

In the category of aptitude or ability tests are all tests that attempt to measure natural aptitude for applying knowledge. The common index of aptitude to use natural ability is known as the intelligence quotient (I.Q.). Two well-known intelligence tests are the Thurston Intelligence Test and the Otis Self-Administering Intelligence Test. The psychological examinations developed by the American Council on Education are also widely used.

A study made by Hepner [5] uses a seven-point classification of intelligence levels ranging from feeblemindedness to genius. It is an interesting deduction to make from the Hepner studies that 88 percent of our entire population probably fall into three of the classifications—"dull," "average," and "superior."

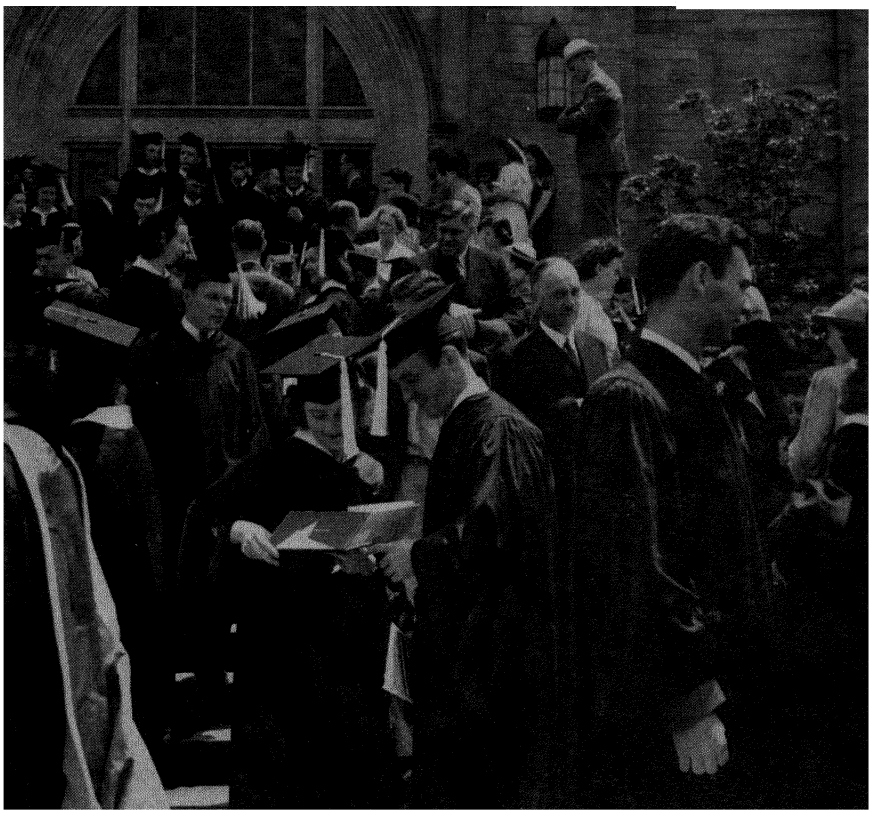
Intelligence, or the faculty of understanding, includes not only adaptability but also resourcefulness in assuming responsibilities and creative imagination as well, for all jobs demand some imagination.

Mechanical-aptitude tests usually cover such fundamental exercises as recognizing kinds of tools and combining materials used in simple computations for mechanical problems. The following mechanical-aptitude tests have been used with marked success:

[5] Hepner, H. W., *Psychology Applied to Life and Work*, p 275. New York: Prentice-Hall, Inc., 1941.

1. Bennett Mechanical Comprehension Test
2. Minnesota Paper Form Board
3. Purdue Mechanical Adaptability Test

These measure marketable skills. A typical illustration is the stenographic proficiency test. In the case of typewriting, the applicant's proficiency is expressed in terms of writing speed and accuracy.



*Courtesy Grove City College, Grove City, Pa.*

*Figure 1-4. Graduation and Employment.* Alert employers are eager to interview the graduates of business schools, because from this source they get some of their best employees.

Unfortunately, tests of proficiency or achievement frequently constitute the only basis for choosing employees quickly. This is true, first, because the work required in lower-level jobs is standardized and essentially limited to a few routine processes. Secondly, proficiency tests often serve as indexes of other desirable qualities. High marks on clerical and stenographic proficiency tests reveal other abilities or work

habits that are useful to an employer. However, it does not follow that low scores on such tests reflect inability to do other things like selling, advertising, or factory assignments.

## Finding Employment

### Applications

The process of recruiting personnel for business occupations is often quite simple because employers usually have more or less permanent lines of contact with schools and other training agencies where people are prepared for business careers. Employers turn to established train-

*Courtesy School of Business, Texas Christian University*

*Figure 1-5. The Interview.* Many of a prospective employee's individual qualifications are revealed in a personal interview.

ing agencies because their graduates are usually well prepared in special areas, and usually have a desirable social background. Furthermore, school channels are usually inexpensive. When an employer contacts a training institution for applicants, most of the screening is done for the employer before he sees the list of applicants or schedules their interviews.

However, it must not be overlooked that many positions in business are found independently, without the aid of school officials, training agencies for specialty occupations, and employment offices.

## Interviews

The first interview, common to all channels of employment, is usually a short visit with a recruiting officer, or employer, who is obviously looking for positive characteristics that may be suitable for employment in his company. Positive factors usually gain a second and much more detailed interview; negative ones either disqualify the applicant permanently or cause his name to be placed in a reserve file. Speech, personality, manners, dress, and even family commitments are strong determiners in screening prospective employees during the first interview.

Some of the objectionable personal traits observed by interviewers in talking with people about jobs is seen in the following report of three interviewers: [6]

| *Interviewer A* | *Interviewer B* | *Interviewer C* |
|---|---|---|
| Biting fingernails | Chewing and snapping gum | Short arms |
| Talking with cigarette in mouth | Being jittery or fidgety | Bad breath |
| Interrupting you | Non-stop talking | Shifty-eyed |
| Playing with articles on person | Too aggressive | Too well-groomed |
| Smoking chain fashion | Loud clothing | Sloppy |
| Being pretentious or bragging | Not meticulous about personal hygiene | Ugly |
| Using "I" continuously | Mousy and bashful | Jiggling legs continuously |
| Inconsideration | Fresh and "smart-alecky" | Tapping |
| Avoids looking you in the eye | Making gestures with hands | Doodling |
| "Alibi" | Foreign-looking | Acne |

An interview at any stage of screening may or may not follow conventional approaches to the applicant in gaining desired information. For a long time employers have used the guided interview (one that follows a plan for questioning the applicant). More recently, the unguided interview (one that does not follow a plan for questioning the applicant) has been widely accepted because it brings out so many

[6] Drake, Frances S., *Manual of Employment Interviewing,* p. 15. New York: American Management Association, Research Report No. 9, 1946 (reported by Bellows, R. M., *Psychology of Personnel in Business and Industry,* p. 105. New York: Prentice-Hall, Inc., 1949).

personal characteristics that represent an applicant's ability to think and express himself. Yet the unguided interview covers the usual, basic questions about job qualifications.

There are differences, of course, in the techniques employed by interviewers. Table I-1 [7] shows several techniques used by 23 different kinds of business organizations in interviewing prospective employees. The table also shows the title of the person who interviews applicants.

TABLE I-1 TECHNIQUES APPLIED IN THE INTERVIEWING PROCESS.*

| Nature of Company | No information on rating | Use ratings, judgment blanks | Do not use ratings, judgment blanks | Reorganizing selection program | Use preliminary application blank | Have preliminary personal interview | Use formal application blank | Have formal interview with applicant | Number of interviews before employed | Use employment manual | Use interviewer's guide | Aptitude and intelligence tests | Interviewed by |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Aircraft manufacturers | X | | X | | | | | | | | | | |
| Automobile | X | | | X | | X | | | | | | | |
| Bakery | X | | | X | | | | | | | | | |
| Building | | X | | | X | X | | | 1 | X | X | | |
| Building supply | | X | | | X | X | X | X | 2 | | X | | Branch Managers |
| Business machines | | X | | | X | X | X | X | 3 | X | X | X | Branch Managers |
| Business machines | | | X | | X | | | X | 1 | | | | Branch Managers |
| Camera | | | X | | X | X | X | X | 2 | | | | Personnel Officer |
| Canned goods | X | | | X | | | | | | | | | |
| Cereal production | | | | X | | | | | | | | X | Branch Manager |
| Chemical | | X | | | X | X | X | X | 3 | | X | | Branch Manager |
| Farm machinery | | X | | X | | | | | | X | | | |
| Food | X | | X | | | | | | | | | | |
| Glass .... . | X | | | | | | | | | | | | Warehouse Manager |
| Life insurance | | X | | | X | X | X | X | 2 | X | X | X | Agency Director |
| Mail-order | | | X | | X | | | X | 1 | X | | X | Store Manager |
| Meat packing | | X | | | | | X | X | 1 | | X | | Personnel Officer |
| Retail | | | X | | X | | | X | 1 | X | | | Personnel Director |
| Soap .. | X | | | X | | | | | | | | | |
| Soap | X | | | X | X | | | | | X | | | Field Supervisor |
| Tire . | | X | | | X | X | X | X | ? | | X | | District Manager |
| Typewriter ... | | X | | | X | X | X | X | 2 | X | X | X | |
| Woolen goods . | X | | | | | | | | | | | | |

* Source· Adapted from R D. Henderson and D W Hoover, "Interviewing Methods Used in the Selection of Salesmen," *Personnel Journal*, XXVI, No. 1 (1947), 16-17

[7] Bellows, R. M., *Psychology of Personnel in Business and Industry*, p. 118. New York: Prentice-Hall, Inc., 1949.

Before going far with interviews, the applicant is asked to fill out a formal employment application blank. These forms vary with different industries, depending upon their purpose and use. As a standard practice, a great deal of personal information is crowded into application forms and thus this source constitutes a strong foundation around which total evaluations of applicants are built. The subject is graded not only on the content but also on the manner of his answers.

Since finding employment is not limited to one contact with an employer, it becomes necessary that each interview and application form be carefully planned around the idea of getting a job. An employer would expect a letter of application to reveal not only the basic personal factors possessed by the applicant but also, for example, something of the aggressiveness of the person seeking employment. It would also reflect the individual's ability to express himself. The following is offered only as an illustrative style or pattern. Incidentally, a recent report shows that the ability to write clear, understandable, and interesting business reports constitutes 41 percent of the basic factors involved in the promotion of young executives.[8]

Box 361
Fort Worth, Texas
January 15, 1950

Atlantic Refinery Company
Philadelphia, Pennsylvania

Gentlemen:

The accounting position you advertised in last Sunday's *Dallas News* is, I believe, one for which I am well qualified. Let me tell you about my college training and my business experience.

Four years of intensive business training at Southern University with a major in accounting, three years of summer employment as an assistant auditor for an income tax consultant, and a great deal of ambition to become a practicing accountant should qualify me for an initial assignment in your office.

I feel that my business training at the University was exceptionally thorough and well-balanced between theory and practice, because all my instructors were certified public accountants, and four of the seven were associated with private practice outside the classroom. Furthermore, the accounting curriculum at Southern University

[8] Fellows, Arnold L., and Amsbary, George S., "How Does Business Writing Rate in Our Colleges?" *Collegiate News and Views,* October, 1948, Vol. II, No. 1, p. 1.

was wisely blended with courses in business law, management, production, distribution, and finance. Summer employment with the Larry B. Rigg Company gave me a wonderful opportunity to practice much of what I had learned previously at the University.

I am a married veteran, 24 years of age, weigh 175 pounds, and am six feet tall, in good health, and willing to move immediately to any reasonable location where I can begin an accounting position which challenges the best that is in me. I financed my college education through savings from summer employment, and working as a grader for the accounting laboratory proctors at the University. My college life was as active as studies would permit and allow me to finish in the upper 5 percent of my class. Although I was never on the varsity, I took an active part in athletics and was a member of three social and literary clubs.

Dean J. Morris Moore and Dr. J. J. Cox have given me permission to use their names as university references. Mr. Larry B. Rigg of Fort Worth will also be glad to tell you something about my work in his office.

Of course a letter of application cannot tell all you wish to know about the man you select for this important position as an accountant in your organization. Therefore, I intend this letter to introduce my qualifications and hope you will give me the opportunity to call at your office and tell you more about my qualifications.

My residence telephone is 9-2861 (Fort Worth), or you can reach me through the instructors' office at the University, 4-4345 (Fort Worth).

Yours very truly,

HORRIS W. TALLEY

## Going into Business for Yourself

### Recognizing personal objectives

Why do some individuals prefer to be in business for themselves rather than work for an employer? Considering the large number of failures in business and the relatively short life span of most concerns, it is somewhat difficult to understand their motives. As a matter of fact, several factors influence people to establish their own businesses. The following list, which is not intended to be all-inclusive, gives some of these motives:

1. Opportunities for financial gain
2. Strong personal interests and desires
3. Relative ease of getting started
4. Opportunity to be one's own boss

How can an individual get into business for himself? The most obvious way by which many young men and women enter business is by inheritance—first as an employee, later a junior executive, and finally the general manager-owner. Or, in emergency situations, a young person may move directly to the head of the company, with little or no experience, assuming all the responsibility the job entails. Father-son (or son-in-law) arrangements are the most common.

Added to the security of financial resources that family arrangements seem to insure, parents and kinfolk are usually quite zealous of leaving their firm name and reputation to their younger generation. Furthermore, the transition from older to younger management is easy, inexpensive, flexible, and often quite satisfying to older people.

For those who are born into an inheritance, the problem of future employment is solved, provided, of course, that the work is suitable to their talents and interest.

If you must make your own way without family subsidy, there are at least three intelligent, practical, and attractive ways to go in business for yourself:

1. Buy an interest in an established business.
2. Start your own new business in competition with others.
3. Start your own business with a new idea or invention.

Many fantastic get-rich schemes advertised in pulp magazines bypass conventional routes for entering business and thus may entice poorly informed victims with the promise of quick dollars. Few if any of these plans justify consideration.

Many authorities feel that employment opportunities lie within *new industries.* Any new industry not only creates wealth but multiplies the opportunities for employment at *all* levels of work. A quotation from Benson Ford is pertinent on this subject: "The plastic industry now provides over 100,000 jobs and produces more than a half billion dollars' worth of goods. The synthetic fibre industry has nearly doubled the value of its products in the last ten years.... The television receiver manufacturing industry and broadcasting business expects to provide employment for 475,000 people by the end of 1953." [9]

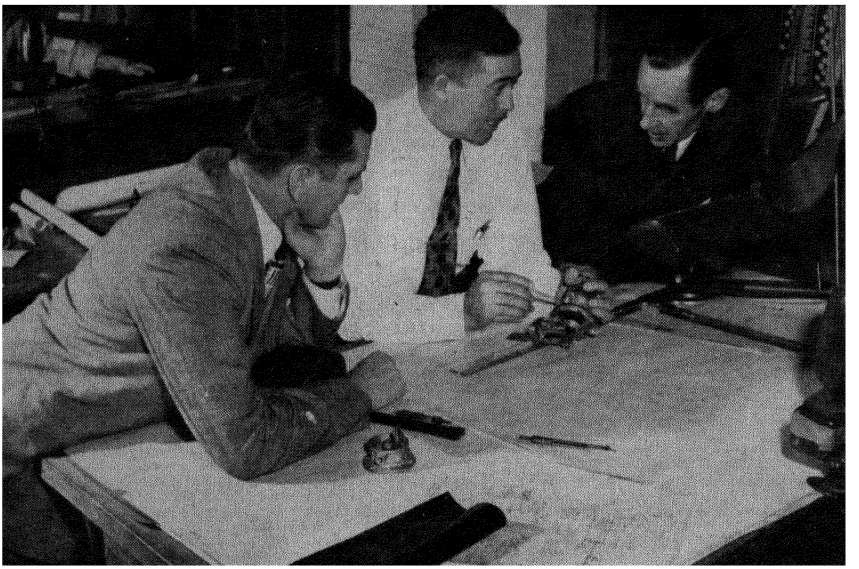
## Looking Ahead

America is one of the few countries today that afford young men and women great individual opportunities. If you have the character,

[9] Ford, Benson, "Five Jobs for Young Men," an address before the Los Angeles Junior Chamber of Commerce, Los Angeles, California, February 28, 1949.

enthusiasm, and energy to engage in business, your opportunities are truly limitless.

As previously pointed out, one's personal objective determines in large measure the character of his future employment. Inasmuch as nearly 75 percent of all people employed in business today are working for someone else, only 25 percent can expect to be proprietors and employers. Therefore, most business students will ultimately think in terms of employee status.



*Courtesy E. I. du Pont de Nemours & Company*

*Figure 1-6. Planning for the Future.* Ideas create employment. Here ideas are taking form on the drafting board.

Whether you work for someone or operate your own business, the problems of occupational adjustment, of course, are much the same. And the realistic approach to employment is that you may never know what kind of work you want until you have experienced several occupations.

Training, scientific testing for aptitudes, and sideline philosophical interest count for nothing unless the job gives you personal satisfaction. Compensation comes in strange ways, too. Monetary values are basically important, but service factors and the satisfaction of seeing a job well done count heavily.

Scientific devices for detecting your aptitudes are valuable, but some-

thing more than these psychological screens determines your success in employment situations. The *will to work* and the proper attitude toward work inevitably lead to permanent success, provided there is ability. Standing out above cheap philosophies of "get the most and give the least" remain those cardinal virtues of hard work that make America great. The truth of the axiom, "You get what you pay for," has no greater application than to employment.

### The reward for effort

Service should be the ultimate goal for all worth-while business employment, although some people cannot rationalize this objective in economic terms. The gap between the ethics of service and the monthly pay check seems too great! Nevertheless, the long-range results of service are usually closely related to reward. We have only to look at those in business and industry who have given their lives to the development of ideas they believed in. Their rewards, financial and personal, have been commensurate with their effort.

Although it is impossible to project specific salary scales here that will satisfy the interest and curiosity of business students, it is possible to see average earnings for those employed in major industrial groups. Table I-2 gives the information from 1929 through 1947. Of course, average annual earnings are much lower than would normally be considered representative of a particular occupation, because averages absorb extreme differences that are not normally counted when reviewing a particular job.

### Terms for Study

Achievement
Aptitude
Career
Commensurate
Complementary elements
Employer practices
Employment agency
Initiative
Intelligence
Managerial leadership
Nonagricultural industries
Objective
Occupation
Offsetting values
Placement bureau
Potential employment
Profession
Proficiency
Psychological screens
Quality standards
Rationalizing
Recruit
Refinement
Self-employed
Skills
Sociability
Specialists
Standardize
Technological
Terminal issues
Unguided interview
White-collar occupation

TABLE I-2 AVERAGE ANNUAL EARNINGS PER FULL-TIME EMPLOYEE, BY MAJOR INDUSTRY GROUPS IN THE UNITED STATES, ANNUALLY, 1929–1947.*

(Dollars)

| | 1929 | 1930 | 1931 | 1932 | 1933 | 1934 | 1935 | 1936 | 1937 | 1938 | 1939 | 1940 | 1941 | 1942 | 1943 | 1944 | 1945 | 1946 | 1947 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| All industries | 1,421 | 1,380 | 1,292 | 1,136 | 1,064 | 1,109 | 1,153 | 1,199 | 1,270 | 1,238 | 1,269 | 1,306 | 1,450 | 1,719 | 1,966 | 2,121 | 2,204 | 2,365 | 2,595 |
| Agriculture, forestry, and fisheries | 455 | 429 | 352 | 272 | 253 | 288 | 328 | 358 | 411 | 401 | 403 | 415 | 503 | 649 | 838 | 983 | 1,100 | 1,225 | 1,292 |
| Mining | 1,526 | 1,424 | 1,221 | 1,016 | 990 | 1,108 | 1,154 | 1,263 | 1,366 | 1,282 | 1,367 | 1,388 | 1,579 | 1,795 | 2,160 | 2,499 | 2,621 | 2,723 | 3,112 |
| Contract construction | 1,674 | 1,526 | 1,233 | 907 | 869 | 942 | 1,027 | 1,178 | 1,278 | 1,193 | 1,268 | 1,330 | 1,638 | 2,194 | 2,505 | 2,603 | 2,599 | 2,539 | 2,840 |
| Manufacturing | 1,543 | 1,488 | 1,369 | 1,150 | 1,086 | 1,153 | 1,216 | 1,287 | 1,376 | 1,296 | 1,363 | 1,432 | 1,653 | 2,023 | 2,350 | 2,517 | 2,517 | 2,512 | 2,795 |
| Wholesale and retail trade | 1,597 | 1,568 | 1,497 | 1,318 | 1,187 | 1,232 | 1,281 | 1,299 | 1,356 | 1,357 | 1,365 | 1,391 | 1,491 | 1,626 | 1,804 | 1,966 | 2,138 | 2,404 | 2,661 |
| Finance, insurance, and real estate | 2,090 | 2,001 | 1,886 | 1,687 | 1,591 | 1,635 | 1,668 | 1,747 | 1,819 | 1,762 | 1,761 | 1,754 | 1,805 | 1,918 | 2,071 | 2,210 | 2,371 | 2,592 | 2,759 |
| Transportation | 1,642 | 1,610 | 1,549 | 1,373 | 1,334 | 1,393 | 1,492 | 1,582 | 1,644 | 1,676 | 1,723 | 1,754 | 1,888 | 2,181 | 2,491 | 2,678 | 2,734 | 2,949 | 3,149 |
| Communications and public utilities | 1,474 | 1,497 | 1,514 | 1,438 | 1,351 | 1,426 | 1,486 | 1,522 | 1,601 | 1,674 | 1,692 | 1,718 | 1,766 | 1,881 | 2,075 | 2,248 | 2,425 | 2,566 | 2,797 |
| Services . . . | 1,069 | 1,058 | 1,002 | 914 | 850 | 852 | 868 | 893 | 932 | 938 | 943 | 949 | 1,016 | 1,131 | 1,337 | 1,518 | 1,670 | 1,871 | 1,973 |
| Government and government enterprise | 1,552 | 1,554 | 1,549 | 1,479 | 1,330 | 1,286 | 1,293 | 1,281 | 1,356 | 1,338 | 1,339 | 1,349 | 1,392 | 1,647 | 1,815 | 1,962 | 2,091 | 2,348 | 2,559 |

* Source: U S Department of Commerce, *National Income Supplement* to *Survey of Current Business*, July, 1947, adapted from Table 26, p 38, for data 1929–1943; data for 1944–1947 from *Survey of Current Business*, July, 1948, Table 26, p. 22, as reported in Peach, W. Nelson, and Krause, Walter, *Basic Data of the American Economy*, rev. ed., p. 31. Chicago. Richard D Irwin, Inc , 1949

## Questions

1. Should the training given in industry supplement or replace that offered by schools?

2. From what sources do employers choose their employees for business occupations? Does the level of employment make a difference?

3. Do you feel that science and invention can open up enough new jobs to counteract the shrinkage in employment created by laborsaving devices produced by the same science?

4. Would you classify business experience as business training? Discuss.

5. What do the initials "I.Q." represent in terms of this chapter?

6. In the face of constant change, why prepare for specific areas of employment?

7. Why are most people careless in their evaluation of their own qualities? Can you suggest ways to improve one's ability to grade one's qualifications for employment more accurately?

8. There is an old saying, "Nothing succeeds like success." Can you apply this to your plans for making the most of your business career? Explain.

9. Do the statistics for the national economy bear directly upon the operations of an individual business enterprise? Comment.

10. What compensation other than monetary does a job afford?

11. What is your interpretation of the phrase "will to work"?

12. Why is maintaining yourself in a job often more difficult than getting a job?

13. How do you account for the fact that some people seem to "get all the breaks"? Is their good fortune an accident or do these people create the "breaks" that seem accidental? Comment.

14. What part does "married wealth" or "inherited wealth" seem to have in business success? Is an individual's chance of financial success completely blocked if he has neither?

15. In what ways do you feel the government is rendering service today in making entrance into business more scientific?

16. How would you compare the professional aspects of business career (opportunities, compensation, advancement, required preparation, and the like) with those of other professions?

17. Name and discuss three ways an individual can get into business for himself.

18. How do you account for the change in attitude of employers in recent years in favoring well-educated employees?

19. What place does the application letter occupy in making contact in business employment?

20. How does a program of home study share in preparing individuals for business occupations?

## Problems and Projects

1. Select one successful businessman in your community and analyze his success in terms of the following:

a. What one quality or combination of qualities is responsible for his place in the business world today?
b. What special qualifications will the young businessman of today need in order to replace the last generation?
c. Do you feel that modern competition will make it more difficult for the new man to secure and maintain a satisfactory position in business?

2. By random choice write the names and occupations of the first five home-town people you can think of who are not in school but are occupied on a full-time basis earning a living for one or more people. In the second column estimate the monthly pay of each. In the third column indicate the number of working hours required each day. In the last column designate the nature of their paid vacations each year.

Rank in order the three most desirable positions.

3. From your analysis in the previous problem, what relationship would you say exists between general educational preparation and so-called success in business? Does education pay dividends in terms of more pay each month?

Comment on the significance of specific business education.

4. Make five copies of the Self-Rating Chart (Figure 1-2) and confer with four other students in a co-operative rating committee. Since each person will prepare five copies of the rating chart, there will be 25 reports, five on each student. One of these will be your own evaluation of yourself.

The name of each student rated will be written on the report, but the rating will be anonymous. After the reports are returned to each student, examine your reports in terms of your own evaluation of yourself. Observe points in your personality that may need improving in order to qualify yourself for a business career.

5. Incompetence ranks high as a cause of business failure. Many businesses have incompetence in their management, yet show a profit. Owners are indifferent toward the situation. List the factors that you think explain this odd situation.

6. Refer to Table I-2, which shows the average annual earnings for the full-time employees in major industrial groups. Arrange four columns. In Column 1 write these industries:

a. Manufacturing
b. Wholesale and retail
c. Transportation, communication, and public utilities
d. Service

In Column 2 show the annual earnings for each in 1937. Do the same in Column 3 for 1947. Finally, in Column 4 show the percentage increase or decrease over the 10-year period.[10] Explain why you think the increase or decrease was more in some industries than in others.

7. List the characteristics you think important to maintaining an individual in a job situation. Which of these characteristics do you feel cannot be acquired in educational institutions?

8. Failure statistics are alarming for many business organizations. Could you overcome the meaning of these statistics for your type of business through superior management or some other means? Illustrate how training in business might be involved in superior management.

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[10] To find the percentage increase or decrease, divide the difference between the two figures by the 1937 figure, and multiply by 100.

CHAPTER II

# THE CONSUMERSHIP APPROACH TO BUSINESS TRAINING

THERE ARE MANY WAYS of presenting an introductory course in business, some more effective than others. We could begin with raw materials, work through the factory system, and then study marketing methods, distribution, and the fundamentals of control through records; or we could begin with buying and selling, without which production processes would be useless. Business activities might also be viewed through the biographies of great American businessmen.

Finance, personnel, accounting, or statistics might be featured. Furthermore, the case-study approach is widely used.

However, the area of consumership furnishes a far more satisfactory approach. Learning is easy when knowledge is related to present experience. The psychology of beginning a learning experience with what is already known has been proved sound.

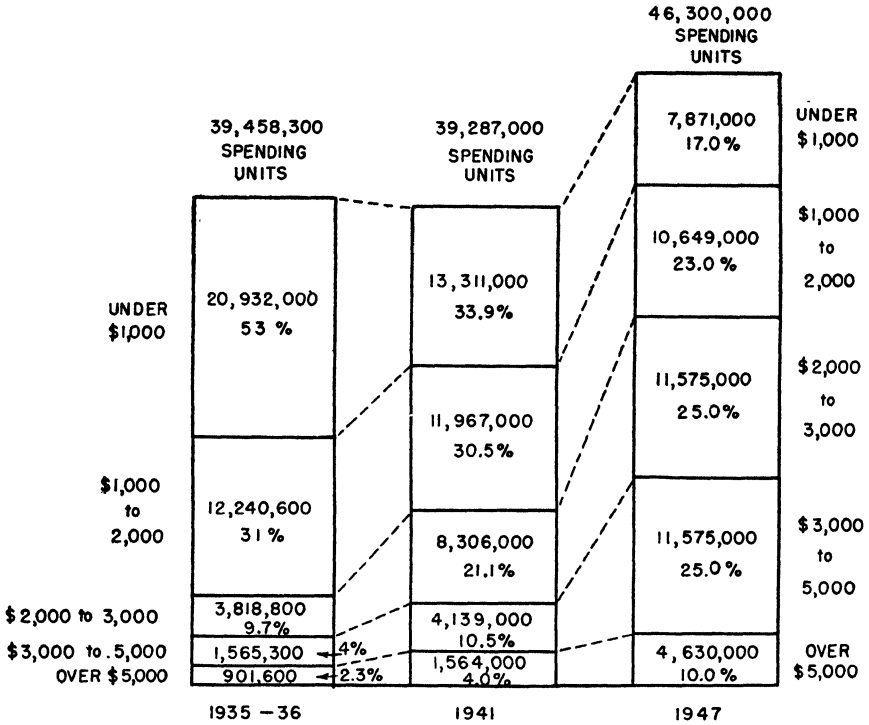
In this book, then, the subject matter should be reviewed by the student in terms of his personal position as a consumer. This does not mean that each chapter is necessarily formed around specific consumer references, but it does mean that the student will have a chance to visualize the importance and meaning of business more effectively by constantly projecting himself as a consumer of goods and services.

## Consumer Characteristics

### Consumer's position in the national economy

More than 143 million men, women, and children made up the American consuming public in 1949 and forecasts indicate that the population will approximate 155 million people in 1955. Our phenomenal growth during the 1938-1948 decade made a new market equivalent to the combined population of New York, Philadelphia, and Chicago!

What is the national income of our country? How much does each American share in it, and how much money does each have for spending purposes? Our national income attained a record-breaking high during the early months of 1948, when the annual rate approximated




| MEDIAN INCOME | $946 | $1,500 | $2,300 |
|---|---|---|---|
| TOTAL WITH INCOMES OVER $2,000 | 6,285,700 (16.0%) | 14,009,000 (35.6%) | 27,780,000 (60.0%) |

*Figure 2-1. Income Distribution of Consumer Spending Units in the United States.* (SOURCE: Johnson, Arno H., "Market Potentials, 1948." *Harvard Business Review,* January, 1948, Vol. XXVI, No. 1, p. 24.)

$200 billion. The enormity of this figure emphasizes the extraordinary size of our economy in recent years compared with the $90-billion economy of 1929,[1] the last year of prosperity before the depression span of the 1930's.

So large a national income is good explanation for the fact that Americans own more than 90 percent of the world's bathtubs, 60 percent of all electric refrigerators (23,500,000), most of the automobiles, and countless other consumer conveniences, making our standard of living the highest in the world.

[1] Johnson, Arno H., "Market Potentials, 1948." *Harvard Business Review,* January, 1948, Vol. XXVI, No. 1, pp. 11-31.

According to the United States Bureau of the Census, the average family income in 1947 was $3,000. This was the highest figure ever reported. There were 4½ times as many buying units with incomes over $2,000 in 1947 as there were in 1935-36 (see Figure 2-1). From a market point of view, 1947 was the peak year also, because 46,300,000 spending units were tabulated. The fact that so many more buying units had incomes above $2,000 (approximately 60 percent made more than $2,000 in 1947) indicates generally a desirable type of prosperity.

### Types of consumers

Irrespective of age, financial standing, occupation, or earning capacity, each individual represents an important consuming unit—a potential customer who directly or indirectly sustains American business. But statistics that describe the *number* of consumers and their financial status are useless unless specific knowledge of consumer types is first obtained.

No one classification of consumer types can be completely satisfactory, because information is compiled for different uses. Consumers may be classified according to the following:

1. Actions
2. Occupation
3. Personal data (age, sex, marital status, and so forth)
4. Geographical location of residence
5. Living conditions
6. Standards of living (dietary habits and so forth)
7. Income bracket
8. Education
9. Religious characteristics
10. Political views
11. Wants

Of course, consumers would not be classified and studied from a marketing point of view with only one description in mind. Understanding consumer types involves a combination of factors. Age, buying power, needs and wants, and disposition toward spending, among other characteristics, should be known. For example, a single, male student who came from a middle-income family group and who had liberal spending habits would make a special type of customer—that is, a consumer—from a clothier's point of view.

Under the first grouping, consumers are further classified according to actions, which should be interpreted in terms of strict sales promo-

tion or management. At least seven types need special consideration and care in selling:

1. Impulsive
2. Deliberate
3. Changeable
4. Positive
5. Friendly
6. "Gabby"
7. Silent

*Courtesy Jamestown, N. Y., Chamber of Commerce*

*Figure 2-2.* Here in a typical American community we see a cross section of the consumer pattern. In the background are many retail stores with well-known names.

Under the second grouping, it is possible to learn how the consumer population is composed according to areas of interest. Occupational patterns reveal important facts about levels of income, living habits, social customs, attitudes, and levels of intelligence. Consider the following occupational classification, made by the United States Department of Labor in 1947: [2]

[2] Goldstein, Harold, "The Changing Occupational Structure." *Monthly Labor Review,* December, 1947, Vol. 65, No. 6, p. 655.

| | | |
|---|---|---|
| 1. | Proprietors, managers, and officials | 10.2% |
| 2. | Professional and semi-professional workers | 6.8 |
| 3. | Sales and kindred workers | 5.8 |
| 4. | Clerical and kindred workers | 12.4 |
| 5. | Craftsmen, foremen, and kindred workers | 13.3 |
| 6. | Operatives and kindred workers | 21.5 |
| 7. | Laborers | 6.0 |
| 8. | Domestic service workers | 3.2 |
| 9. | Other service workers | 7.2 |
| 10. | Farmers, farm managers, foremen, and laborers | 13.6 |
| | | 100.0 |

## Character of human wants

All plans for utilizing human effort contribute to the satisfaction of man's wants. It is fortunate, from a business point of view, that he has an almost inexhaustible number of wants and is willing to work diligently for their attainment. Wants vary with age, temperament, health, occupation, social standing, and environment.

What is the origin of human wants? First, all human beings have elementary, basic, or biological wants, constituted of food, clothing, shelter, and family or reproduction.[3] Food sustains life, clothing and shelter protect life, and through the family, populations are maintained and developed. Basic human wants do not change, but with the advances of civilization the form and number in which wants appear are different.

For example, by analyzing minimum food requirements for the human body, science has made our needs seem quite complicated. The National Research Council recommends that the average adult take approximately two or three thousand calories into his body each day.[4]

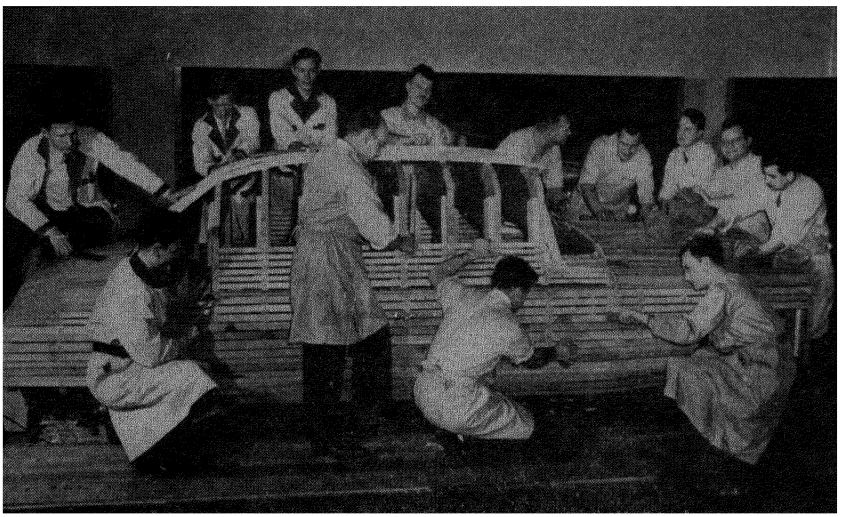
[3] Dunlap, Knight, *Civilized Life,* p. 64 (Baltimore: Williams and Wilkins Company, 1935), classifies primary or biological wants into seven categories:

| | | |
|---|---|---|
| 1. | Alimentary wants | for food and drink |
| 2. | Excretory wants | to be rid of the unpleasant |
| 3. | Protection wants | for warmth and shelter |
| 4. | Activity wants | for physical and mental expression |
| 5. | Recuperative wants | for rest and relaxation |
| 6. | Erotic wants | for association with the opposite sex |
| 7. | Parental wants | for the possession of children |

[4] The breakdown of this complicated ration is:

| | | |
|---|---|---|
| Good energy | 2,800 | calories |
| Protein | 66 | grams |
| Calcium | 0.9 | grams |
| Iron | 12 | milligrams |
| Vitamin "A" | 4,650 | international units |
| Thiamin | 1.5 | milligrams |
| Ascorbic acid | 70 | milligrams |
| Riboflavin | 2.2 | milligrams |

Secondly, there are many wants that are not basic to human existence. These are irrational or emotional in character and differ vastly from basic needs. Many of them are luxury items that originated in scientific laboratories to make life easier and more enjoyable but also more complicated. Others came about by dressing old consumer goods in new forms to make them more appealing to the buyers.



*Courtesy Automobile Manufacturers Association*

*Figure 2-3. Tailor-made Consumer Transportation.* Manufacturers eagerly seek and interpret consumer wishes regarding style, size, price, and form of automobiles. Here an automobile manufacturer is building the mock-up that later facilitates the making of dies for mass production.

The speed with which we have multiplied the number of wants is seen in the fact that 100 years ago consumers had 72 wants, of which 16 were necessities. Today consumers have 484 wants, of which 94 are considered necessities—that is, things essential to the maintenance of life and work.[5]

## Consumer spending

The gratification of human wants is reflected in consumer spending. It is significant to note that the estimated increase in consumer spending in 1950 over that in 1941 will aggregate $35.8 billion. Table II-1 gives a digest of where consumer dollars have been spent since 1940 and estimates expenditures for 1950 and 1960, using 1944 prices.

[5] Gordon, Leland J., *Economics for Consumers,* p. 24. New York: American Book Company, 1939.

TABLE II-1. WHERE CONSUMER DOLLARS GO.*
(Figures in billions of dollars)

| | 1940 | 1941 | (1944 prices) 1950 | 1960 |
|---|---|---|---|---|
| Total Consumer Expenditures | 70.6 | 80.4 | 116.2 | 134.2 |
| Food, Liquor, and Tobacco | 21.9 | 25.3 | 36.2 | 41.1 |
| Clothing and Personal Care | 9.8 | 11.5 | 16.2 | 18.7 |
| Housing | 12.6 | 13.3 | 19.3 | 21.4 |
| Rent † | 9.1 | 9.7 | 14.0 | 15.4 |
| Fuel | 1.7 | 1.8 | 2.5 | 2.8 |
| Electricity | 0.9 | 1.0 | 1.6 | 1.8 |
| Household Equipment and Operation | 8.7 | 10.3 | 15.0 | 17.4 |
| Appliances | 1.0 | 1.3 | 1.8 | 2.4 |
| Consumer Transportation | 7.3 | 8.6 | 12.7 | 16.4 |
| Autos and Private Planes ‡ | 5.7 | 6.8 | 9.6 | 12.7 |
| Local Bus and Street Car | 0.7 | 0.8 | 1.5 | 1.5 |
| Intercity Bus | 0.1 | 0.2 | 0.2 | 0.2 |
| Airlines | § | § | 0.1 | 0.5 |
| Railroads | 0.3 | 0.3 | 0.4 | 0.3 |
| Medical Care, Insurance, and Death expenses | 4.7 | 5.2 | 7.7 | 8.7 |
| Recreation | 3.3 | 3.7 | 5.7 | 6.9 |
| Radio and Television Sets | 0.6 | 0.8 | 1.1 | 1.3 |
| Private Education, Religion, and Welfare | 2.3 | 2.4 | 3.4 | 3.7 |

* Adapted from Dewhurst, J. F., and Associates, *America's Needs and Resources,* pp. 81, 354, 367. New York: Twentieth Century Fund, 1947.

† Includes estimated rent for owner-occupied homes.

‡ Includes original cost and operating expenses.

§ Less than $50 million.

The Bureau of Labor Statistics has been surveying the buying habits of consumers in major cities as a part of its program to revise the consumer price index. In the Bureau's 1947 report from the cities of Washington, D. C., Manchester, New Hampshire, and Richmond, Virginia, many spending habits are revealed. For example, the low-income groups spend a larger proportion of their income for food and housing than those in the upper brackets. As incomes go up, the proportional amounts spent for clothing increase. Although there were some minor variations, Washington may be taken as typical:

| | Incomes between 1,000 and 2,000 | 6,000 and 7,000 |
|---|---|---|
| Food | 42.5% | 29.0% |
| Housing, utilities, and furnishings | 31.0 | 29.0 |
| Clothing | 8.5 | 14.0 |
| Transportation | 5.0 | 11.0 |
| Medical care | 5.0 | 5.0 |
| Other items | 8.0 | 12.0 |
| | 100.0 | 100.0 |

Food, housing, furnishings, clothing, household operations, and medical care accounted for approximately 90 percent of family expenditures for those with net incomes under $1,000.

A simplified manner of showing spending characteristics of consumers is through individual or family budgets. A summary of family budgets is shown in Table II-2.

*Courtesy The National Cash Register Company*

*Figure 2-4.* Food constitutes so large an item on the consumer's budget that the housewife must be thrifty. In addition to price, she must consider size, perishability, and food value.

Consumer purchasing power increased 162 percent between 1940 and 1948. Figure 2-5 shows that surplus income for discretionary spending or saving increased 255 percent, basic living costs required to maintain a 1940 standard of living increased 82 percent, and personal taxes increased 727 percent. The figure for basic living costs includes food, clothing, housing, and household operation. There was an increase of 60 percent in consumer prices from 1940 to 1948 and an increase of 13½ percent in the number of families, resulting in an 82 percent increase in total expenditures required to maintain a 1940 basic standard of living.

## What "King Consumer" wants

The consumer is commonly regarded as king, or as the court of last resort. As one marketing authority says, a consumer represents a member of the jury in a courtroom and a voter in the market place. Furthermore, his vote cannot be ignored without disastrous results to the operation of a business.[6]

TABLE II-2. BUDGET OF AMERICAN FAMILIES, 1941.*

| *Goods* | *Percentages of Income* |
|---|---|
| Food | 22.8 |
| Tobacco | 2.5 |
| Alcoholic beverages | 4.5 |
| Clothing | 10.3 |
| Furniture, furnishings, appliances, radios, musical instruments | 7.2 |
| Household supplies | .8 |
| Drugs, etc. | 1.3 |
| Toilet goods | .6 |
| Books, magazines, stationery | 1.6 |
| Jewelry, including clocks and watches | .8 |
| Autos, auto fuel, tires, accessories, pleasure boats | 5.4 |
| Fuel (coal and gas) | 1.8 |
| Toys, games, sporting goods | .7 |
| Other Goods | .2 |
| Total for goods | 60.5 |
| Services: | |
| Housing | 9.3 |
| Home maintenance | 1.7 |
| Household utilities | 2.6 |
| Total housing | 13.6 |
| Personal care | 1.9 |
| Transportation | 2.8 |
| Medical care (inc. funeral expenses) | 3.3 |
| Recreation | 2.1 |
| Other | 3.6 |
| | 27.3 |
| Total consumer expenditures | 87.8 |
| Direct personal taxes | 4.4 |
| Savings | 7.8 |
| | 100.0 |

* Converse, Paul D., and Huegy, Harvey W., *The Elements of Marketing*, 3rd rev. ed., p. 29. New York: Prentice-Hall, Inc., 1946.

[6] Maynard, H. H., and Beckman, T. N., *Principles of Marketing*, 4th ed., p. 88. New York: Ronald Press Company, 1946.

What does the consumer expect? What does he want from the agencies that bring him goods and services? He wants many, many things that can make him happy, and wise businessmen try to discover these.

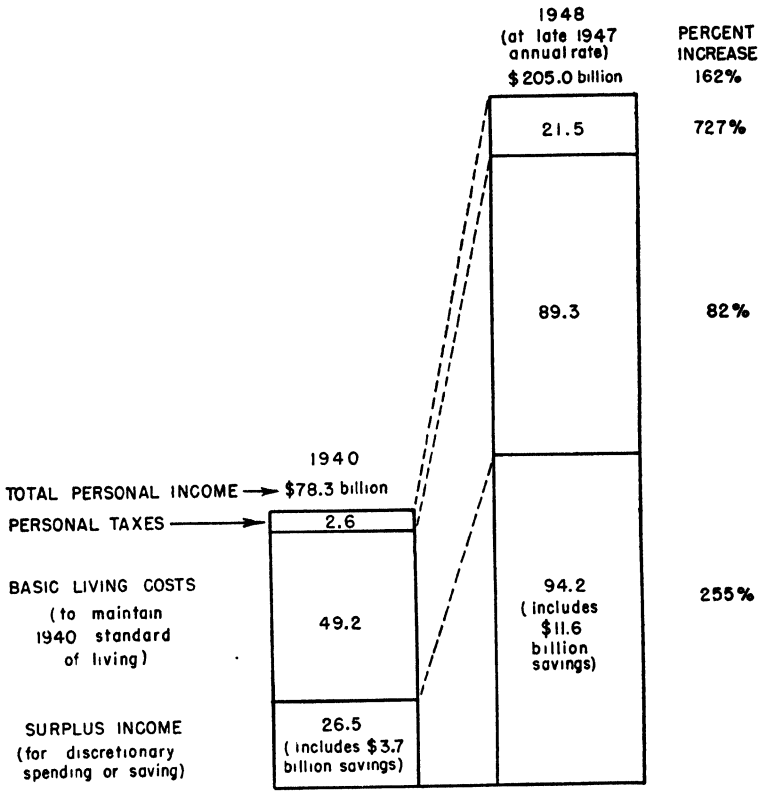


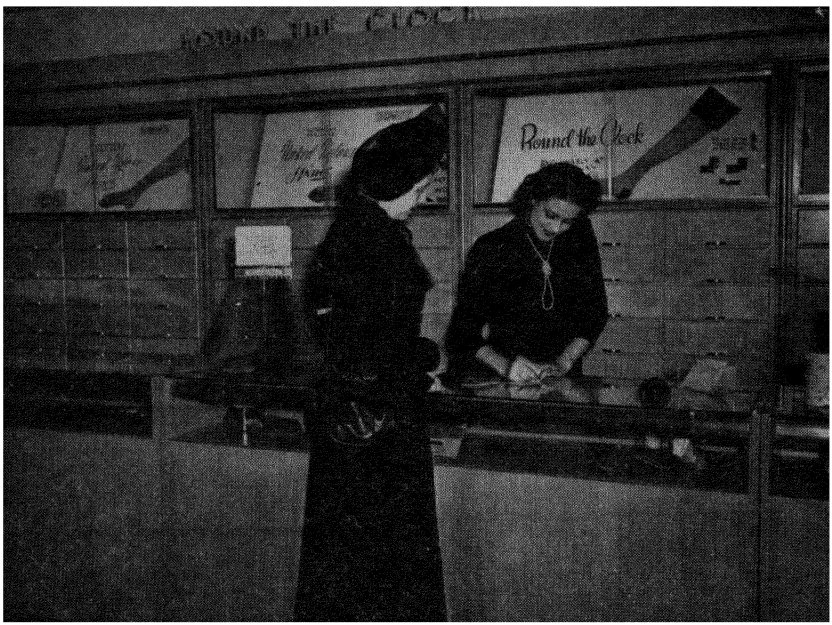

*Figure 2-5. Aggregate Increase in Consumer Purchasing Power, 1940-1948.* (SOURCE: Johnson, Arno H., "Market Potentials, 1948." *Harvard Business Review,* January, 1948, Vol. XXVI, No. 1, p. 13.)

*Service.* Many volumes could be written on the service aspect of business. We shall present here only one or two simple illustrations that show how producers and distributors try to please their customers.

A case study taken from the Pittsburgh shopping district reflects the customer's attitude toward sales service.[7] More than 3,000 contacts were made over a period of months. The following five aspects were rated highest:

[7] "What Is Important in Selling" (mimeographed study), p. 1. Pittsburgh: Research Bureau for Retail Training, University of Pittsburgh, 1946.

1. Interest during the transaction
2. Effective presentation (show) of merchandise
3. Willingness to help nonpurchase customers again
4. Acknowledgment of customers in courteous and friendly manner
5. Ability to answer questions or objections satisfactorily




*Courtesy The Leon Godchaux Clothing Co , Ltd., New Orleans, La , and Remington Rand Inc*

*Figure 2-6.* Retailers spend fabulous sums on modern interiors, attractive displays, clever stock systems, and comfortable surroundings where "Queen Consumer" can enjoy buying. Most of all, they choose and train people who meet customers pleasantly, interpret their wants, and appear happy in their work.

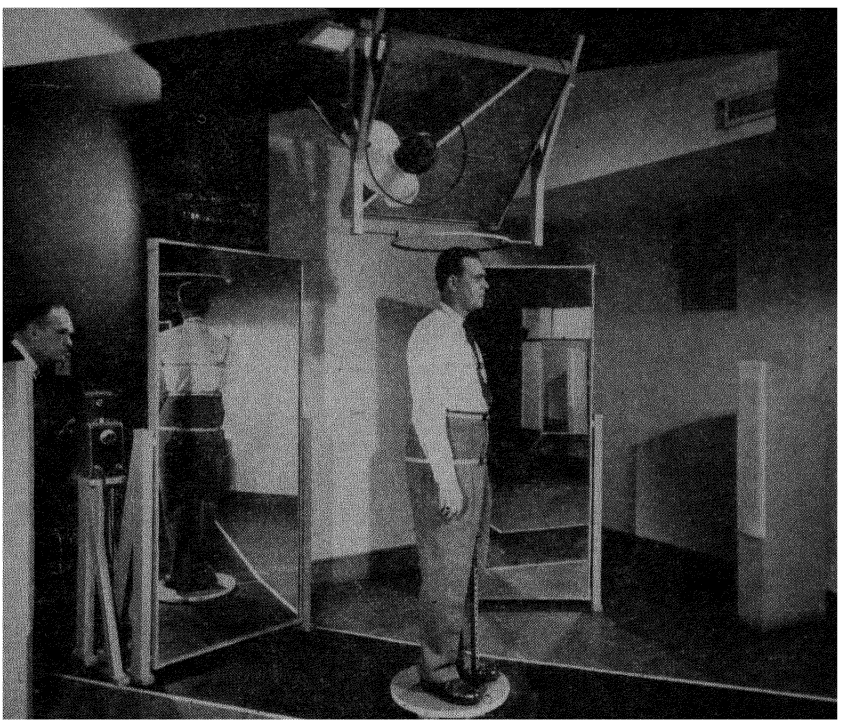
A study made by the American Home Economics Association shows excellently what women expect in the house dresses they buy. These points of service have probably been reviewed millions of times by women, but not until the information had been brought together statistically could conclusions be reached. More than 11,500 women from 22 widely scattered cities throughout the United States were asked what they wanted in house dresses. Their answers can be briefly summarized:

1. They wanted improvements in the different sizes of garments. Stout women should have youthful designs, and small women should be given styles commensurate with their maturity and not designed for schoolgirls.

2. They wanted variety in large sizes, with more selections for warm and cold seasons. Also, they pointed out the need for more comfort in arm openings and shoulder construction.

3. They wanted better labeling systems by manufacturers, so that consumers might know the quality and character of garments.

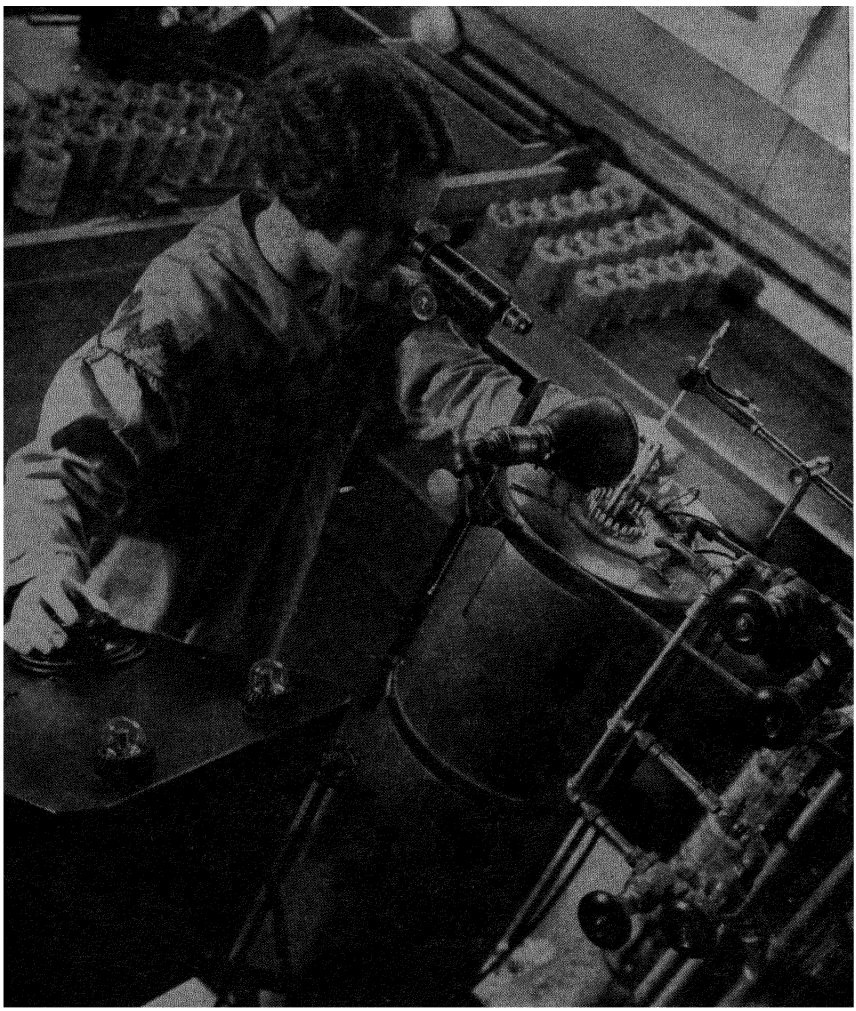
On the basis of such information, intelligent marketing plans can be built.



*Courtesy The PhotoMetric Corporation*

*Figure 2-7.* The modern PhotoMetric process, by making possible accurate measurements, gives the consumer a suit that has the maximum in wearing comfort, styling, and durability.

*Taste.* The General Motors Corporation has spent thousands of dollars seeking accurate information about what the American automobile public wants in transportation. Their engineers were convinced that certain body styles, designs, and colors would probably be accepted by the public, but not until facts were obtained from field studies could they plan new models with confidence. Millions of consumers reported to General Motors by questionnaire what they wanted in their cars.



*Courtesy Taylor Instrument Companies, Rochester, N. Y.*

*Figure 2-8. Maintaining Standards with Precision Instruments.* Here a technician is shown in a laboratory dedicated to the production and maintenance of standardized instruments of measurement. Private laboratories as well as government agencies guarantee the standards upon which our measurement systems are based.

Furthermore, they were given a chance to sketch the car they thought ideal.

*Price.* Consumers are interested in price because it represents what must be exchanged for goods or services. Many economic factors determine the level of prices during periods of prosperity or depression or

locally under varying degrees of competition or monopoly, but when consumers do their shopping, they are not so much interested in economics or dealers' costs or operating ratios as in how much money they are required to pay for what they buy.

Here we inevitably touch subjects like: Does price indicate quality? Who offers the lowest price? Does price alone determine value in the total transaction?

All stores do not ask the same price for their merchandise. Neither do all stores of one type ask the same price for their goods. For example, a Dallas department store advertised silk crepe dresses for sale on the third floor at $50 and in the basement at the same time for $30. The furnishings department of a large department store in Chicago sold slipcovers for $10 on the fifth floor and for $5.95 in the basement.

The price levels that are acceptable to consumers can be fairly well determined. One clothing store analyzed the prices at which 365 of their men's suits were sold. More than 70 percent of the sales were made at 6 of the 25 different prices in which suits were stocked ($22.50, $25, $28.50, $35, $37.50, and $45).[8]

*Standards.* Prices are meaningless without standards. But what is a standard? "A standard may be defined as a model for a material object or a rule for a course of action established by authority, custom, or general consent by which others of a like nature may be identified, compared, or regulated, or which in itself represents the ideal or the 'one best' for a particular purpose."[9]

Fortunately, the federal government and state governments have led the way in setting up standards by which descriptive values can be determined. Probably the most satisfactory standard used by consumers generally is that determined by experience in using what are called "name quality" goods. Food lines particularly can be bought with more confidence when a packer is known to be consistent in his labeling.

## The Student as a Consumer

To illustrate in what ways a student is a consumer, let us consider Frank Bates, a business student at Stratmore College. With the assistance of a school catalogue, Frank will probably engage in some financial planning for the year ahead. His first introduction to budgeting occurs when he considers what his schooling will cost and how

[8] Converse, Paul D., and Jones, Fred M., *Introduction to Marketing,* p. 350. New York: Prentice-Hall, Inc., 1948.

[9] Coles, Jessie V., *Standardization of Consumers' Goods,* p. 78. New York: Ronald Press Company, 1932.

much money he will need to defray expenses. This technique is precisely the same as the one used by businessmen in budgeting future operations, whether they be problems of production, research, expansion, or other activities.

## The student's budget

Frank Bates' budget will probably include four classes of expenses:

1. Tuition, fees, books
2. Living expenses
3. Personal expenses
4. Self-development and maintenance

Table II-3 develops these four classes in a complete budget.

TABLE II-3. FRANK BATES' BUDGET FOR ONE SEMESTER.

| | | | | |
|---|---|---|---|---|
| 1. | Tuition, fees, books | | | |
| | Tuition | $150.00 | | |
| | Laboratory fees | 10.00 | | |
| | Student activity fee | 3.00 | | |
| | Athletic fee | 7.00 | | |
| | Books and supplies | 35.00 | $205.00 | 23.7% |
| 2. | Living expenses | | | |
| | Room | 75.00 | | |
| | Board | 180.00 | | |
| | Laundry and tailor | 60.00 | 315.00 | 36.4 |
| 3. | Personal expenses | | | |
| | Clothing (new values added) | 150.00 | | |
| | Entertainment | 20.00 | | |
| | Transportation | 30.00 | 200.00 | 23.1 |
| 4. | Self-development and maintenance | | | |
| | Medical (school fee and drugs) | 25.00 | | |
| | Contributions | 10.00 | | |
| | Self-development | 10.00 | | |
| | Insurance | 10.00 | | |
| | Personal services (haircuts and so forth) | 40.00 | | |
| | Toilet articles, small equipment, and so forth | 40.00 | | |
| | Miscellaneous | 10.00 | 145.00 | 16.8 |
| | Total | | $865.00 | 100.0% |

## The student's role in business experiences

Beyond the area of budgeting expenses, the student should be curious to know what disposition is made of the funds he budgets and what effect the money has on business and economic activity.

A typical American university may receive from its community three and one-fourth million dollars in one semester, originating in tuition, endowment, governmental appropriations, gifts, sales, and services. At

the same time the university will return to the community nearly three million dollars for the same period in payroll, libraries, materials, supplies, and development.[10] The remaining $350,000 will also be invested later in buildings and local improvements.

The salary item alone in the budget provides employment for 880 people, distributed as follows:

| | |
|---|---|
| General administration | 10 |
| Instructional | 125 |
| Organized research | 20 |
| Extension | 300 |
| Libraries | 10 |
| Operating and maintenance | 5 |
| Organized activities related to instructional departments | 350 |
| Auxiliary enterprises and activities | 55 |
| Other noneducational personnel | 5 |
| Total | 880 |

Added to the employment of these 880 people, the expenses of supply and equipment aggregating another million dollars represent trade with wholesalers, retailers, and jobbers who are in business for profit and cater to educational institutions. More specific application of these general statistics can be seen in one specific case.

Remove from the budget Professor James C. Carver's salary of $400 monthly and trace the effects of his spending it in the community. Figure 2-9 shows how widely his budget distributes this amount.

Carver's family includes himself, his wife, and two children. The

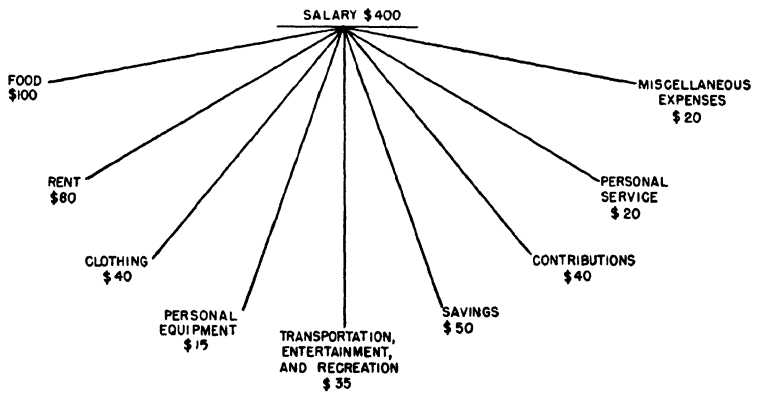



*Figure 2-9. Monthly Salary Distribution.*

[10] Ideas adapted from National Committee on Standard Reports for Institutions of Higher Education, *Financial Reports for Colleges and Universities*, p. 138. Chicago: University of Chicago Press, 1935.

$100 he spends for food would probably render the grocer $15 profit for himself and his family, in addition to helping with the employment of five clerks, who have families and consumer problems of their own. Furthermore, this money will help pay the rent, insurance, taxes, and miscellaneous items in the grocer's operating budget.

The purchase of clothing from the local department store affords profit for the owner, employment for the clerks, and maintenance of the building, equipment, and fixtures. Beyond the retailer is the wholesaler, similarly interested in sales, turnover, and profit. Manufacturers of clothing, who look to wholesalers for market outlets, have labor, supply, equipment, and fixed costs that are affected by sales on the wholesale market. Behind the manufacturers are the mills where woolen cloth is woven, the yarn spinners, and the woolgrowers.

These points in the buying cycle illustrate the significant idea: Human beings are essential to the commercial development of ideas and are intimately related one to another. Specifically, the son of a sheep rancher may easily see how, through a long series of related events, his school budget is affected by the fashion in men's clothing.

### The school cafeteria as a business organization

Although commonly accepted as a necessary type of nonprofit service, cafeterias and dining halls represent real business organizations capable of illustrating practices useful to students in learning about similar business operations. Observe how many varied contacts the students can have in the average cafeteria. He may analyze (1) income statistics, (2) cost of food, (3) labor and supervision, or (4) overhead expenses including light, heat, insurance, and depreciation of equipment. Let us consider the first and the last of these.

Frank Bates' budget included $180 for board during one semester. Dividing this figure by 18, the number of weeks in one semester, and by 7, for the number of days in one week, gives us $1.43 as income per day for each boarding student. Taking this as an index, we may see how much various numbers of boarding students would contribute to the total income for one semester:

| *No. of Students* | *Amount of Income* |
|---|---|
| 25 | $ 35.75 |
| 50 | 71.50 |
| 100 | 143.00 |
| 200 | 286.00 |
| 300 | 429.00 |
| 400 | 572.00 |
| 500 | 715.00 |

Overhead expenses such as light, heat, insurance, and depreciation have relatively little sensitiveness to numbers; the basic cost of keeping a serving room conditioned for eating is practically the same for a small group of students as it would be for a larger one, although depreciation of equipment, of course, would show a slight increase. The following tabulation shows possible differences in cost figures when various numbers of students are served:

| *No. of students* | *Day rate* | *Cost per student per day* | | | | *Total income* | *Total cost* | *Profit* |
|---|---|---|---|---|---|---|---|---|
| | | *Food* | *Labor* | *Supervisor* | *Overhead* | | | |
| 25 | $1.43 | $.93 | $.10 | $.05 | $.15 | $ 35.75 | $ 30.75 | $ 5.00 |
| 50 | 1.43 | .92 | .10 | .05 | .08 | 71.50 | 57.50 | 14.00 |
| 100 | 1.43 | .88 | .10 | .04 | .06 | 143.00 | 108.00 | 35.00 |
| 200 | 1.43 | .85 | .09 | .03 | .06 | 286.00 | 206.00 | 80.00 |
| 300 | 1.43 | .85 | .08 | .03 | .04 | 429.00 | 300.00 | 129.00 |
| 400 | 1.43 | .84 | .06 | .02 | .03 | 572.00 | 380.00 | 192.00 |
| 500 | 1.43 | .80 | .05 | .01 | .03 | 715.00 | 445.00 | 270.00 |

The routine through which a student's boarding expense moves suggests a number of other business experiences, which may be briefly summarized as follows:

1. Finances must be provided with which to begin operations.
2. Personnel must be chosen according to aptitudes for each job to be filled. Training will facilitate their work.
3. Equipment orders involve careful planning and shopping.
4. Supplies should be arranged for and minimum balances maintained through stock-control systems.
5. Bookkeeping and clerical work follow invoices, banking, and payments of funds.
6. Legal aspects are involved in dealing with not only employees but also the public.
7. Some attempt should always be made to find the optimum volume needed in the business. Promotion of ideas in eating habits can increase business to that desired level.

If these ideas are taken seriously, students will be able to gain valuable understanding of many significant and important business experiences.

## Terms for Study

Appropriations
Auxiliary
Commodity
Consumer movement
Consumership
Craftsmen
Cycle
Discount
Discretionary spending
Discrimination
Domestic workers
Endowment
Fair-trade practices
Index
Maintenance
Monopolistic
"Name quality"
National Income
Nonprofit organization
Operative workers
Potential consumer
Prosperity
Purchasing power
Researches
Spending unit
Standard of living
Technique
Unbiased

## Questions

1. How many consumers comprise the American market?
2. Although it is commonly said that demand controls production, actually production creates and controls demand in modern industry. Do you agree with this idea? Explain your answer.
3. How much did consumer purchasing power increase from 1940 to 1948? How would you challenge the significance of this figure?
4. Do you agree that most buying today is done on an amateurish basis?
5. What are some of the results of exercising poor judgment in buying?
6. Would you say that the typical American consumer is content with the necessities of life?
7. Name several organizations that have their own testing laboratories for merchandise manufactured or sold.
8. Why is the consumer approach used in this textbook?
9. Why are percentages often more effective than figures in evaluating personal expense items?
10. Name five facts that express desirable characteristics of the American market.
11. Some conveniences of today were the luxuries of yesterday. Explain.
12. How can you explain the fact that man's economic life involves a constantly increasing number of wants and desires for various kinds of goods and services?
13. High-priced goods in retail stores often help to sell low-priced goods. How would you explain this condition?
14. How would you minimize the importance of population statistics alone in evaluating the consumers' place in a market problem?
15. In what ways would more intelligent consumer buying habits affect managerial policies for operating a retail store?
16. Does the average store manager contribute anything to the education of his customers in how to buy?

## Problems and Projects

1. Estimate your personal expenditures for last year. What percentage of your expenditures do you feel was imposed upon you by your standard of living, and what percentage was dictated by your individual needs?

2. Make a list of common consumer wastes in which students engage. How would you go about correcting these?

3. Ex-Lieutenant Charlie Turner has $200 that he has long wanted to invest in a set of power tools for his hobby shop. His wife would like several electrical appliances, including a washing machine that would cost about $200. Both Charlie and his wife feel that their G.I. subsidized home could stand some repairs, but in the end they buy the washing machine. Money is not available for more than the one purchase.

What economic factors were involved in making this decision?

Set up an original plan of evaluation in which you tabulate comparative values for the three possible choices.

4. The economic changes in the cost of living are usually reflected through consumer goods like food, drugs, and clothing. All are important parts of the total cost of living. Fees for professional and personal services have also come into importance in computing the cost of living.

On the following items, estimate the fees charged in 1940 and those charged currently. Show the percentage change.[11]

| | *1940 Estimated Fee or Price* | *Current Estimated Fee or Price* | *Percentage Change (plus or minus)* |
|---|---|---|---|
| *a.* Dental fee for cleaning teeth | | | |
| *b.* Doctor's fee for residence call | | | |
| *c.* Architect's fee for plans and building supervision | | | |
| *d.* Attorney's fee for representing client in law suit under $100 | | | |
| *e.* Registered nurse's fee (by the day) | | | |

[11] Percentage change is computed in the following manner: Divide the difference between the 1940 and the current figure by the 1940 figure and multiply by 100. Call the change plus if the current figure is larger and minus if it is smaller. For example: If one service cost $4.00 in 1940 and costs $5.00 currently, divide 1.00 (the difference between 4.00 and 5.00) by 4.00 (the 1940 figure) and multiply by 100. The percentage is 25; it is plus, since the current figure is larger.

| | *1940 Estimated Fee or Price* | *Current Estimated Fee or Price* | *Percentage Change (plus or minus)* |
|---|---|---|---|
| *f.* Automobile washing and greasing | _____ | _____ | _____ |
| *g.* Haircut (or hairset) | _____ | _____ | _____ |
| *h.* Cleaning and pressing suit (or dress) | _____ | _____ | _____ |
| *i.* Fee for blood test | _____ | _____ | _____ |
| *j.* Fee for preparation of income tax return | _____ | _____ | _____ |

Would you say these charges for services have increased proportionately more or less than prices for consumer goods? Explain your answer.

5. In the space provided after each of the articles listed, place the right letter to indicate the buying motive that prompted each purchase. The first item is used as an illustration.

| *Buying Motive* | *The Purchase* | *Answer* |
|---|---|---|
| A. Shelter | O. A package of razor blades | (I) |
| B. Income | 1. An automobile purchased for the family | ( ) |
| C. Pleasure | 2. A public-address system purchased by a large department store | ( ) |
| D. Convenience | 3. A new hot-water heater purchased by a homeowner | ( ) |
| E. Health | 4. An accident policy purchased for personal protection | ( ) |
| F. Safety | 5. Stocks purchased as an investment | ( ) |
| G. Protection of life | 6. A new tire purchased for your automobile | ( ) |
| H. Communication efficiency | 7. An athletic membership purchased in a local sports club | ( ) |
| I. Appearance | 8. A ticket purchased for a football game | ( ) |
| | 9. Five gallons of gasoline purchased for your family car | ( ) |
| | 10. The purchase of a new G.I. home | ( ) |

6. (a) List the various organizations, agencies, or forces at work in your community that offer some protection for individuals who are poorly educated as consumers.

(b) In your opinion, which are most effective? Why?

7. Evaluate the population of your home community by referring to the occupational classification made by the U. S. Department of Labor in 1947. On the basis of this government report, find out theoretically how many people are in each of the 10 occupations classified. This information is quickly available by multiplying the percentages by your population figure. Set up the answers in tabulated form.

8. In how many ways are students different from other consumers in terms of their market potentialities? (Refer to statistical data in the chapter if needed.)

9. Construct a list of products you think have been falsely advertised or misrepresented and have thus taken advantage of you as a consumer.

10. The following tabulation shows how management can be applied to the control of personal finances. The percentages used are, of course, subject to revision as economic conditions change. With this schedule as a working basis, select the appropriate monthly-income bracket and estimate the extent to which your family at home or a friend maintains control over expenses.

| *Monthly Income* | (*a*) *Food* | | (*b*) *Clothing* | | (*c*) *Housing* | | (*d*) *Miscellaneous* | | (*e*) *Development* | | (*f*) *Savings* | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| $ | $ | % | $ | % | $ | % | $ | % | $ | % | $ | % |
| 200 | 64 | 32 | 40 | 20 | 46 | 23 | 20 | 10 | 16 | 8 | 14 | 7 |
| 250 | 73 | 29 | 42 | 17 | 53 | 21 | 22 | 9 | 30 | 12 | 30 | 12 |
| 300 | 75 | 25 | 59 | 19 | 66 | 22 | 30 | 10 | 40 | 14 | 30 | 10 |
| 400 | 84 | 21 | 72 | 18 | 88 | 22 | 40 | 10 | 68 | 17 | 48 | 12 |
| 500 | 100 | 20 | 85 | 17 | 100 | 20 | 60 | 12 | 80 | 16 | 75 | 15 |

Tabulate the figures you find in the appropriate columns:

| | *Higher* | *About the same* | *Lower* |
|---|---|---|---|
| (a) Food | | | |
| (b) Clothing | | | |
| (c) Housing | | | |
| (d) Miscellaneous | | | |
| (e) Development | | | |
| (f) Savings | | | |

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CHAPTER III

# ECONOMIC ASPECTS OF BUSINESS

THE IMPORTANCE OF EVERYTHING that appears in this study of elementary business hinges upon the fundamental economic factors that constitute our society. Although the subject of economics is much too broad for thorough review here, it is possible to summarize the basic forces that underlie business activity. Figure 3-1 shows the skeleton graphically. Economic activity is divided into (1) production and distribution of goods and (2) provision of services. The first is subdivided into production and trade; the second shows services to the economy and to the individual.

## An Appreciation for Our Economic History

### Importance of the Industrial Revolution

In many ways the influences of the Industrial Revolution were as potent in molding economic life as the Italian Renaissance was in reviving artistic and intellectual thinking in the fourteenth and fifteenth centuries. Our economic development during the 70 years following 1770 make those years one of the most significant periods in our national history. Yet the Industrial Revolution cannot be accurately described as a period, because it represented changes that date far back into the history of economic life. No single act, date, invention, or person can be singularly identified as representing the Industrial Revolution, although popular writers carelessly single out one or two inventions as starters of this period of economic development. A few inventions did almost instantly revolutionize methods that had been used for centuries, but *many* changes contributed to make this period what it was. Furthermore, the social and economic background of the people during the eighteenth century was an ideal setting for the explosion of new ideas. Inventions of earlier times, such as Leonardo da Vinci's engine, testify to the futility in revolutionary mechanical developments that do not have the proper economic conditions to support them. The last quarter of the eighteenth century was an ideal time for change.

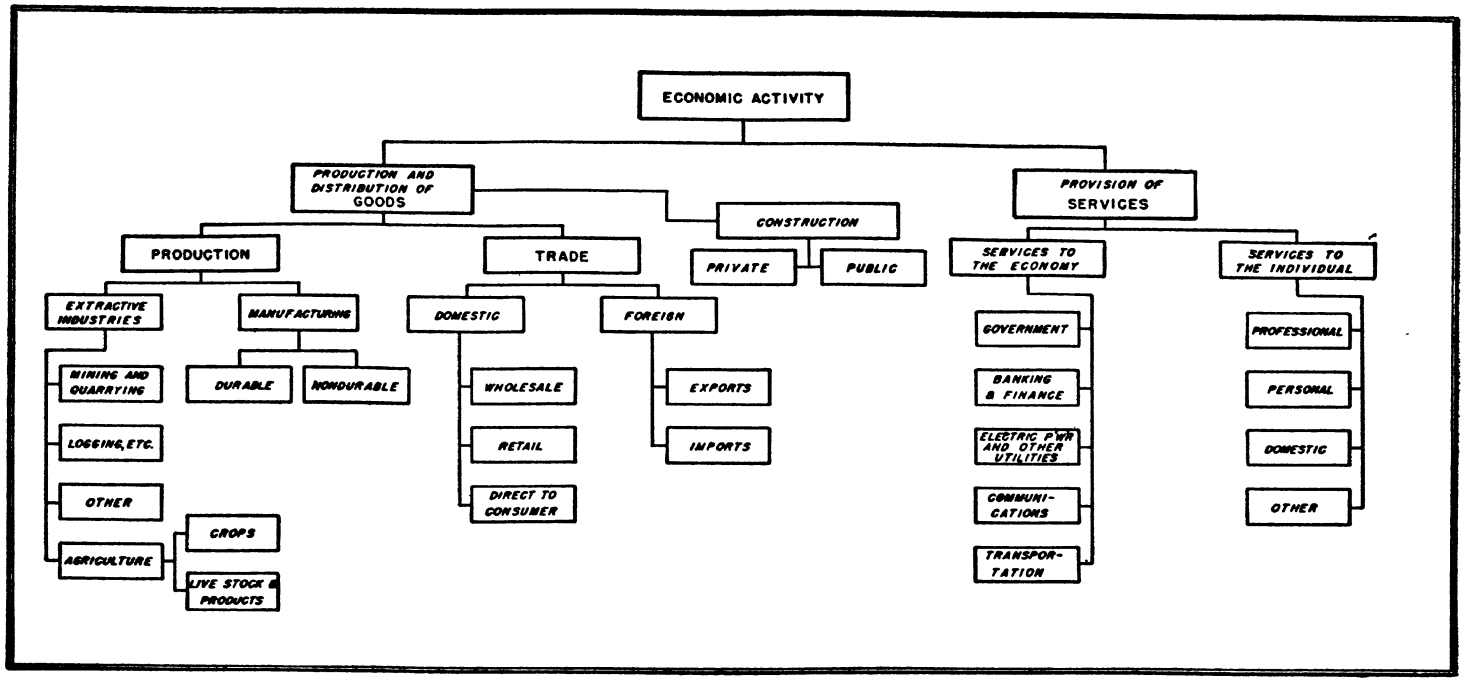



*Figure 3-1. Principal Elements of the Economy of the United States.* (SOURCE: Railroad Committee for the Study of Transportation, *Transportation in America,* p. 8. Washington: Association of American Railroads, 1947.)

Briefly reviewing the activities of eighteenth-century merchants, we find that their interests and holdings represented countless contacts throughout the world. Their tradings were limited only by transportation facilities and time to develop their holdings. Within the framework of the sedentary merchant's activities was contained a basic concept that made the Industrial Revolution acceptable to its age. Possibilities for specialization and development in specialized industries were recognized. The spirit of the Industrial Revolution, which fostered specialization, was not greatly unlike that of the petty capitalists or private craftsmen. However, specialization in industry was conceived on a much larger scale at this time than ever before.

Unquestionably, mechanical inventions irresistibly influenced the development of new ways, new processes, and new thinking. Such inventions represent two general transitions: (1) from the handicraft stage to machine methods, and (2) from human or animal energy to natural power taken from water or steam. Kay's flying shuttle in 1738 accelerated the weaving processes so much that weavers found difficulty in getting a sufficient supply of yarn. Hargreaves' jenny (1767) greatly improved hand spinning, and Arkwright's successful roller process in 1771 brought older patents to a practical stage of utilization. The unique character of steam power alone represents the far-reaching characteristics of the Industrial Revolution. Interestingly enough, this one innovation in our factory system had more to do with changing the living habits of men during the next two centuries than all other inventions had had in the preceding 3,000 years!

### Effects of the Industrial Revolution

What were the effects of the Industrial Revolution in terms of employment, wages, job security, living standards, and social conditions? Could it be that we today face a similar transition as atomic energy is translated in terms of our lives? Here are some of the sociological effects of the Industrial Revolution:

1. It influenced the centralization of population; industrial centers developed.
2. It encouraged the concentration of much production in a few industries.
3. It afforded a chance for industrial groups to gain not only in wealth and economic power, but also in political influence.
4. It brought about overcrowded industrial areas with low wages, leading to intolerable slum conditions in many places.

5. It encouraged many divisions of labor through the factory system; specialization was inevitable.

6. It brought consumers lower price tags through efficient factory methods.

7. It opened new markets for new kinds of merchandise.

8. It stimulated improved transportation methods through larger markets.

9. It disturbed the economic life of many people; many highly paid skills were no longer valuable compared with machines for doing the same work.

10. It brought standardization into factory methods; many jobs now involved only simple repetitions that could be handled by women and children as well as by men.

11. It eventually brought about a general increase in the standard of living for most of the factory people.

12. It brought people together in larger numbers in the factories; problems of group adjustment and tolerance arose that had been unknown when isolated craftsmen worked at home with their families or chosen helpers.

## The Capitalistic System

### The need for producing goods and services

The chief problem in man's economic history has been that of finding security—providing for his needs and wants, and seeking to learn how to live agreeably with others. In developing these things he has experimented with countless numbers of social plans designed to improve his lot. First, he chose the clan or family organization. Assignments of work were delegated to the members of the family and work was supervised through strict discipline and efficient leadership. Results were reasonably successful. Then man turned to the military or aristocratic state, where segregation was encouraged. The master-servant system quickly led to class distinctions with a vicious caste system. This was in turn followed by the medieval rural economy, with its arbitrary power of feudal overlords and class structures that fixed a man's life status at birth.

Behind each of these plans there was the primary motive of survival for the race. Food, clothing, and shelter were the difference between life and death. Since life cannot exist without sustenance, man's problem has been to provide the vehicles through which sustaining goods and services can be obtained. The obvious difference between the solu-

tion of man's problem and a similar one for the animal world lies in man's intelligence and his ability to think through his problems.

## Some basic features of capitalism

The same urge to produce goods and services for the satisfaction of human wants dominates our modern society now just as much as it did centuries ago; capitalism is merely a form in which it operates. Actually, all human effort is designed for individual satisfaction, and the system through which this is attained may be secondary in importance to the needs of the people. Capitalism may be broadly defined as the economic system that allows individuals to produce and distribute, with reasonable freedom from outside control, goods and services under a competitive system that offers profit as a reward for individual effort. The mechanics through which these productive and distributive processes are achieved are presented in other chapters of this book. A state of pure capitalism has never existed because of inevitable mixtures of both publicly and privately owned enterprises, but a capitalistic economy is said to exist when the predominating system of production and distribution is privately owned and operated.

Since the beginning of the Civil War, the United States has definitely moved from an agricultural to an industrial society. With all of its weaknesses and shortcomings, the capitalistic system has survived two world wars and the greatest depression of all time. Of course, capitalism as a dynamic economic system may not be permanent in our economy, but it serves our purpose now and we may surely expect to use professional business training of all different kinds in the capitalistic system.

In one recent period measuring 80 years of growth in big business under the capitalistic system, the number of firms increased about 25 percent. During the same time nearly seven times as many people were employed and wages increased more than 180 percent.

Let us examine some features of the capitalistic system.

*Recognition of Self-Interest.* One cardinal point in human motivation is self-interest. People are generally more interested in themselves than in others. The old saying, "Every man for himself and the devil take the hindmost," characterizes most human effort. This attitude is not limited to business, but is found in war, politics, law, education, religion, and almost every other phase of human life.

Interest in self, directly or indirectly, is the strongest motivation known to human effort, and the capitalistic system makes it possible for individuals to develop personal interests to the utmost. In fact, the

capitalistic system sometimes allows self-interest to be developed at the expense of others in the same society.

*Private Property.* Private enterprise is built around the utilization of private property. By private enterprise we mean the system under which individuals are free to carry on business with their own capital, experience, and desires to succeed, without the aid of the government or other subsidizing agencies.

The owners of private property have the privilege and responsibility of deciding what they shall produce and distribute. In most cases private capitalists determine when, where, and how much to produce.

*Competition.* Freedom of enterprise under the capitalistic system inevitably brings competition. Competition is defined as the practice of trying to get something sought by others under similar circumstances at the same time. The ground rules and ethics of competitive practices are set by the members of society. From many angles, competition is good for both businessmen and consumers. Self-interest encourages high prices for big profits, but when competitors bid for the same business, price reductions ultimately enter the picture. In addition, the aggressive characteristics of one dealer may make him more efficient than another; thus, under a competitive plan of operation, managerial practices tend to become standardized on a high plane of efficiency.

*Pricing and Profits.* We have already seen the effect of competition on prices. Prices are set by laws of supply and demand in the capitalistic system. When the supply of a commodity is restricted, the demand increases and the amount that buyers are willing to pay is raised by competitive bidding. An abundance of supply reduces the demand and, of course, lowers the price correspondingly.

There are several kinds of prices. Although radically different in nature, they are closely related in many respects. Manufacturers' prices are determined largely by costs of production, which in turn are governed largely by the principles of mass production. Wholesale prices to retailers are determined both by the efficiency of the wholesaler's distribution system and by competition in the market. Retail price levels operate much the same as other pricing systems. Throughout the entire pricing system, however, supply and demand set the pace.

A number of business barometers can be used in the interpretation of prices. Examples are: indexes of department-store sales, labor statistics, steel production, freight-car loadings, bank clearings, and postal receipts.

The question might well be asked: How much profit should an entrepreneur be allowed? Should he be allowed to make an unlimited

amount of profit, as he has formerly been allowed to do under free enterprise? Or should control devices be set up in such a manner as to allow only a reasonable profit? A reasonable profit would be interpreted as meaning enough money to allow a fair rate of interest on invested capital, an attractive reward for management's ability and effort, and something for the element of risk involved in the business.

*Responsibilities to Government.* Almost from the beginning, commercial developments have been regulated by varying degrees of legal authority. In England as late as in the nineteenth century, regulations fixed prices, limited production, and named quotas for the employment of labor. Under Queen Elizabeth, justices of the peace were even given authority to set labor's wages. These conditions ultimately gave rise to the belief that there was too much government control and quickly gained acceptance for the principle of *laissez faire* ("let alone"). Adam Smith's *An Inquiry into the Wealth of Nations* helped crystallize people's thinking about *laissez faire*. Smith's philosophy justified men's freedom to engage in any reasonable activity of their choice. Individual initiative was recognized, personal liberty enjoyed, and private property accorded full legal standing. Government was regarded as a necessary agency that functioned best when it had little or no part in regulating business.

Now our modern economy tends to swing back to more government in business. The subject is of such paramount importance that a separate chapter has been reserved for its treatment. Suffice to say here that government brings increasingly more and more control into business through laws, regulations, codes, taxes, and ordinances. Yet none of these are intended to be discriminatory. All control is ostensibly designed for the benefit of society, and anyone who complies may operate his business.

## American Economic Factors

### Physical description

Our great economy cannot be understood without reviewing its geographical dimensions. This nation measures 3,000 miles from east to west and more than 1,000 miles from north to south, without including Alaska. Its many inland waterways include the five Great Lakes, draining into the Atlantic Ocean through the St. Lawrence River, and the great Mississippi with its tributaries, the Ohio and the Missouri.

From approximately 800,000,000 acres of land extending from the Atlantic Coast to the plains beyond the Mississippi and into the Pacific

Northwest, 400,000,000 acres have been converted into farm and pasture land, 250,000,000 acres either have been burned out or for other reasons lie useless for cultivation, and approximately 130,000,000 acres of virgin timber remain. An average annual rainfall of between 20 and 60 inches makes *good* crop-growing seasons, and the productivity of arid sections has been greatly increased by irrigation. Regions in California, Arizona, Texas, and New Mexico have become world-famous garden spots for growing fruits and vegetables.

### Desirable climatic conditions

Climate is the most important physical factor influencing commerce and industry. It determines not only which plants and animals can live and thrive in various parts of the world but also the work habits of people. Warm tropical climates make life simple and enjoyable because food, clothing, and shelter are easily obtainable. A humid climate discourages physical activity to the extent that ambitious work habits are frequently nonexistent.

On the other hand, cold climates limit the number of plants that can be grown and thus curtail production. Under such conditions man must fight vigorously for his existence. Inasmuch as three-fourths of the world's commerce comes from temperate zones, America can be proud of having many regions that are conducive to commercial and industrial development.

### Natural resources

The greatness of the American economy is determined largely by our ability to obtain necessary supplies of raw materials for productive processes from the abundance of natural resources at our disposal. With the possible exception of the Soviet Union, we are more nearly able to supply our demands from within our own boundaries than any other country in the world. Except for tin and some alloys like nickel and chrome, we lack few essentials. Our normal industrial consumption of many essential raw materials equals that of all the rest of the world.

The following quotations from a study made by the Twentieth Century Fund [1] emphasize some of the more important phases of our economic resources:

> .... In the period between 1925 and 1929 during which world consumption and production of raw materials reached their highest pre-war levels,

[1] Dewhurst, J. F., and Associates, *America's Needs and Resources*, p. 573. New York: Twentieth Century Fund, 1947.

the United States was the largest consumer in the world of every important metal and of asbestos, coal, mica, petroleum, phosphates, and sulphur. During the same period the United States was the world's largest producer of aluminum, copper, iron ore, lead, molybdenum, zinc, coal, mica, petroleum, phosphates, and sulphur. It was the second largest producer of bauxite and magnesite, and practically tied for second place in the production of wool. It was the third largest producer of mercury, tungsten, vanadium and nitrates.

....The physical production of industrial minerals in the U.S. in 1939 was nearly four times as large as Russia's, and larger than combined output of Russia, Germany, the British Isles, Canada and Newfoundland, Venezuela, France and the Japanese Empire.

....We produced 1,483,000,000 tons of raw materials, or 11.4 tons per capita in 1939.

....Gross value of crude (unrefined) mineral materials approximated $4.2 billion in 1939. Eight of all 91 varieties of minerals reported by the Bureau of Mines in 1939 accounted for 84 percent of the total value and 93 percent of the total weight. These minerals were petroleum, coal, natural gas, cement, iron ore, stone, sand and gravel, and copper.

*Courtesy Pittsburgh Plate Glass Company*

*Figure 3-2. Coal, One of Our Most Vital Natural Resources.* Here the very latest modern equipment and safety devices are employed by skilled workers in the production of coal.

## The labor picture

An effective analysis of labor begins with population statistics. We should review the size of the entire labor population as well as the proportions in different categories.

Our population, representing all nationalities, many religions, varying social positions, and many economic backgrounds, has grown to more than six times its size in 1850. This growth has been caused by an accelerated birth rate, a low death rate, and a heavy inflow of immigrants. Table III-1 gives an analysis of population changes from 1850 to 1940.

TABLE III-1. GROWTH OF POPULATION OF THE UNITED STATES, 1850-1940.*

| *Census Year* | *Population as Reported by Census* | *Increase Over Preceding Census (In Millions)* | *Immigration in Preceding Decade*(a) | *Immigration as Percent of Population Increase* | *Number of Immigrants Arriving After 1840 and Their Descendants (In Millions)*(b) |
|---|---|---|---|---|---|
| 1850 | 23.2 | 6.1 | 1.7 | 27.9 | 1.9 |
| 1860 | 31.4 | 8.3 | 2.6 | 31.3 | 4.9 |
| 1870 | 39.8(c) | 8.4 | 2.3 | 27.4 | 7.8 |
| 1880 | 50.2 | 10.3 | 2.8 | 27.2 | 12.2 |
| 1890 | 62.9 | 12.8 | 5.2 | 40.6 | 20.0 |
| 1900 | 76.0 | 13.0 | 3.7 | 28.5 | 28.0 |
| 1910 | 92.0 | 16.0 | 8.8 | 55.0 | 41.0 |
| 1920 | 105.7 | 13.7 | 3.7 | 27.0 | 53.0 |
| 1930 | 122.8 | 17.1 | 3.2 | 18.7 | 64.0 |
| 1940 | 131.7(d) | 8.9 | —0.04 | — 0.4 | 67.0 |

* Dewhurst, J. F., and Associates, *America's Needs and Resources,* p. 32. New York: Twentieth Century Fund, 1947.

(a) Up to 1867, passengers arriving; 1868-1903, immigrants arriving; 1904-1906, aliens admitted, 1907-1910, immigrant aliens admitted; since 1910, net immigration. Only net immigration shows the actual contribution of immigration to population increase; unfortunately no statistics of net immigration are available for the period before 1910.

(b) Rough estimates.

(c) Revised figure.

(d) Without correction for underenumeration.

Note: Slight discrepancies between the first and second columns are due to rounding.

Until the first United States census in 1820, nothing had been done to learn about the economic characteristics of our population. This census showed that over 70 percent of those gainfully employed were persons interested in some form of agriculture. Manufacturing had already become significant, but commerce was insignificant. Only 2½ percent

of those gainfully occupied were primarily engaged in some form of business endeavor.

Since the 1820 census study, the occupational picture of the American economy has undergone significant changes. In 1920, 20 percent of the population was agricultural, and by 1940 only 19 percent of those gainfully employed in the United States were engaged in either agriculture, forestry, or fishing. The percentage of personnel engaged in manufacturing increased steadily until the years 1920-1940, when for the first time a slight decline was noted. Such occupations had begun to reach a partial saturation point in taking workers from agricultural regions.

The 1940 census figures indicate that three-quarters of all workers earn their living in 150 major occupations, although the *Dictionary of Occupational Titles* lists about 18,000 different ways of earning a living.

## Characteristics of labor

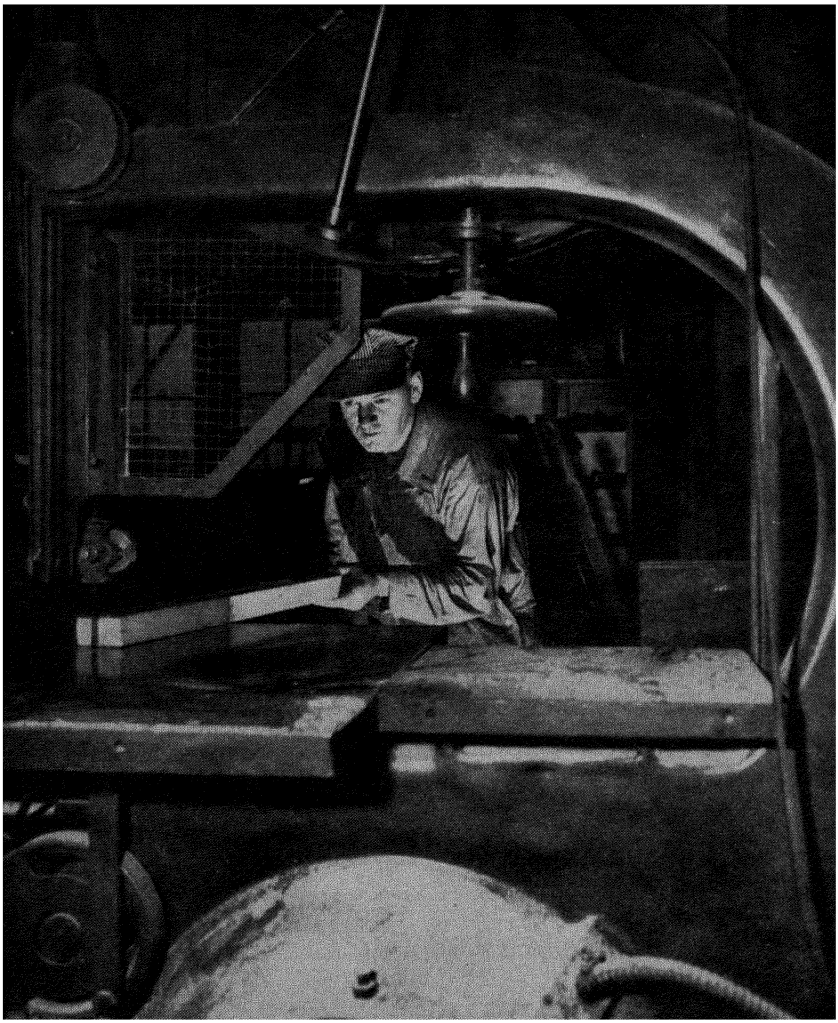
The personal characteristics of labor include earnings, intelligence, education, adaptability, productivity, industry, and, of course, spending characteristics.

The labor force in 1940 averaged 54.4 million people, which was about seven times the number gainfully employed in 1850. In 1946 there were nearly 41 million workers in nonagricultural establishments alone. Table III-2 gives an analysis of these nonagricultural workers in 1946 in terms of eight kinds of employment.

TABLE III-2 ESTIMATED NUMBER OF WAGE AND SALARY WORKERS IN NONAGRICULTURAL ESTABLISHMENTS BY INDUSTRY.*
(In Thousands)

| *Kind of Employment* | *1946* |
|---|---|
| Manufacturing | 14,365 |
| Mining | 836 |
| Construction | 1,493 |
| Transportation and Public Utility | 4,023 |
| Trade | 8,448 |
| Finance | 1,523 |
| Service | 4,430 |
| Government | 5,595 |
| Total | 40,713 |

* *Statistical Abstract of the United States*, 69th ed., p. 200. Washington: U. S. Department of Commerce, 1948.



*Courtesy Keystone Steel & Wire Company*

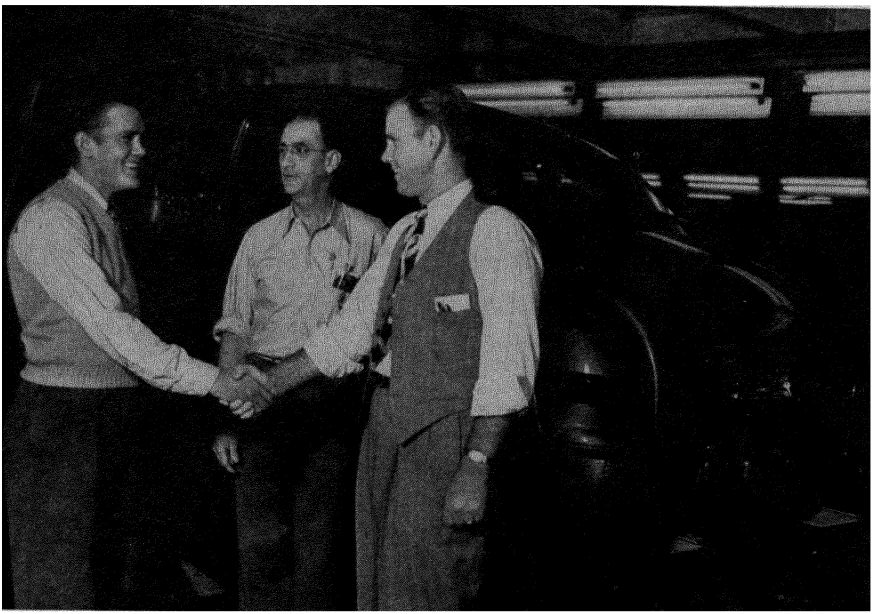
*Figure 3-3.* Modern equipment requires intelligent, adaptable, industrious, and productive labor.

There are many ways of analyzing labor's earning power, but the layman understands dollars and cents best. Therefore, we shall first look at average hourly earnings for wage workers in all manufacturing industries. This will give a representative view of a large block of the labor supply. Table III-3 gives this information on a comparative scale from 1929-1946, and thus significant changes in amounts paid labor can be noted.

TABLE III-3. AVERAGE HOURLY EARNINGS: 1929-1946, WAGE WORKERS IN ALL MANUFACTURING INDUSTRIES.*

| *Year* | *Cents per Hour* | *Year* | *Cents per Hour* |
|---|---|---|---|
| 1929 | 56.6 | 1938 | 62.7 |
| 1930 | 55.2 | 1939 | 63.3 |
| 1931 | 51.5 | 1940 | 66.1 |
| 1932 | 44.6 | 1941 | 72.9 |
| 1933 | 44.2 | 1942 | 85.3 |
| 1934 | 53.2 | 1943 | 96.1 |
| 1935 | 55.0 | 1944 | 101.9 |
| 1936 | 55.6 | 1945 | 102.3 |
| 1937 | 62.4 | 1946 | 108.3 |

* Bureau of Labor Statistics. Statistics do not include earnings of supervisory forces above working foremen and clerical employees. As used in: Railroad Committee for the Study of Transportation, *Transportation in America,* p. 88. Washington: Association of American Railroads, 1947.



*Courtesy Ford Motor Company*

*Figure 3-4. A Job for the Future.* The opportunities for promotion are an important part of every job. Here a young man is being introduced to a factory job that may lead to his becoming foreman, superintendent, or an executive with the company.

It has been estimated that all employees in private industry averaged $1,408 annually in 1929, whereas in 1945 the average was $2,242. The length of the average work week has decreased. Furthermore, labor

has demanded more as compensation through systems of job upgrading and job classification, special allowances for travel and dressing time, and the abolition of territorial differentials in pay, to mention the most important items.

Figure 3-5 presents an accurate picture of the gains labor received from 1939-1948. Consider the cost of living as an index or basis of measurement. In approximately 10 years the cost of living rose 72.2 percent. At the same time manufacturing wages rose 122.7 percent. By 1944 prices had advanced 26.3 percent and wages had advanced 93.1 percent. From 1944 to 1948, however, prices increased 45.7 index points, whereas manufacturing wages rose only 31.5 points.

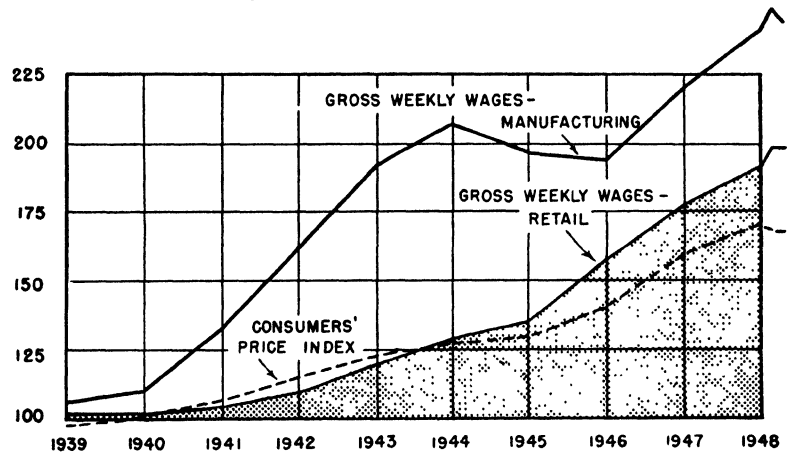



*Figure 3-5. Index of Wages and Prices.* (SOURCE: "Labor in the War Decade." *Fortune,* August, 1949, Vol. XL, No. 2, p. 151.)

The results of labor's efforts can be significantly reviewed in terms of total industrial production. Figure 3-6 gives this information for the years 1919-1946. With the years 1935-1939 representing 100 as a basis of comparison, it is possible to evaluate (1) total manufactures, (2) minerals, and (3) total industrial production. Labor has an integral part in all these.

The educational characteristics of labor reflect the culture of the day represented. Education generally expresses something of the wants of people, and wants make up markets. Education also shows the character of the intellect with which management deals in bringing labor into industry and business. Table III-4 shows how many years of education twelve age groups had in 1940. Nearly 70 percent of the population in 1940 had a grade-school education, and more than 27 percent

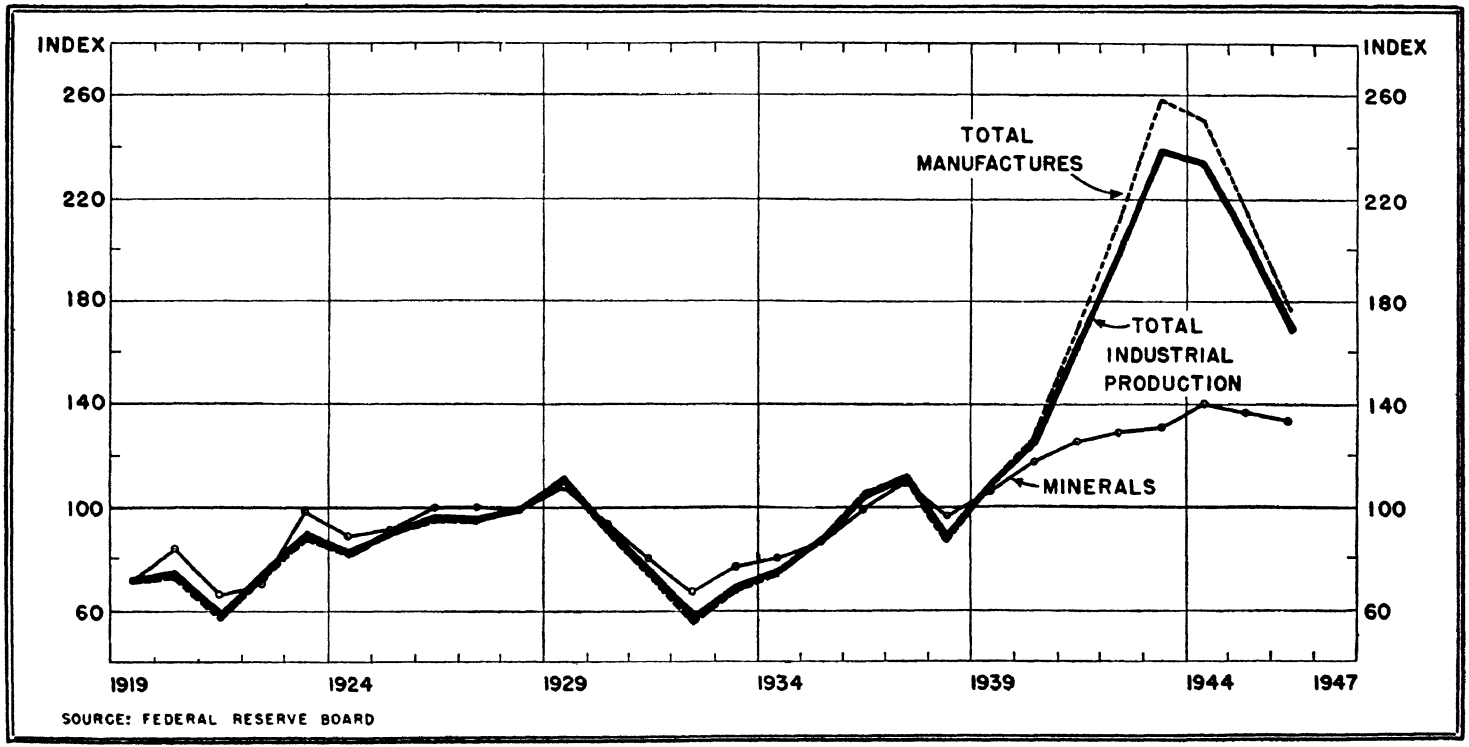



*Figure 3-6. Index of Industrial Production for the Years 1919-1946.* 100 equals the years 1935-1939. (SOURCE: Railroad Committee for the Study of Transportation, *Transportation in America,* p. 76. Washington: Association of American Railroads, 1947.)

had finished high school. Almost 13 percent of the population had had either two or four years of college.

TABLE III-4. EDUCATIONAL LEVEL OF ADULT POPULATION BY AGE GROUPS, 1940.*

| Age Group | Median School Year Completed | Percentage Who Completed at Least: Grade School | High School | 2 Years of College | 4 Years of College |
|---|---|---|---|---|---|
| 20 or over | 8.8 | 69.8 | 27.2 | 8.4 | 4.4 |
| 20-24 | 11.2 | 83.0 | 44.4 | 9.1 | 3.3 |
| 25-29 | 10.3 | 80.2 | 38.1 | 10.5 | 5.9 |
| 30-34 | 9.5 | 77.1 | 33.0 | 11.1 | 6.3 |
| 35-39 | 8.8 | 72.0 | 26.9 | 9.8 | 5.5 |
| 40-44 | 8.6 | 68.9 | 23.7 | 8.5 | 4.7 |
| 45-49 | 8.5 | 62.5 | 19.9 | 7.3 | 4.1 |
| 50-54 | 8.4 | 61.5 | 18.5 | 6.7 | 3.8 |
| 55-59 | 8.3 | 55.9 | 17.1 | 6.0 | 3.4 |
| 60-64 | 8.3 | 58.7 | 16.4 | 5.8 | 3.3 |
| 65-69 | 8.2 | 55.1 | 14.2 | 5.1 | 2.9 |
| 70-74 | 8.1 | 54.6 | 13.1 | 4.6 | 2.6 |
| 75 or over | 8.0 | 51.4 | 11.5 | 3.9 | 2.3 |

* Dewhurst, J. F., and Associates, *America's Needs and Resources*, p. 301. New York: Twentieth Century Fund, 1947

Further proof of the caliber of industrial labor is seen in a comparison of educational experience (years of school) of enlisted men in the army during World War I and World War II. Table III-5 shows that three-fourths of the soldiers in the first war had only a grade-school education, whereas in the second war only 31 percent were so limited. Nearly 18 percent had some high-school education in World War I, whereas more than 53 percent had the same amount of schooling in World War II. The proportion of men with from one to four years of college training was three times as large in World War II as in World War I.

TABLE III-5. DISTRIBUTION OF SAMPLINGS OF ENLISTED MEN IN THE ARMY BY YEARS OF EDUCATION, WORLD WARS I AND II.*

| Years of Schooling | Percentage in: World War I | World War II |
|---|---|---|
| Grade School | 76.7 | 30.9 |
| High School | | |
| 4 years | 4.1 | 23.3 |
| 3 years | 2.7 | 11.2 |
| 2 years | 4.8 | 10.9 |
| 1 year | 6.3 | 7.8 |

* Dewhurst, J. F., and Associates, *America's Needs and Resources*, p. 302 New York: Twentieth Century Fund, 1947.

| *Years of Schooling* | *Percentage in:* *World War I* | *World War II* |
|---|---|---|
| College | | |
| 4 years | 1.2 | 3.6 |
| 3 years | 0.9 | 2.0 |
| 2 years | 1.5 | 4.0 |
| 1 year | 1.8 | 6.3 |

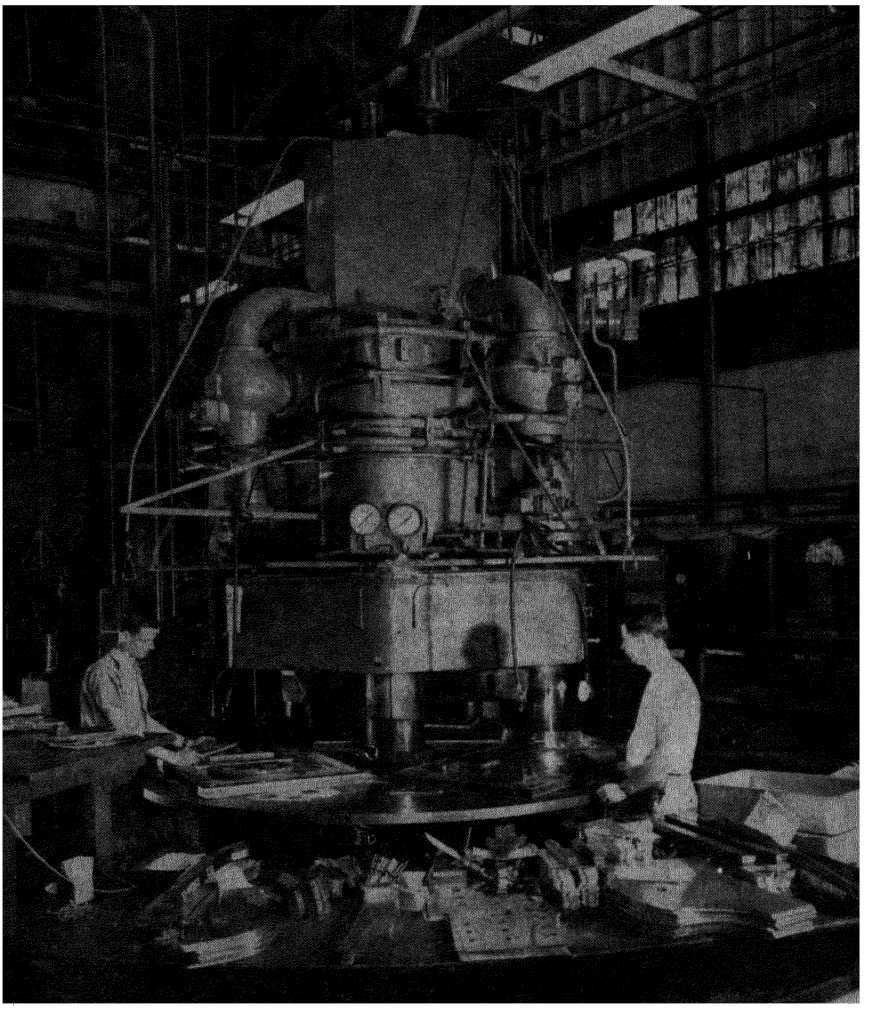
### Technological achievements

The magnitude of the present employment picture is difficult to conceive. It is estimated that American labor in more than 18,400 factories and on 6,000,000 farms produces more goods per man than labor in almost any other industrial nation in the world! It has been accurately estimated that the physical output for each factory worker devoted to the production of consumer goods in the United States was approximately 84 percent higher than that of the English worker and twice as high as that of the German worker under comparable conditions.

The machine age greatly changed the character of labor in America. The new age did not play "freeze-out" with labor, but it did modify techniques and cause man to seek new ways to use his skills. Technological advancements show American progress. In 1918 it took one man 24 hours to make 40 electric light bulbs; one year later the electric companies were using a machine that could make 73,000 bulbs of the same quality in the same amount of time. In the boot and shoe industry 100 machines replaced 25,000 men. One man could produce 32,000 razor blades in 1931 in the same time it took him to produce 500 in 1913.

Cigars were made by hand in 1928. A year later 35 percent of them were made by machines operated by inexpensive labor, and in 1933 half or more of all cigars were machine-made. In 1929, 250 men were required to produce 100 eight-cylinder motor blocks; in 1935, 19 men could do the same amount of work. The industrial-rayon engineers have perfected a continuous-spinning process that cuts time in one phase of operation from 85 hours to 5.5 minutes! Although the cotton-picking machine is as yet unknown to most Southern farmers, it could probably take the place of 500,000 human pickers if widely used.

These are only a few samples of what has gone before and in no way suggest the limitless possibilities ahead. What the peacetime application of nuclear physics and atomic power alone can bring about staggers the imagination. Electronics is another field that holds much promise for industrial expansion.



*Courtesy Beech Aircraft Corporation*

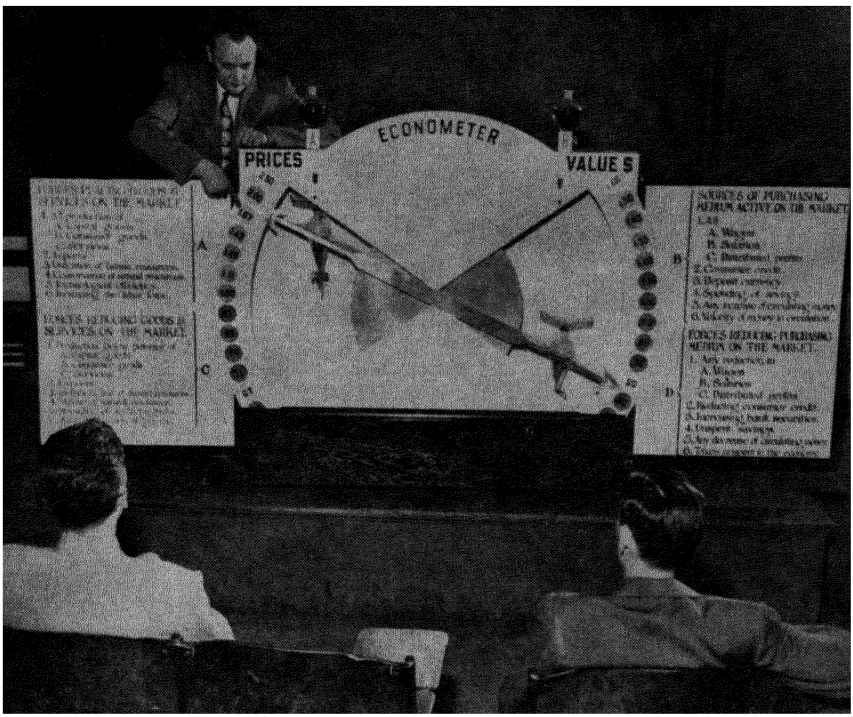
*Figure 3-7. Mass Production through Technological Achievements.* This 1200-ton hydraulic press involves a multiple setup for forming aluminum parts under hydraulic pressure. The speed, accuracy, and efficiency of this modern factory giant are aided by skilled workmen operating around a scientifically designed rotary table.

## Cyclical Behavior Patterns of Our Economy

Economic life has been marked by definite cyclical periods of change throughout history. These changes have marked primitive or preindustrial societies as well as industrialized communities.

In nonindustrial communities, prosperity was marked by feasts or

celebrations. Depression was registered in famine. The same pattern carried over into the elementary forms of private industry, including fishing, hunting, and agriculture. Similar conditions apply to prosperity, too. As a community's cotton, wheat, or grain crops prosper, so prospers the entire community. Poor crops create a shortage in retail sales, in bank deposits, and in employment, and eventually lower the price levels.




*Courtesy Dr. Carl E. Gregory, New York University*

*Figure 3-8. The Econometer.* This ingenious device has been devised as a visual aid to clarify the relationships among various economic forces that influence the business cycle.

There are four phases of activity in the business cycle: (1) prosperity, (2) decline, (3) depression, and (4) recovery. An analysis of the characteristics of these four phases is succinctly illustrated in Table III-6.

## Prosperity

The period of prosperity is the period of economic acceleration. The output of goods is rapid, income from wages is high, savings are available in abundance for investment in plants and equipment, business

TABLE III-6. AN ANALYSIS OF THE BUSINESS CYCLE.*

| PROSPERITY | DECLINE | DEPRESSION | RECOVERY |
|---|---|---|---|
| 1. Labor is fully employed | 1. Profits decline | 1. Volume of business is low | 1. There is an accumulated shortage of goods |
| 2. Wages are high | 2. Goods are forced onto the market | 2. Buying is only for immediate requirements | 2. Most debts are paid |
| 3. Costs of operation increase | 3. Prices are reduced | 3. Wages are low | 3. Outlook is favorable |
| 4. Selling prices increase, but not enough to show profits | 4. Buying is reduced | 4. Production is efficient | 4. Sales increase |
| 5. Stocks of goods are large | 5. Volume of business decreases | 5. Prices are low | 5. Construction increases |
| 6. Construction begins to decrease | 6. Unemployment results | 6. Costs of operation are low | 6. Borrowing begins |
| 7. Creditors begin to demand payment | 7. Businesses cease to expand | 7. Costs of construction are low | 7. Prices begin to rise |
| | 8. Businesses quit borrowing | 8. Stocks of goods are small | 8. Buying begins in anticipation of rising prices |
| | 9. Prices decline | 9. Shortage of goods develops | 9. People go back to work |
| | 10. Debtors press for payment | 10. Interest rates are low | 10. Business begins to operate at a profit |
| | 11. Failures increase | 11. Demands for loans are small | |

* Shields, H. G., and Wilson, W. H., *Consumer Economic Problems,* p. 474. Cincinnati: South-Western Publishing Company, 1940.

people are optimistic about almost everything, and lending is on a relatively free and easy basis.

In this phase, as well as in subsequent ones, it will be necessary to measure specific changes that occur from time to time. Index numbers are commonly employed for this purpose. An index number is a numerical value that indicates relative change in value as determined by using a given year or period as a base.

Management soon becomes concerned about this question: When is the top of the business cycle reached? Surely if it were possible to locate the peak precisely, management could proceed with future plans more intelligently and profitably. No one can tell just when the peak comes, but there are specific characteristics that serve to give warning and can be easily evaluated by the businessman in such a way as to give meaning to his problem.

First, general commodity prices have a tendency to fluctuate at a very high level and at the same time prices of raw materials show a tendency to decline.

Second, many businessmen become concerned about the size of inventories. Wherever there is an accumulation of raw materials in the hands of the producers and these materials are not being consumed so rapidly as they should be, there is concern about the reservoir of supply.

Third, production that rises to a high level and promises to stay there must be viewed with apprehension, because production rates cannot be maintained indefinitely without a corresponding increase in consumption at the other end of the line.

Fourth, the price of money may describe a condition doomed for collapse. When banks continue to charge higher and higher rates of interest for the use of funds, when credit expands to an unprecedented high, and when credit becomes repeatedly strained by insistent demands for more margin, there is trouble ahead.

Fifth, the high cost of labor cannot be maintained indefinitely. True, much of the increase in labor expense can be passed on to the consumer in terms of higher prices, but eventually the cycle will catch up with itself and wages will explode. During 1948 many skilled mechanics in the Southwest, where wages are often lower than in other parts of the United States, were making as much as $25 or $30 for an eight-hour working day—an increase of almost 300 percent over the prewar level.

In addition to these five points, several miscellaneous warning signals may describe conditions at the height of prosperity. For example,

statistics on speculation, stock-market changes, obvious upsets in index numbers, and import-export data help in rounding out the businessman's judgment about the character of prosperity.

### Decline

A period of prosperity is often described as a period of optimism, but when that spirit fades away and the businessman discovers that some of his decisions have not worked out to his advantage, he loses interest and becomes quite casual in his responsibilities for the problems of his business. Production stops more or less abruptly, investors become wary about their holdings, industry becomes reluctant to borrow additional funds for expansion, banks tighten up on lending, unemployment sets in, and wages go down. Pessimism and doubt are born in the minds of people. The psychology of this situation within itself spells catastrophe for any society. When these conditions set in, business activity inevitably drops to a low level. At first the drop-off is rather gradual, constant, and deliberate. Then it moves with much force and speed; enough momentum is gained through pessimistic leaders to ruin one industry first and then all those related to it.

Psychology plays a tremendous part in bringing about the collapse of prosperity. The working of small groups is particularly significant in bringing about negative conditions. For example, eight or ten innocent businessmen collected at a service-club luncheon may hear someone say conditions are bad. The hearsay is accepted because the listeners have confidence in the speaker. If he thinks business is bad, others must repeat the same idea. Whether their business is good or bad does not matter, sometimes; they keep repeating the negative slogan until business becomes bad because of lack of confidence and trust not only in specific industries but in the economy as a whole.

### Depression

In the third stage business shows a downward movement and tends to stabilize itself at a low level of activity. This stage is best known as depression. Unemployment usually runs at an unprecedented figure and wages go extremely low. Sales drop off, production lags, and chaos in general breaks out everywhere. During this period most bankruptcy cases are born.

What are the earmarks of conditions at the bottom of the business cycle? First, after commodity prices continue to decline for a long time there is a tendency for them to level off. Raw materials maintain a consistent level but have a slight tendency to show increases in value

and price. In spite of an abundance of funds, banks become extremely careful in making loans, various stocks pass their low points of value, and no signs of upward movement are evidenced. Employment, after a steady decline, frequently begins to increase, and the wage cuts given by employers tend to disappear from the labor front. Factories usually have few unfilled orders.

### Recovery

In the fourth stage of the business cycle the course of economic life begins to pick up considerably. Recovery is noticeable. The characteristics of economic weakness in the country begin to disappear, labor conditions improve, wages go higher, employment becomes easier to find, and a general attitude of constructiveness prevails everywhere. This period then brings the cycle back to a period of prosperity, and the four stages are subsequently repeated in the same order.

## Terms for Study

| | | |
|---|---|---|
| Artisan | Cyclical behavior | Labor turnover |
| Barter | Deflation | Marginal worker |
| Bear | Depression | Mechanization |
| Boycott | Diversification | Mercantilism |
| Business barometer | Economic goods | Profit |
| Business cycle | Franchise | Sabotage |
| Capitalism | Human motivation | Security market |
| Craftsmanship | Inflation | Solvent |
| Credit | Insolvent | Subsidize |

## Questions

1. What relationships do you see, politically, socially, and economically, between the effects of the Industrial Revolution and a similar revolution in our modern atomic age?
2. Are present-day wants fundamentally different from those of American consumers one hundred years ago? Explain.
3. Name specific ways in which policy-making personnel for business management can profit by a review of economic history.
4. Define capitalism.
5. What are the basic features of capitalism that you can recognize immediately in your society?
6. How does competition affect the prices you are asked to pay in retail stores?
7. Trace briefly the economic stages in man's development. Are similarly marked changes taking place in the twentieth century?

8. How do physical factors contribute to American wealth?

9. How are human wants related to economic factors involving prices, labor, and credit?

10. In what ways have economic conditions changed the occupations people follow?

11. List several ways in which technological achievements have affected your economic life.

12. Many so-called fortunetellers have enjoyed a mildly popular reputation for their successes in predicting the character of future events. Why can't these people be brought into business and consulted in matters of business planning?

13. Of what real value to a businessman are statistical charts that express changes in economic activity?

14. Do general economic statistics for the nation affect the operations of an individual business? Explain.

15. Do you think the average businessman is capable of interpreting economic conditions that affect his business?

16. Why do we Americans generally take our free-enterprise system for granted? Are there now serious threats to the security of this system? List several.

17. How would you intelligently relate index numbers to an interpretation of economic activity?

18. As a consumer, how could you profit in your buying by knowing the four-stage cyclical pattern of our economy?

## Problems and Projects

1. List those whom you have known as specialists in predicting future economic events. How many of their predictions have proved sound economically? How many would you say resulted from guesswork or chance?

2. Tabulate specific instances in which you feel the eminence of private property today stands above the interests of others or of the government.

3. Refer to a local classified telephone directory or a similar source and list 10 modern industries that remain essentially in the handicraft stage today. Analyze these in terms of production costs, market factors, and consumer buying habits. Why have they not been converted into mass-production systems?

4. Refer to a standard chemistry textbook and library sources or consult your science instructor for information about the material content (chemistry) of an automobile. Check this list against the natural resources of your own community. How many and how much does your local area contribute toward the manufacturing of an automobile?

5. Consult local sources (unions, interviews, payroll records, public reports, and so forth) to determine prevailing hourly wages for those engaged

in manufacturing industries. Compare your average, made up of a minimum of five reports, with that given in Table III-3. Reconcile the difference in terms of local labor conditions.

6. Refer to Figure 3-5 and explain why gross weekly wages in manufacturing groups were higher than gross weekly wages in retail groups. How would you explain the slump in manufacturing wages following 1948?

7. List specific ways in which you could effectively employ the information about educational levels of adult population (Table III-4) in an advertising and selling campaign.

8. After reading your daily newspaper and the financial section of your favorite magazine, what is your prediction for next year's:

| | *Prices will be* | *Supply will be* | *Quality will be* | *Comments* |
|---|---|---|---|---|
| (1) General business conditions? | | | | |
| (2) Wages? | | | | |
| (3) Rents? | | | | |
| (4) Food? | | | | |
| (5) Clothing? | | | | |

(This assignment may be done either by reproducing the chart or by reporting the answers in essay form.)

9. Refer to Table III-6, which gives an analysis of the business cycle. Locate the economic point at which you feel we are now situated.

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CHAPTER IV

# FORMS OF BUSINESS ORGANIZATION

PLANNING THE ORGANIZATION of a business venture involves a number of major considerations, all of which are important to the success of the enterprise. Several different forms of business organizations have been developed. One form is not equally satisfactory for all establishments. The form suitable for a large manufacturing concern may not be satisfactory for a small retail store that is owned and managed by one person. In this chapter, we shall study the legal forms of organization in use today. These are:

1. Individual proprietorship
2. General partnership
3. Limited partnership
4. Joint-stock company
5. Corporation
6. Massachusetts Trust

Each of these has certain advantages and disadvantages. A characteristic that is an advantage for one business may be a distinct disadvantage for another. Each form requires a distinct plan for organizing, financing, and managing the enterprise. The proper one can be chosen only after careful analysis of the business's peculiar characteristics.

Considering the following questions will help to determine which form best meets the needs of a particular business:

1. How easy or difficult is the organization to start?
2. What is to be the liability of the owner or owners?
3. How much capital is required to start the business?
4. What are the legal requirements for the enterprise?
5. To what extent is the form free of government control?
6. What is the plan for delegating authority and responsibility?
7. What is the effect of taxation on the form of ownership?

Many businesses start as individual proprietorships; others are organized as partnerships, joint-stock companies, and corporations. Some concerns that start as proprietorships are later changed to partnerships or corporations. Some that begin as partnerships change to individual

proprietorships or corporations. As a business grows, it is often necessary to change its form of organization in order to obtain certain advantages considered necessary to increase its efficiency or to obtain additional capital. Sometimes the owners of a business find that by changing the form of organization it is possible to reduce business or personal taxes. Because single proprietorships and partnerships enjoy more freedom from government control than do corporations, some corporations have been known to change their form of organization to gain this advantage. This is particularly true of small corporations where stock is held by a very small group.

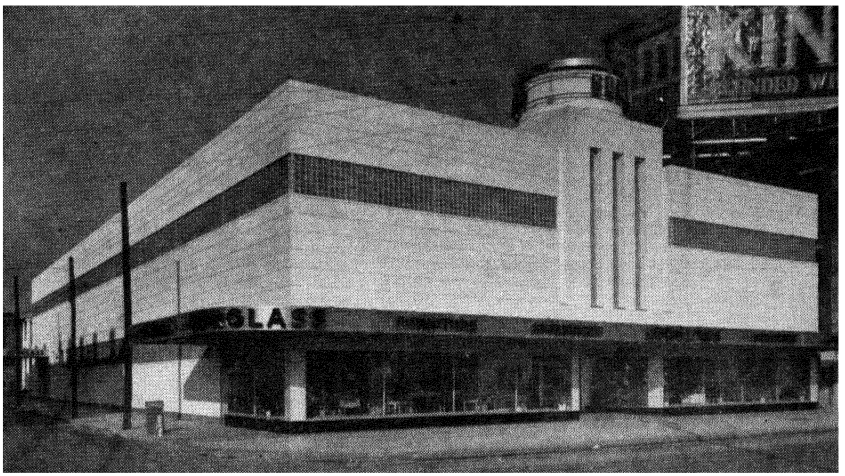
Courtesy Houston Chamber of Commerce

*Figure 4-1.* This air view shows a center of business activity. Within these buildings are large and small commercial units, each of which is a form of business organization that has contributed to the growth of the city.

## Individual Proprietorship

A business that is owned and operated by one person is known as an *individual proprietorship, single proprietorship,* or *sole proprietorship.* The individual proprietorship is the oldest and most common of all legal forms of business organization. It was used by the ancient

Egyptians, Phoenicians, Greeks, and Romans. Many of our modern giant corporations, such as F. W. Woolworth, J. C. Penney, H. J. Heinz, Eastman Kodak, and International Harvester, started as single proprietorships.



*Courtesy American Structural Products Company, subsidiary of Owens-Illinois Glass Company*

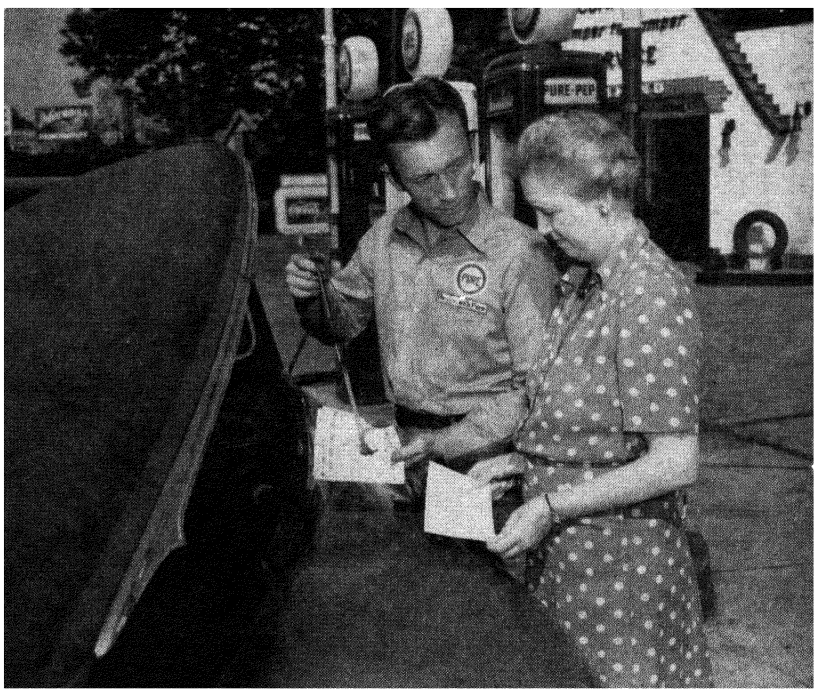
*Figure 4-2. The Corner Store.* Proprietorships serve consumer needs by maintaining well located, efficient, and well-stocked retail stores. In this modern furniture store customers can choose the furnishings that will satisfy their home requirements.

What are the kinds of business to which the proprietorship form is well adapted? It is most practical for small businesses that have a low capital investment. Ordinarily, small concerns serving a limited number of customers can be operated efficiently as individual proprietorships. Retail establishments are generally regarded as the easiest to start in this way. The single proprietorship is the characteristic form in business where size is not a serious handicap to efficient operation and where close personal supervision of employees is necessary.

Grocery stores, meat markets, poultry houses, appliance shops, automobile agencies, and service stations are typical examples of small organizations for which the individual proprietorship is well suited. Many firms tend to remain small simply because the owner lacks either the capital or the credit to expand into some other form of organization. The single proprietorship seldom becomes a very large organization employing hundreds of persons unless the owner has ample

personal wealth to expand the firm or unless he is willing to assume greater risk by borrowing from outside sources.

The personal-service type of business is ideal as a single proprietorship. Such enterprises as barber shops, beauty shops, tailor shops, shoe-repair stores, hotels, and printing businesses are relatively easy to organize and operate as proprietorships. The barber, for example, opens his own shop. His stock in trade is personal service. By learning the names of his customers and knowing their likes and dislikes, he is able to render a highly personalized service. No matter how large his business may grow, its success depends upon a continuation of such service.



Courtesy The Pure Oil Company

*Figure 4-3.* Individual proprietorships specialize in personalized service. The proprietor of a small service station has the opportunity of knowing his customers and their automobiles thoroughly

Numerically, there are more single proprietorships than all other kinds of business. A large majority of the 6,000,000 farms in this country are single proprietorships. In the retail and wholesale field the single proprietorship is the most common form of organization. Proprietorships are also found in real-estate, amusement, and finance businesses. Such concerns as insurance companies, banks, public utilities,

average consumer thinks of corporations as "big business," such as United States Steel, Chrysler, American Telephone and Telegraph, General Motors, and Western Electric. Actually, this form is widely

Courtesy Houston Chamber of Commerce

*Figure 4-4. Many Business Interests under One Roof.* This 37-story building houses one of America's largest oil companies, a large department store, a bank, and the offices of numerous local and national business organizations.

used in many small- and medium-sized businesses, including agricultural enterprises, service institutions, and transportation, finance, trade, and mining companies. Probably three-fourths of all business in terms of trade dollars is accounted for by corporations.

## Definition

A definition often used is one written by Chief Justice Marshall in an opinion delivered on the famous *Dartmouth College* case, handed down in 1819:[3]

> A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence. . . .

A corporation is a voluntary association of persons organized under the laws of a single state for the purpose of conducting a specific activity. Since it is considered to be an artificial person, separate and distinct from those who compose it, it has the right as an organization to perform as a natural person all the functions expressed in the provisions of the charter granted by the state. Hence, a corporation can buy, sell, hold, manage, mortgage, and dispose of any such property as it may possess; or it may sue and be sued. It has continuous succession during the period of existence specified in the charter.

Contrary to general opinion, a corporation can be organized for nonprofit purposes as well as for profit. Corporate forms are widely used for nonprofit organizations, including government agencies, cities, towns, municipalities, and political subdivisions. Religious and charitable organizations often incorporate under the laws of the state where the principal business is conducted.

## Historical growth

Since the beginning of the twentieth century, the growth of American corporations has been phenomenal. For example, in 1903 corporations owned about 23 percent of all manufacturing establishments in the United States. These firms produced about 70 percent of the dollar value of goods and employed nearly 75 percent of the total wage earners. Forty-five years later corporations owned 48 percent of the manufacturing establishments, produced 92 percent of the dollar value of merchandise, and employed approximately 90 percent of the total wage earners. Growth of corporations is due largely to the fact that this form of ownership provides advantages not found in any other form of enterprise.

Table IV-1 offers a summary listing of American corporations in terms of size, capital, working force, and stockholders.

[3] *Dartmouth College* v. *Woodward*, 17 U. S. (4 Wheaton 518) 659.

TABLE IV-1. CORPORATIONS WITH ASSETS IN EXCESS OF ONE BILLION DOLLARS, NUMBER OF EMPLOYEES, AND NUMBER OF STOCKHOLDERS, 1948.*

| *Company* | *Assets in millions* 1948 | 1929 | *Number of employees* | *Number of stockholders* |
|---|---|---|---|---|
| American Telephone and Telegraph Company | 10,001 | 4,228 | 524,100 | 723,000 |
| Standard Oil Company of New Jersey | 3,526 | 1,767 | 123,000 | 171,000 |
| General Motors Corporation | 2,958 | 1,324 | 376,000 | 435,000 |
| United States Steel Corporation | 2,535 | 2,286 | 286,000 | 228,000 |
| Pennsylvania Railroad | 2,306 | 2,078 | 149,000 | 260,000 |
| New York Central Railroad | 1,754 | 1,606 | 120,000 | 60,000 |
| Southern Pacific Railroad | 1,736 | 2,278 | 65,000 | 48,000 |
| du Pont (E. I.) de Nemours | 1,585 | 541 | 76,000 | 95,000 |
| Standard Oil Company of Indiana | 1,500 | 610 | 46,000 | 97,000 |
| Consolidated Edison of New York | 1,448 | 1,171 | 30,000 | 157,000 |
| Socony-Vacuum | 1,443 | 708 | 43,000 | 145,000 |
| Commonwealth and Southern | 1,308 | 1,134 | 24,000 | 3,000 |
| Atchison, Topeka and Santa Fe Railroad | 1,293 | 1,262 | 66,000 | 62,577 |
| Texas Company | 1,277 | 610 | 39,000 | 100,000 |
| Pacific Gas & Electric | 1,210 | 454 | 16,000 | 141,000 |
| Gulf Oil Company | 1,191 | 687 | 43,000 | 21,000 |
| Union Pacific Railroad | 1,187 | 1,195 | 52,000 | 56,000 |
| Baltimore & Ohio | 1,186 | 1,110 | 60,000 | 25,000 |
| General Electric Company | 1,177 | 492 | 186,000 | 250,000 |
| Commonwealth Edison | 1,043 | 376 | 18,000 | 117,000 |
| Bethlehem Steel Corporation | 1,029 | 801 | 133,000 | 57,000 |
| Ford Motor Company | 1,026 | 761 | 130,000 | family |

* Adapted from Merrill Lynch, Pierce, Fenner & Beane, *Investor's Reader*, April 27, 1949, Vol. 12, No 9, p. 10 Figures used are those given in the annual reports, with no allowance for bookkeeping methods

## Advantages of corporation

1. *Limited liability to owners.* Stockholders of a corporation, who are the owners of the business, are liable only for the purchase price of their stock; this limited liability is definitely an advantage. In case of loss sustained by the corporation, the maximum liability to any stockholder can be no greater than the value of the stock he owns. The limited liability is an advantage not found in general partnerships or single proprietorships.

2. *Ability to raise capital.* It has been pointed out that the corporation is a type of ownership common to large business. One reason for this

fact is the ease with which the corporation can raise large amounts of capital. Ownership of stock is not limited to one, two, or possibly a dozen stockholders; on the contrary, thousands of persons may own stock in a single corporation. For example, the American Telephone and Telegraph Company has more than 700,000 individual stockholders.

Among many of the larger corporations it is not uncommon for the corporation to have more stockholders than employees. The Commonwealth Edison Company, a Midwestern utilities corporation, has more than six times as many stockholders as employees. The ratio of stockholders to employees in Consolidated Edison of New York is more than five to one.

Owners of corporation stock come from many occupations and many different sections of the country. If the corporation is in a sound financial condition, it is not difficult to raise funds through the sale of its securities to the public.

3. *Continuous succession.* The life of a corporation is almost perpetual. Although charters are usually granted for a specified number of years, most states permit their renewal with a minimum of formality and without a break in the firm's operations. Some states grant charters providing perpetual succession. Neither the death of a stockholder nor the disposal of stock by sale or gift will dissolve the corporation. When an important stockholder dies, his shares automatically pass on to the beneficiaries of his estate. If an officer of the company retires, resigns, or dies, another person is appointed to fill the position without interrupting the activities of the business. There are but few ways to terminate a corporate enterprise: (1) A corporation may choose to surrender its charter by approval of the stockholders. (2) A corporation can be terminated by court order. (3) A corporation can be terminated by expiration of its charter.

4. *Convenience in transferring ownership.* Another advantage is the ease with which stockholders may purchase or dispose of their shares. Disposal of an investment in a partnership automatically dissolves the organization, but in the corporation transfer of stock from one person to another has no effect on the firm's operations.

The procedure followed in making stock transfers originates with the stockholder. The owner places his stock in the hands of a broker with authority to sell the issues at a specified price. The broker endeavors to do this and is paid a commission. Thousands of shares of stock change hands daily through the various stock markets operated for this purpose.

5. *Specialized management possible.* The corporation is unique in that it generally employs specialists for specific functions. This is particularly true where the size of the corporation is considerable and there is a wide spread between ownership and management. Since the stockholders are often not close to the management and much of the personal influence they might exert is lost, corporations depend heavily upon specialists.

6. *Flexibility of expansion.* The case with which a corporation can expand its capital structure is another advantage. Being able to raise large amounts of additional capital, it can expand to almost any extent. Although corporate operations are limited to those activities covered in the charter, most charters are not too limited in scope to cover the basic activities related to the trade or industry. As corporations prove their merit through good management, satisfactory profit, and new business, they are "naturals" for investors who seek new places to put their money.

### Disadvantages of corporation

1. *Complicated to organize.* Organizing a corporation is more complicated than organizing a single proprietorship or a partnership. First, it is necessary to apply for a charter to the appropriate official in the state where the concern expects to do business. This requires the preparation of legal forms, usually by an attorney at law. If the stock is to be sold on one of the national stock exchanges, approval to list the securities must be obtained from the Federal Securities and Exchange Commission. The cost of obtaining a charter may be expensive if many legal documents are required to support the application. To meet state requirements, it may be necessary to provide many legal data not easily prepared by businessmen unfamiliar with legal procedures. All this takes time and usually requires the services of an expert.

2. *Limitations of activities.* A corporation is permitted to engage only in the activities authorized in its charter. This limitation restricts the corporation's area of operations. A charter authorizing a company to buy and sell automobile supplies and accessories does not permit it to buy and sell household electrical goods unless the charter is amended. Neither the individual proprietorship nor the partnership is so limited.

3. *Taxation.* Perhaps the most serious disadvantage of a corporation is the imposition of special taxes. The federal government and the states have singled out corporations as sources of revenue. For example, the federal government taxes a corporation on its profits. When profits are distributed to the stockholders as a dividend, the stockholders are

required to pay individual taxes on them. This double tax is not levied against the single proprietorship or the partnership.

Many states require from any corporation doing business within its boundaries an annual franchise tax. Corporations are also required to pay real-estate and property taxes similar to those required of individuals. If there is a state income tax, the corporation must pay it on business obtained in that state. The corporation must pay other state taxes not required of single proprietorships and partnerships, such as a filing fee, which is payable on application for a charter; an organization tax, based on the amount of authorized capital stock; and, in some states, special types of taxes that are levied against corporations doing business as insurance companies, railroads, and public utilities. There are also state and federal taxes on the transfer of stock shares.

4. *Federal and state regulation.* During recent years there has been an increase in federal and state regulation of corporations, which will be discussed more fully in the chapter on government regulation in business. Many types of special and annual reports are now required by both the federal and state governments. Some companies, such as railroads and public utilities, find it necessary to maintain special departments for the sole purpose of preparing these reports.

## Organizing a corporation

In the case of every business enterprise someone had an idea that became the basis for starting an organization. King C. Gillette, whose picture appears on millions of razor-blade packages, became weary of stropping his straight-edge razor, so he created a crude homemade device that has since developed into the modern safety razor. Today the Gillette Safety Razor Company is one of the largest corporations manufacturing safety razors and blades. The birth of a single idea is often the beginning of a business that develops into a thriving corporation.

Unlike the proprietorship or general partnership, a private corporation can be formed only after authority has been granted by the state, which issues the charter. However, corporations organized in one state may transact business in other states, provided they meet the legal requirements of those states. Despite the fact that state laws governing corporations differ, a corporation chartered by one state generally has little or no difficulty in meeting the requirements of other states.

The persons who originally form a corporation are known as the incorporators. Most states require at least three persons of adult age as incorporators. It is less difficult and cheaper to incorporate in some

states than in others. For various reasons Delaware, Maryland, and New Jersey are popular states in which to apply for a charter, and Nevada, South Dakota, Maine, and Florida also attract many incorporators.

### Securing a corporation charter

After the incorporators have decided upon the state in which they wish to incorporate, a written application form is presented to the Secretary of State or some other state officer. This application must bear the signatures of at least three incorporators, it must be notarized, and it must be supported by the required financial information. In general, an application for a corporation charter would include the following:

1. Name and business address of the proposed corporation.
2. Names and addresses of the incorporators.
3. Proposed duration of the organization, which may be either perpetual or for a specified number of years.
4. Statement of the purpose of the business. This must be fully described.
5. Names and addresses of the officers and directors.
6. Amount of capital stock to be authorized. The capital structure is officially known as the *authorized capital stock,* which is divided into shares of ownership ranging in value from $1 to $1,000. Some states require a minimum of $1,000 in capital stock; all require at least $500. The shares of capital stock are usually designated as having par value or no par value.
7. Number of shares to be included in each class, if the stock shares are to be classified, together with stock privileges, voting rights, preferences, or any other restrictions. Shares are in the form of stock certificates, which are numbered serially. To be valid, they must bear the officers' signatures.
8. Name and address of each subscriber to corporation certificates, together with a statement showing the total number of shares of stock each has.

The following illustrates what a corporation charter might contain:

## CHARTER

of

## SAN JACINTO INVESTMENT COMPANY

THE STATE OF TEXAS }
COUNTY OF HARRIS }

KNOW ALL MEN BY THESE PRESENTS: That we, John Doe, Richard Roe, and George Anderson, all residents and citizens of Houston, Harris County, Texas, under and by virtue of the laws of the State of Texas, do hereby voluntarily associate ourselves together for the purpose of forming a private corporation under the terms and conditions hereinafter set forth:

I.

The name of this corporation is SAN JACINTO INVESTMENT COMPANY.

II.

The purpose for which it is formed is to erect and repair buildings and improvements, and to accumulate and lend money for said purposes, and to purchase, sell and subdivide real property in towns, cities and villages and their suburbs not extending more than two miles beyond their limits and to accumulate and lend money for that purpose, as authorized by the statutes of the State of Texas.

III.

The place where the business of the corporation is to be transacted is at the City of Houston, Harris County, Texas, and elsewhere in the State of Texas.

IV.

The term for which it is to exist is Fifty (50) years.

V.

The number of the Directors of the corporation shall be not less than three nor more than five, as fixed from time to time by the By-laws. The number of Directors for the first year and thereafter until changed by the By-laws of the corporation shall be three, and their names and post-office addresses are as follows:

| NAME | POST-OFFICE ADDRESS |
|---|---|
| John Doe | Houston, Harris County, Texas |
| Richard Roe | Houston, Harris County, Texas |
| George Anderson | Houston, Harris County, Texas |

VI.

The amount of capital stock is Twenty-five Thousand dollars ($25,000.00), divided into two hundred and fifty shares of One Hundred Dollars ($100.00) each; all of which capital stock has been subscribed and all of which has been paid in, as per affidavit attached hereto.

IN TESTIMONY WHEREOF, we hereunto sign our names this _____ day of _____, A.D. 19— .

_____
John Doe

_____
Richard Roe

_____
George Anderson

THE STATE OF TEXAS }
COUNTY OF HARRIS }

BEFORE ME, the undersigned authority, on this day personally appeared John Doe, Richard Roe, and George Anderson, known to me to be the persons whose names are subscribed to the foregoing instrument, and severally acknowledged to me that they executed the same for the purpose and consideration therein expressed.

Given under my hand and seal of office this _____ day of _____, A.D. 19—.

_____
Notary Public in and for
Harris County, Texas

If the information submitted is adequate and satisfactory, upon payment of the necessary corporation fees a charter is granted by the state, authorizing the corporation to do business within the boundaries of that state for the purposes described in the charter. At the first meeting of the stockholders the by-laws are approved. The by-laws provide the general rules for operating the business and include an outline of the duties of the officers, the amount of stock that must be represented at the stockholders' meetings in order to constitute a quorum, and such other rules as are necessary to conduct affairs.

## Corporation ownership and control

The owners of a corporation are its stockholders. Some corporations are classified as *closed corporations*. This means the stock of the corporation is not offered for sale to the general public but is owned by a few persons, some or all of whom may be actively engaged in the

business. One of the largest and best-known closed corporations is the Ford Motor Company, the stock in which is owned and controlled by members of the Ford family. Since a closed corporation does not offer its stock to the general public, most states do not require such a corporation to make public its annual earnings and other financial facts. It must, however, submit its annual reports to the state from which it obtained its charter and pay the required state and federal taxes.

An *open corporation* is one that offers its stock for sale to the general public. An open corporation is required to furnish stockholders with complete financial reports at least once each year. This is done to provide the stockholders with accurate and up-to-date facts about the business. These reports must be prepared in accordance with state and federal laws and the provisions of the various stock-exchange regulations where the stock is sold in interstate commerce.

The two kinds of stock most generally issued by a corporation are *common* and *preferred*. Both of these will be discussed in the chapter on finance and banking. Here it is important to note the general characteristics of each as they relate to ownership and control of the corporate form of organization.

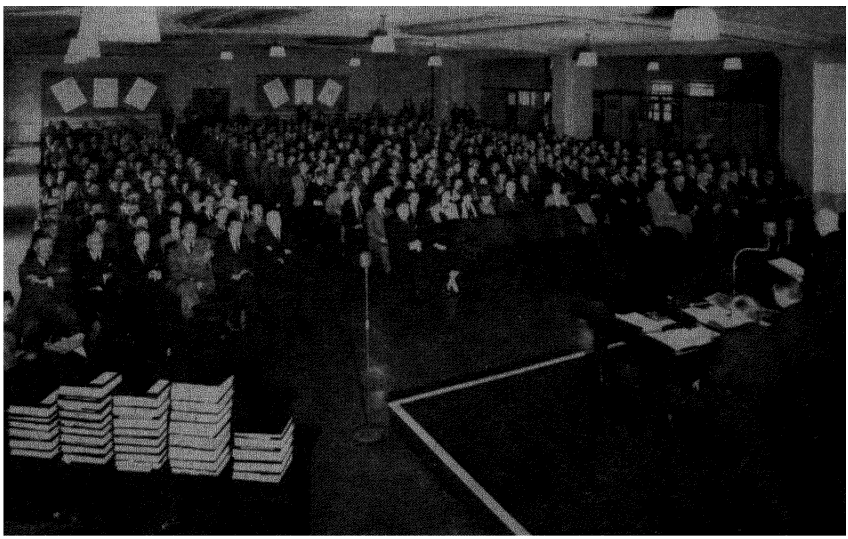
*Common Stock*. Common stockholders are part owners in the business, in the same capacity as partners in a partnership. They share in the profits and losses. They do not receive any earnings until all other claims against the business have been paid. They are free to transfer ownership of their shares at any time, but the procedure must conform to the corporation regulations covering registration of new owners. The liability of common stockholders is limited to the value of their stock. Consequently, the maximum loss any common stockholder can sustain is the loss of his investment.

Since common stock is the voting stock, those who own it have a right to vote on all matters to be determined at the stockholders' meetings. They exercise control of the business by delegating executive responsibilities to a board of directors elected by them. The directors appoint the officers, such as the president, vice-president, secretary, and treasurer. In many states the common stockholders reserve the right to appoint or dismiss the directors according to the corporation laws of that state. The stockholders also vote on their choice of the accounting firm to be employed to make the annual audit of the company books and records.

Common stockholders also have a right to share in the dividends after all other obligations have been paid, including interest on bonds

and dividend payments to preferred stockholders. Likewise, common stockholders share in the liquidation of a corporation after bondholders and creditors are paid.

Holders of common stock also have the right to inspect the books, but in actual practice this privilege is rarely exercised. Usually at the annual meeting a full report of the financial status of the corporation is given in detail.



*Courtesy Consolidated Edison Company of New York, Inc.*

*Figure 4-5. Annual Stockholders' Meeting.* Corporation stockholders are given a chance to participate in corporate organization and management through their annual meetings.

The board of directors, the officers, and the stockholders are required to meet at least once each year. The corporation secretary notifies the stockholders by mail of the date, time, and place of the meeting, and of the main topics to be considered. Corporations with several thousand stockholders seldom get all the holders together at the meeting. Hence, it is a common practice for the secretary of the corporation to enclose a proxy form, which the common stockholder may sign and return in lieu of attending the meeting. Stockholders who cannot attend are not required to return the proxy form, but if they do not, they lose their vote.

Legally, a proxy is a power of attorney transferring to a third party the owner's right to vote without transferring legal title or ownership

of shares held. The proxy is usually a temporary affair, applicable for a given meeting. The following is a typical proxy form:

**PROXY—1949**
**TWENTIETH CENTURY-FOX FILM CORPORATION**

The undersigned, a holder of voting stock in TWENTIETH CENTURY-FOX FILM CORPORATION, hereby constitutes and appoints W. C. MICHEL, DONALD A. HENDERSON and WILFRED J. EADIE, the attorneys and proxies of the undersigned, with full power of substitution and revocation, for and in the name, place and stead of the undersigned, to attend the annual meeting of stockholders of said Corporation to be held at 444 West 56th Street, N. Y., at 2 P. M. (Eastern Daylight Time) on May 17, 1949, and any adjournments thereof, and to cast all votes and to do all things which the undersigned would be entitled to cast or do if present, and especially to vote: (1) For the election of directors; (2) For ☐ or against ☐ approval of the selection of Touche, Niven, Bailey & Smart as auditors for 1949; and (3) For or against such other matters as may be presented.

A majority of such persons or their substitutes so present or if only one, that one, may exercise all the powers hereby given. All proxies heretofore given to anyone other than the persons named above are hereby revoked. Receipt is acknowledged of the notice of the annual meeting and the proxy statement.

**If no specific direction is given in (2) this proxy will be voted for such approval.**

Dated, , 1949.

. . . . . .

Signature

**This Proxy is Solicited on Behalf of the Management**

The proxy may be returned to the management with only the signature of the stockholder; in the case of this illustration, that would mean that all issues stated on the proxy will be voted for by the management in the affirmative. If the stockholder is opposed to any of the issues, he may vote accordingly. Occasionally, spirited proxy contests arise when one faction is attempting to take control from another group. If the opposition is unable to buy sufficient stock to control the voting, it may endeavor to obtain sufficient proxy ballots to gain a voting advantage.

*Preferred Stock.* As the name implies, preferred stock guarantees rights and privileges not common to other classes of stockholders. Pre-

ferred stockholders are entitled to a special rate of dividends out of earnings prior to payments to other stockholders. Holders of this class of stock also possess priority in case of dissolution.

Preferred stock may be cumulative or noncumulative. If dividends are not paid in full in one or more years, payments on cumulative preferred stock carry forward from year to year until fully paid. The usual practice is for common stockholders not to receive dividends until full payment has been made to such preferred stockholders. Holders of noncumulative preferred stock do not receive such make-up dividends. Holders of preferred stock rarely have voting rights. Dividends at a stipulated rate of interest make this stock resemble corporation bonds.

Why do corporations issue different classes of stock? Preferred stock is frequently easier to sell to a certain class of investors, who seek a stipulated return in preference to speculation. When preferred stocks are adequately protected by a substantial margin of capital subscribed by the common stockholders, the preferred stockholders assume less risk.

Smaller corporations often find it advantageous to raise funds through the sale of common stock in preference to preferred stock, since the former involves no fixed obligations in the form of interest or stipulated dividends. Those who buy common stock do not receive any dividends unless there are sufficient earnings to justify dividend payments.

Some classes of investors prefer common stock chiefly because it offers a chance to speculate. Large corporations are often able to raise additional working capital by issuing common stock because it is regarded as a more appealing investment, paying a higher rate of return than preferred issues. This is especially true when it appears that the company will make unusually high profits, even though corporation income taxes may reduce the earnings materially.

It must be understood that few corporations are able to finance themselves exclusively by stock. Almost every business finds it necessary to borrow occasionally for short periods. Some even find it profitable to utilize long-term bonds in addition to stock.

### Social impact of corporate growth

The importance of the corporation in the American system of free enterprise is no longer controversial. Because our total economic system is tied in so intimately with the corporate structure, we seldom find relief in any other manner of organizing for big business. More and

more of our gainfully employed citizens work for others and fewer are entering business for themselves. What would be the effect if corporations should grow so strong as to remove completely from the national economy the incentive, purpose, and drive behind the individual forms of business ownership? Would this situation be generally desirable or undesirable for the nation? There is something to say in favor of returning to an economy where ownership and management are brought closer together.

The idea is well expressed in the thought that something is lost when property is divorced from management. It is true that stockholders own the corporations, but there is a gap between ownership and management.

From another point of view, corporations present a social problem because they require governmental control and supervision. Corporate holdings are widespread, touching the lives of many, and the power of the giant companies is far-reaching. The expense of government supervision must be paid by taxpayers, many of whom find this cost easier to accept after a look at the revenue that corporations contribute to the state and federal treasuries.

## Massachusetts Trust

The Massachusetts Trust resembles the corporation. Originally applied to real estate as a plan for owning and managing business properties, the idea soon spread to other types of businesses. Until 1912, Massachusetts laws forbade a corporation to own and deal in real estate. Thus, in that state there was no desirable form of business organization legalized for raising and spending large amounts of money for real-estate promotion and building developments. The trust idea was used to meet legal requirements. It has been called the Massachusetts Trust because the idea of adapting the trust to business use was first developed and used in that state. The use of the term "trust" is not to be confused with its use to designate monopolies and big-business combinations.

### Principle of the trust

The basic principle of the Massachusetts Trust is that of trusteeship. That is, the owners of property or large amounts of cash place their investments in the hands of a second party who manages the investment for the benefit of the original owners or of a third party. A board of trustees is appointed to serve with pay; their duties and responsibilities in managing the business are set forth in a deed of trust.

Trust certificates, or certificates of beneficial interest as they are sometimes called, are issued. The parties to a trust are (1) the trustor, often called the grantor, donor, or settlor, who is the person placing the property in trust; (2) the trustees, who are those designated in the trust plan to receive legal title to the property and to manage the affairs of the trust, and (3) the beneficiary, the one for whose benefit the trust is established. Not every trust has a beneficiary.

### Advantages of Massachusetts Trust

1. Its formation is inexpensive and simple.
2. It admits the use of large sums of capital.
3. It is relatively free from government control.
4. The duration of the organization is not affected by the death of a trustee.
5. There is freedom from personal liability on the part of the trust-certificate holders unless they have a choice of trustees.
6. It is generally not subject to dual taxation, as is the corporation.
7. It may engage in any kind of business where the principle of trusteeship can be applied.
8. It offers flexibility of management and operation, since all decisions are made by the trustees.

### Disadvantages of Massachusetts Trust

1. The life of the trust is limited.
2. Trust-certificate holders have little control over trustees.
3. As a business organization, its securities are sometimes more difficult to sell than are shares of a corporation.
4. Business credit is somewhat limited because of the uncertainty of liability of those participating in the trust.

### Application as a business organization

The Massachusetts Trust is not a widely used form of business organization, despite its advantages when compared with the corporate enterprise. Probably fewer than 50 large organizations operate under this plan. In the textile business the Pepperell Manufacturing Company is so organized, and the New England Power Association, the Massachusetts Utilities Association, and the Eastern Gas and Fuel Association are examples of such trusts in the utility field. A large number of hotel and apartment properties throughout the state of Massachusetts are owned by Massachusetts Trusts. In recent years some small corporations have changed to trusts to avoid heavy taxation.

Immunity from taxes, which existed during the early years of the Massachusetts Trust, is disappearing and many states now have laws placing all types of trust organizations on tax lists similar to those used for corporations.

## Terms for Study

Capital investment
Charter
Closed corporation
Common stock
Corporation
Creditor
Dividends
Incorporators
Individual proprietorship
Joint-stock company
Limited partners
Massachusetts Trust
Open corporation
Partnership
Preferred stock
Proxy
Trust
Trusteeship
Trustor

## Questions

1. What are the basic characteristics of the single proprietorship?
2. What are the advantages and disadvantages of the single proprietorship?
3. What are some common types of businesses operated as single proprietorships?
4. What are the characteristics of the partnership?
5. What essentials should the articles of partnership contain?
6. Why should a partnership agreement be in writing?
7. What is the difference between a general partner and a limited partner?
8. If the distribution of profits and losses is not provided for in the articles of partnership, what is the general rule?
9. How is a partnership affected when a partner withdraws from the business?
10. What types of enterprises are best suited to the partnership?
11. What are some of the advantages and disadvantages of the partnership?
12. In organization structure, how does the joint-stock company compare with the partnership?
13. What is the extent of liability shared by members of a joint-stock company?
14. Who are the owners of a corporation?
15. What are the legal procedures necessary to form a corporation?
16. What laws govern the formation of a corporation?
17. What is the name of the legal document that describes the scope of the corporation?
18. What facts are usually found in the articles of incorporation known as the corporation charter?

19. What are some of the advantages and disadvantages of the corporation?
20. What authority is granted in a proxy?
21. How does common stock differ from preferred stock?
22. What is the basic principle of the Massachusetts Trust?
23. Who are the parties to a trust?
24. What types of businesses can best be organized as trusts?

## Problems and Projects

1. Explain the difference between common stock and preferred stock.
2. Discuss some of the rights and privileges of common stockholders.
3. Describe some of the reasons why the corporation has grown in popularity.
4. Explain what is meant by limited liability of stockholders in a corporation.
5. Give at least two instances where a joint-stock company would be a suitable form of business organization.
6. Prepare a list of all the essential information that should be contained in a partnership agreement.
7. Investigate and prepare a written report showing the steps necessary to form a business corporation in your state.
8. Three persons plan to organize a business for the purpose of buying 40 acres of land to be subdivided into real-estate building sites. These persons desire to form an organization that can be easily dissolved after the land has been sold. Prepare for these individuals two proposed plans for two different forms of business organization for this project. In each case, give the advantages and disadvantages.
9. Prepare articles of partnership for the following proposed business: Four young men, all over 21, desire to start a drugstore. One of them is a registered pharmacist in your state. He has no money to invest in the partnership, but he is willing to offer his services as a druggist. Two of the others are willing to invest $2,000 each. Both wish to take an active part in the business. The fourth is willing to invest $4,000 but desires to take no active part in the management of the drugstore.

It is tentatively agreed that the druggist is to be paid a salary of $275 a month and a bonus of 5 percent of all net sales per month above $7,500. The second and third partners will each receive a salary of $240 a month. The fourth partner is to have a drawing account of $50 a month. All profits are to be divided as follows: one-fifth for the druggist, two-fifths for the silent partner, and one-fifth for each of the other two partners. All losses are to be borne equally. The partnership may be dissolved by mutual consent, but any one partner may purchase the interests of another partner within three months after his notice to sell is given. It is agreed that the

first three partners are to be regarded as general partners; the fourth member is considered a limited partner because he plans to take no active part in the business. The duration of the partnership is to be 10 years.

In preparing the partnership agreement, make up the names of the partners. The address of the partnership may be a location in your community.

10. Under the circumstances outlined in the previous problem, explain the procedure necessary if one partner buys out another and a new partnership is formed.

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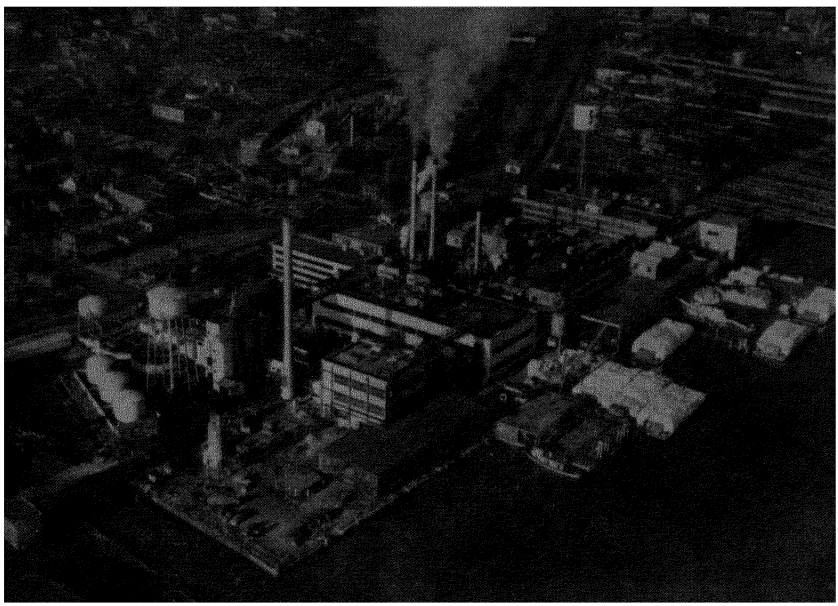
CHAPTER V

# BUSINESS MANAGEMENT AND INTERNAL ORGANIZATION

THE SUBJECT OF BUSINESS MANAGEMENT and internal organization is easily one of the most important areas of business administration. After a business has been organized, the elements of management and the internal organization must be considered. This chapter explains how business management and organization function in the production and distribution of goods and services.

## What is Management?

To most executives, management is the force responsible for bringing together the various elements and operations of an enterprise for



*Courtesy Scott Paper Company*

*Figure 5-1. Management the Motivating Factor.* Materials and human effort are skillfully brought together in this large manufacturing establishment. Note the effectiveness with which natural resources are utilized in transportation.

the purpose of directing and controlling the activities of the enterprise. "Management is the art and science of organizing, preparing, and directing human effort applied to control the forces and to utilize the materials of nature for the benefit of man." [1] The purposes of management are the following:

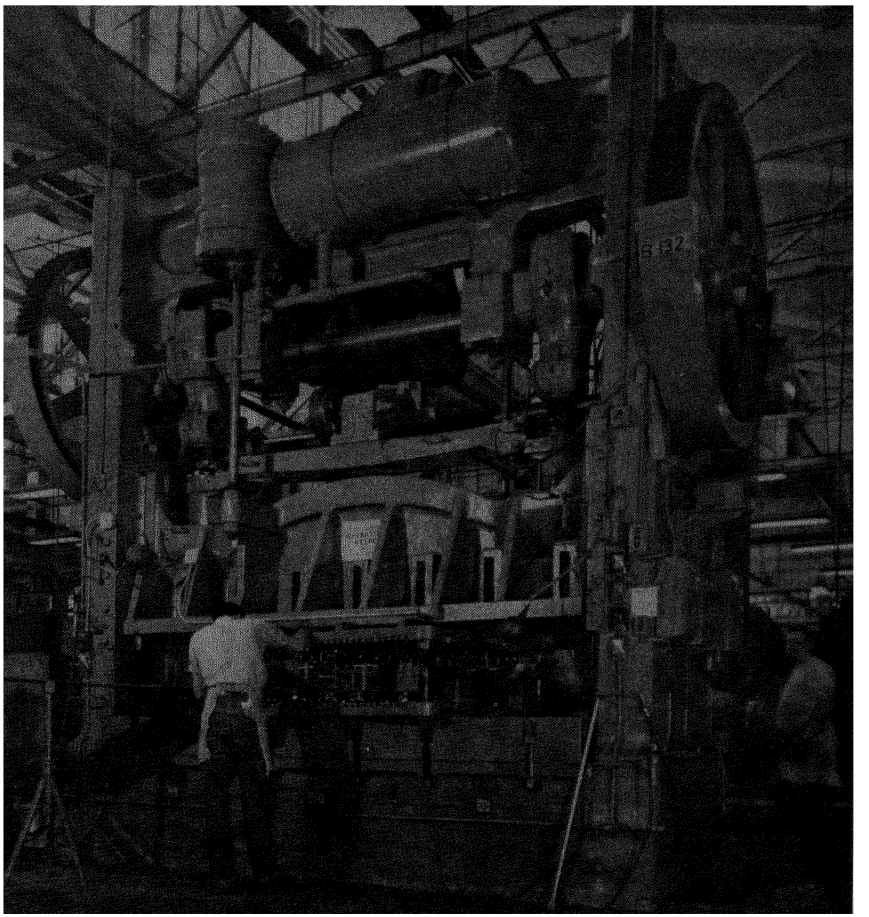
1. To establish the basic policies of an enterprise as they pertain to all phases of business operations.
2. To develop plans for administering business policies.
3. To build the internal organization necessary for promoting and carrying out the plans and policies.
4. To provide means for executing plans through the use of organization.
5. To appraise the effectiveness of organization and the plans by which it functions.
6. To establish and maintain control of organization for increased efficiency.

The elements with which management is concerned, whether the business is a department store, manufacturing concern, oil company, or wholesale house, are (1) men, (2) money, (3) machines, and (4) materials.

In one way or another these elements appear constantly in the administration, supervision, and control of an enterprise. The problems of business management are both human and material ones. A satisfactory solution of these problems requires planning, direction, and control.

Management may be divided into two phases of operation, (1) administrative and (2) executive. Administrative management is primarily concerned with the contacts a business makes with other organizations and individuals outside its own organization. It is responsible for determining the broad policies related to competition, to public relations, to government, and to general business situations. Business administration has certain responsibilities to the owners. The owners' investment must be protected. At the same time, administration must earn a profit for the owners. There is a responsibility of administration to consumers of products and services to render the best commodity for the price paid. The administration must comply with

[1] This definition of management was adopted in 1921 by the Management Division of the American Society of Mechanical Engineers.



*Courtesy Beech Aircraft Corporation*

*Figure 5-2. Men, Machines, and Materials.* This giant 290-ton crank press is capable of blanking large skin sections for the aircraft industry.

the laws of government as they apply to the business. Executive management is concerned with carrying out the policies and decisions of the administration.[2] The business executives must have the ability to organize and control the work of others so that the affairs may run smoothly.

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[2] It is common in government agencies to use the term *administration* to mean what private business means by *management*—persons authorized to make important policy decisions.

## GENERAL OBJECTIVES OF MANAGEMENT *

| OBJECTIVES | REQUISITE CONDITIONS |
|---|---|
| 1. ORGANIZATION—To develop and maintain a sound and clear-cut plan of organization through which Management can most easily and effectively direct and control the enterprise. | a. Organization structure (organizational components) designed best to facilitate management, prevent overlapping of functions, and duplication of effort.<br>b. Function, responsibilities and authority, and relationships clearly defined for each management position<br>c. Proper delegation of authority by management to permit decisions to be made at the lowest practicable level of management<br>d. Thorough understanding of the requirements and responsibilities of their positions on the part of personnel.<br>e. Proper co-ordination of the entire organization plan |
| 2. PERSONNEL—To develop and administer a constructive personnel development and training program which will gradually ensure that all positions in the organization are filled by individuals fully qualified to meet the requirements of their respective positions. | a. Adequate control to ensure selection of best-qualified personnel available for the different types of work, first from within the organization, and then, if necessary, through outside hiring.<br>b Effective training by superiors, with the assistance of appropriate staff agencies, of all employees to meet the requirements of their jobs.<br>c. Comprehensive annual rating of all employees in terms of job requirements.<br>d. Positive action to correct deficiencies in qualifications and assignments as disclosed by the rating program.<br>e. Carefully planned personnel utilization program to take the best advantage of demonstrated abilities, develop each individual's full potentialities, ensure adequate potential material for responsible positions, and to ensure placement of the best-qualified individual in each job.<br>f. Adequate control to ensure that all promotions and appointments are made from among the best-qualified candidates available.<br>g. Full co-operation in effecting the most advantageous placement of personnel.<br>h. Proper co-ordination of the entire personnel development and training program. |
| 3. PLANNING—To formulate well-considered plans and objectives, covering all operations, activities, and expenditures for each year or longer ahead, as a basis for authorization, a guide to achievement, and a measure of performance. | a Clear conception of essential needs and worthwhile objectives.<br>b. Clear-cut plans for accomplishing these objectives.<br>c. Sound analysis of requirements in terms of manpower, costs, facilities, and money.<br>d. Good business judgment as to justification and extent of proposed undertakings.<br>e. Effective participation of subordinates in formulation of their respective parts of the program.<br>f. Proper co-ordination of each program<br>g. Appraisal of results compared with planning for these results. |

| | |
|---|---|
| 4. ADMINISTRATION—To accomplish all functions and responsibilities fully, effectively, and harmoniously. | a. Guiding policies clearly stated, and well understood by all.<br>b. Effective co-ordination and control of results.<br>c. Prompt, well-considered management decisions.<br>d Close supervision affording first-hand familiarity and appraisal of operations, activities, and management problems on the ground without relieving subordinates of their proper responsibilities<br>e Maximum use of best thought and capabilities of the entire organization in accomplishing the program.<br>f Assumption of proprietary responsibility for successful conduct of all activities under his control, relieving superiors of details, and presentation of matters of justifiable importance.<br>g Active co-operation in furthering the proper interest of other organizational components and of the enterprise as a whole.<br>h Maintenance of good public relations.<br>i Proper co-ordination of operations and activities. |
| 5. COSTS—To keep all costs and manpower at an economic minimum, consistent with essential purposes. | a. Periodic analysis and appraisal of all functions and activities as to justification and required effort<br>b Elimination of all unessential or ineffectual work, expense, and manpower as disclosed by such analysis.<br>c. Establishment of most efficient methods for performing operations and activities.<br>d. Establishment of suitable standards and measures as to what constitutes optimum performance and cost in regard to all operations, activities, and expenditures.<br>e An adequate control system, through which actual results are currently evaluated against the optimum or planned expectations, and all deficiencies are brought to the attention of the proper person for corrective action.<br>f. Proper co-ordination of cost and manpower control programs. |
| 6. BETTERMENT—To plan, stimulate, and develop improvement in methods, products, facilities, and other fields as applicable, keeping abreast of the best thought and practice throughout the industry, and to ensure that out-moded procedures and uneconomical facilities are abandoned. | a. Clear-cut recognition of needs and limitations.<br>b. Well-planned betterment program with clearly defined objectives.<br>c. Solicitation of best thought and suggestions from the entire organization.<br>d Keeping abreast of best thought and practice throughout the industry.<br>e. Effective action in putting desirable improvements into effect.<br>f Proper co-ordination of betterment program.<br>g. Periodic appraisal of results. |
| 7. EMPLOYEE RELATIONS—To make sure that all employees are accorded fair and equitable treatment, and that they are inspired to their best efforts. | a. Personnel policies and practices (including benefit plans, wage and salary schedules, and working hours and conditions) kept up to date and in favorable relation to competition, through well-considered changes as necessary.<br>b Enlightened supervision, ensuring that each employee is treated fairly and justly as an individual, with helpful consideration for his personal feelings, ambitions, and problems, within the scope of reasonably interpreted rules and policies.<br>c Adequate control to ensure that each employee is fairly and appropriately compensated in general conformity with the established rate structure and policies.<br>d Maintenance of close touch with personnel and their problems.<br>e. Effective leadership and stimulation of morale.<br>f. Confidence and respect on the part of superiors, subordinates, and associates.<br>g. Proper co-ordination of entire employee relations program. |

* SOURCE: *The Management Guide*, p. 28. Courtesy, Standard Oil Company of California, 1948.

## Objectives of management

In the process of developing the place of management in business, it is essential to note there are certain general objectives of management as distinguished from its functions. In the chart on pages 104-105, seven general objectives are enumerated. Observe, for instance, the importance of organization as a means of delegating authority to attain the responsibilities of administration.

## Levels of management

Within a given organization the general objectives of management are accomplished at several levels. The extent to which these levels exist as separate and distinct parts of the organization depends upon the size of the business. In large organizations these levels are, in practice, separate and distinct; in smaller firms they often shade off into one another.

The highest management level is *top management.* The top executives, regardless of their ability, cannot function with full effectiveness without a plan of organization. Since this is the top structure, the decisions that are made are reflected downward throughout the organization. The function of top management is to make the major organization policies and to determine the most important decisions affecting matters of finance, production, research, or distribution. These decisions become the patterns of operation to be carried out by officials and other employees who are in subordinate executive and supervisory positions.

A second level is *middle management.* As the title implies, the personnel on this level administer the policy decisions of top management. Middle management is vitally concerned with the proper, efficient utilization of personnel and manpower. At this level are such positions as those of branch managers, personnel managers, and plant superintendents.

The third level is known as *operating management.* These are the foremen and supervisors who have direct supervision and control of those performing the activities of the business. Problems at this level rarely involve any administrative decisions; hence, policy making is not a function. In the case of the foreman, his responsibility is to see that others under him perform their duties in a satisfactory manner.

Here is a summary of these levels, with the titles of the positions frequently found at each:

| | |
|---|---|
| TOP MANAGEMENT<br>Concerned with the determination of major business policies and decisions. | Stockholders<br>Directors<br>President<br>Vice-President<br>Secretary<br>Treasurer<br>General Manager |
| MIDDLE MANAGEMENT<br>Concerned with the interpretation of policies, formulation of plans, and utilization of manpower. | Superintendent<br>Production Manager<br>Personnel Manager<br>Sales Manager<br>Office Manager<br>Other department heads |
| OPERATING MANAGEMENT<br>Concerned with direct supervision and control of operating problems and personnel. | Foreman<br>Supervisor<br>Unit chiefs |

## Rise of modern management

The development of modern business management has placed increasing emphasis upon the need for direction and control in both business and industry. The introduction of laborsaving machinery, mass production, and large-scale distribution has helped to create a need for more effective management methods and procedures. The idea that certain phases of management could be approached on a scientific basis is relatively recent. Its application to industry may be attributed to the early research and writings of Frederick W. Taylor, who is often regarded as the father of scientific management. Taylor launched an entirely new concept of management principles that has since become the basis for improved methods and procedures. He summarized his conclusions in three basic principles: [3]

1. The development of a science for each element of a man's work, thereby replacing old rule-of-thumb methods.

2. The selection of the best worker for each particular task, and then training, teaching, and developing the workman; in place of the former practice of allowing the worker to select his own task and train himself as best he could.

3. Division of the work into almost equal shares between the management and the workers, each department taking over the work for which it is best fitted; instead of the former condition in which almost all of the work and the greater part of the responsibility was thrown on the men.

[3] Taylor, Frederick W., *Principles of Scientific Management,* p. 13. New York: Harper & Brothers, 1919.

The development of the functional organization plan is undoubtedly an outgrowth of the principles advocated by Taylor. This plan is discussed in detail elsewhere in this chapter. Taylor is credited with having introduced the use of research to obtain accurate facts about factory operations. He was also the founder of time study.[4]

## Departments in Business

The way in which a business enterprise is organized depends to a large extent on the kind of business and the number of activities for which management is responsible. A one-man organization may function very efficiently because one person performs the duties, makes the management decisions, and assumes all the responsibilities. As a business grows, it generally becomes necessary to delegate duties and responsibilities to others. In almost all enterprises of any size, the business is organized and subdivided into departments. For example, in a large industrial plant we are likely to find such subdivisions as production, marketing, research, finance, and accounting. These departments become the areas of operation for middle management.

One of the advantages of departmentalization is that the officials of the business are allowed more time to devote to the study of major policies. Departmentalization makes possible the fixing of responsibilities and the assignment of specific duties to personnel within the department. Departments similar to the following are found in almost any large organization:

1. Personnel management
2. Office management
3. Production management
4. Sales management
5. Traffic management

} Middle management

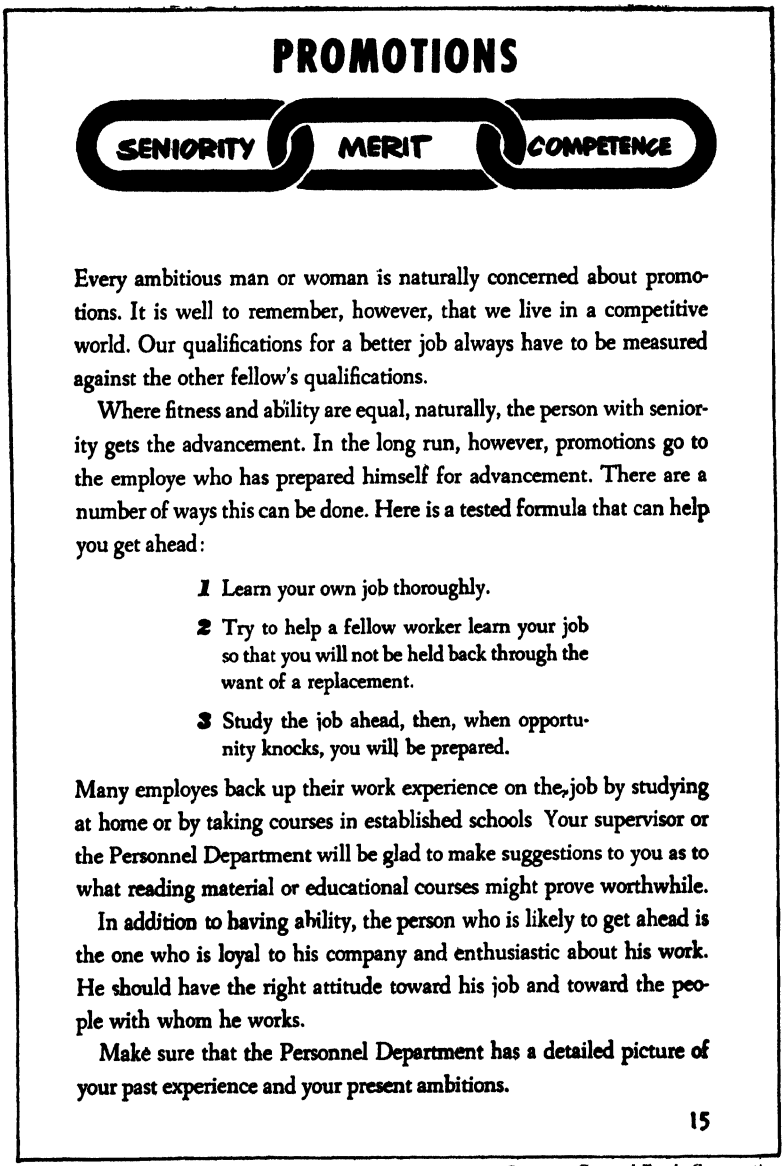
### Personnel management [5]

When the major personnel policies have been decided by the top management, the function of personnel management is to administer such policies and maintain the proper relationship between the management and employees. This department has a primary interest in any activity that concerns the human relations as contrasted with the tech-

[4] Gilbreth, Frank B., *Primer of Scientific Management*, p. 5. New York: Van Nostrand Company, 1912.

[5] This department is also known as the personnel department or the industrial relations department.

nical operations of production management. A more complete analysis and description of this work is contained in the chapter on personnel management.



**PROMOTIONS**

SENIORITY MERIT COMPETENCE

Every ambitious man or woman is naturally concerned about promotions. It is well to remember, however, that we live in a competitive world. Our qualifications for a better job always have to be measured against the other fellow's qualifications.

Where fitness and ability are equal, naturally, the person with seniority gets the advancement. In the long run, however, promotions go to the employe who has prepared himself for advancement. There are a number of ways this can be done. Here is a tested formula that can help you get ahead:

1 Learn your own job thoroughly.

2 Try to help a fellow worker learn your job so that you will not be held back through the want of a replacement.

3 Study the job ahead, then, when opportunity knocks, you will be prepared.

Many employes back up their work experience on the job by studying at home or by taking courses in established schools Your supervisor or the Personnel Department will be glad to make suggestions to you as to what reading material or educational courses might prove worthwhile.

In addition to having ability, the person who is likely to get ahead is the one who is loyal to his company and enthusiastic about his work. He should have the right attitude toward his job and toward the people with whom he works.

Make sure that the Personnel Department has a detailed picture of your past experience and your present ambitions.

15

*Courtesy General Foods Corporation*

*Figure 5-3. A Company Policy on Promotions.* This is an excerpt from a booklet prepared for the employees of one company, describing a tested formula for determining promotions.

### Office management

Although the principles of scientific management have been the backbone of factory management, it is only recently that any effort has been made to apply these principles to the modern business office. The establishment of large central offices where clerical work of every kind is performed has necessitated a more careful study of methods.

The business office is the center of all communications and record keeping. The work of the office manager is to provide the necessary systems for recording transactions, maintain different kinds of specialized records, and compile and analyze facts about the business.

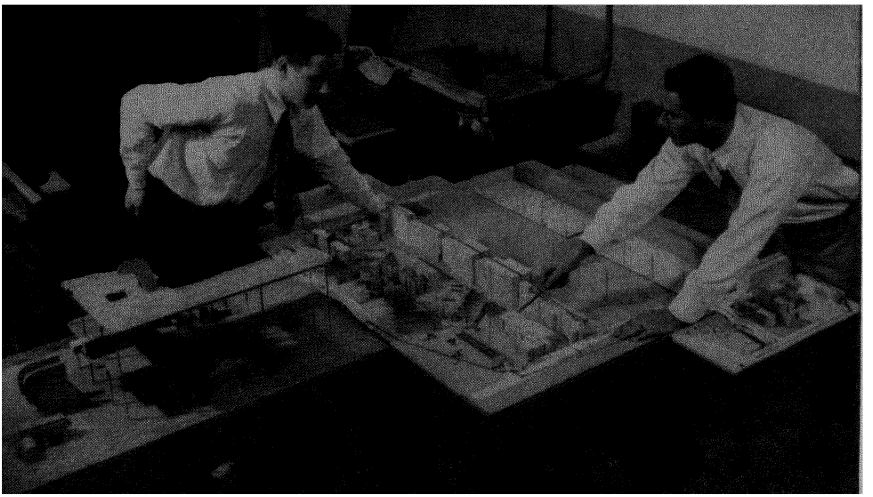
The office is also the focal point for co-ordinating the activities of production, distribution, and transportation. Records of production must be maintained. When the goods are sold, office activities similar to those used in production must be performed. If transportation is involved, the office compiles the necessary information concerning shipper, transporting agent, and customer. Indeed, it is difficult to conceive how any business might operate without the work of the office. Office management, like other areas of manpower utilization, is becoming more scientific in principle. It will be considered at greater length in a later chapter.

### Production management

Management that provides for the planning, operation, and control of manufacturing processes is called production management. Management of production involves creation of procedures, methods, and techniques that will bring about greater unit output at a minimum of cost. Many manufacturing processes have become fairly well standardized. As improvements are made, the work of the production manager is to apply them. Industry is constantly on the alert to find more efficient methods of operation. The contributions of Frederick W. Taylor have had a definite influence upon production management and industrial relations. This kind of management will be discussed in the chapter on production.

### Sales management

Selling is a function of marketing. In performing this function, the sales department is an extremely important unit of a business organization. The business relies on the sales force to find consumers for its product. The greater the production, the larger is the staff needed. Sales management is the planning, organizing, and developing of tech-



*Courtesy Armstrong Cork Company*

*Figure 5-4. Planning Production Processes with Scale Models.* This large manufacturing company uses models to show relative sizes and the relationships among the different kinds of work to be done.

*Courtesy E. I. du Pont de Nemours & Company*

*Figure 5-5. Management of Sales.* Effective selling demands the finest in manpower and management. Talking expressively, this salesman *sells* an order of upholstery fabric to a large furniture manufacturer.

niques that will cause the buyer to act. It is a responsibility of this department to carry out policies that will make more sales and maintain consumer goodwill.

Sales management is also concerned with the analysis of markets, both old and new. In the case of a new product, unlike any item ever produced, a plan of marketing must be devised by the sales management department. This plan may involve selling direct to the consumer, through wholesalers to retailers, through selling agents, through company branches to the retailer, or by any combination of the four channels. In any event, the type of plan selected must be the one considered to bring the greatest returns at the lowest cost.

Sales promotion is also a part of this department. Salesmen are guided by the sales policy it develops. Finally, sales management is concerned with the training of personnel, which is a continuous process. The subject of sales management will be treated more fully in the chapter on selling.

### Traffic management

Whenever either a seller's or a buyer's problems of shipping and traffic become sufficiently large and complex, it is economical to organize a department to handle them. The traffic manager is responsible for the organization and operation of personnel in this department. He must know the advantages and costs of transportation by the various methods, such as rail, highway, water, and air.

Such operations as checking tariff rates, handling bills of lading, processing claims, and determining the most economical and satisfactory means of transportation are some of the functions of traffic management. By an intelligent selection of carriers and careful planning of routes, the traffic department can reduce transportation costs for the shipper. The chapter on transportation describes these elements in detail.

## Nature and Purpose of Organization

The various forms of ownership in business have already been discussed in the last chapter. At this point attention is directed to the subject of organization as related to management. Any enterprise needs some type of organization to protect the owner's capital investment and to carry on the purposes of the business. Organization permits the application of managerial specialization in whatever forms seem most appropriate.

By definition, the term *organization* means the structure of a busi-

ness. It is the framework on the basis of which responsibilities are delegated and lines of authority are established. It is through organization that administrative policies and decisions reach workers and are executed by management. Since the primary purpose of business is the production and distribution of goods or services, it is the function of organization to co-ordinate them with maximum efficiency.

Within the framework of an organization are those who work at various levels and whose services must be co-ordinated and synchronized into a smoothly operated force. For instance, if personnel management is to work effectively in handling problems of personnel administration, it must operate within the framework of a well-planned structure wherein all activities are directed toward the major goal of the enterprise.

## Objectives of organization

The primary objective of organization is to provide the structure for co-ordinating the work of others. Without this invisible framework by which individuals are directed, the average establishment could not grow beyond a size that could be supervised by one person. Since organization is a device for getting things done, its extent depends largely on the size of the business.

When an organization is created, its primary test is how well it serves to accomplish the desired ends. Accomplishing these ends is largely a result of recognizing and applying certain basic principles, which for purposes of this discussion may be summarized as follows:

1. *Objective.* Each part of the organization should contribute to the main objective of the enterprise with a minimum of personnel and a maximum of efficiency.
2. *Control.* The organization structure should provide adequate ways for maintaining control over all activities performed by the necessary personnel and at the same time maintain proper organization balance. Every department should carry its proportionate share of the load.
3. *Channels.* The organization structure should establish definite channels of communication so that information may flow without interruption from its origin to the individuals concerned.
4. *Co-ordination.* Provision should be made for permitting complete co-ordination of every department. The work of one department should be related to all allied departments in order to maintain synchronized effort within the organization.
5. *Flexibility.* The organization structure should permit development

and expansion of both individuals and activities without dislocation of activities.

6. *Efficiency.* All available personnel should be used to the fullest extent in accordance with individual abilities and operating efficiency.

## Types of Organization Plans

There are almost as many varieties of organization plans as there are kinds of establishments. Nevertheless, all reduce themselves into three major groups:

1. Line-plan organization.
2. Functional organization.
3. Line-and-staff organization.

### Line-plan organization

The oldest and simplest form of business organization is the line plan. Here authority originates from the top and is passed down until the last operating level has been contacted. Each subordinate employee is directly responsible to the person above him. This plan is an outgrowth of the one-man organization, where ownership is vested in one person who directs and controls all activities.

The line plan is considered a highly efficient structure because a single idea can be transmitted from top to bottom of the organization without interference. It has therefore been quite successful in military organizations. The plan provides for both control and co-ordination of activities. The chain of command is simplified so that few steps are necessary to disseminate information from the highest to the lowest position in the organization.

There is one distinct disadvantage: It requires line officers to supervise others and to perform additional duties that require special knowledge for which they may not be especially qualified. The plan fails to provide a specialized staff for the more highly specialized activities.

Figure 5-6 shows how this type of organization is used by a bank. The line of authority originates with the stockholders and extends down to the president through the directors, chairman of board, and executive committee. The president in turn has authority over each of the six departments. Responsibilities are passed along from one person to another, each being assigned to perform specific duties. Under this plan of organization each person is responsible to only one superior executive, who in turn is responsible to the next higher person in the

organization. Very little red tape is involved because the line of authority is direct.

The advantages of the line plan tend to outweigh the disadvantages when an organization is not unusually large, when line members are experienced, and when the nature of the business is not complicated. This plan also makes provision for adding new departments or activities without changing the channels of communication or the lines of authority.

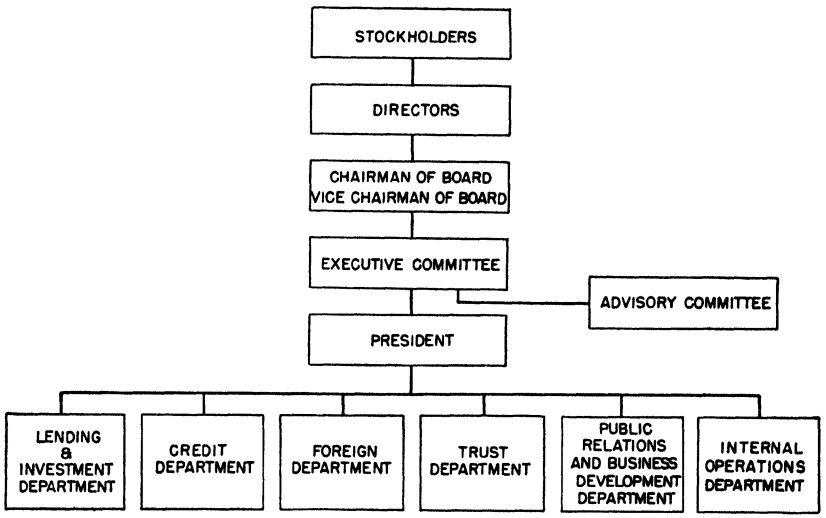



*Figure 5-6. Line-Plan Organization of a Bank.*

## Functional organization

In principle and structure the functional plan is quite different from the line form. This plan provides for specialists to supervise the various specialized functions within the business. In Figure 5-7, for example, the personnel function is performed by the personnel director and not by his immediate supervisor. The one distinguishing characteristic of the plan is the fact that each person, except those at the top levels, reports to several superiors. Chief among the advantages of the plan are the following:

1. One person spends his entire time directing or performing one type of activity.
2. Each individual is allowed to grow in his own specialty, and this means greater growth for the entire organization.
3. A person is assigned according to his specialty.

There are several disadvantages, such as:

1. Narrow specialization among top-ranking specialists makes it difficult to develop the all-around type of executive often needed in times of emergency.
2. At the lower levels there is a tendency for discipline to break down among the employees because each person reports to more than one supervisor.
3. There is a tendency for an overlapping of authority and a lack of definiteness among supervisors that often result in buck passing.

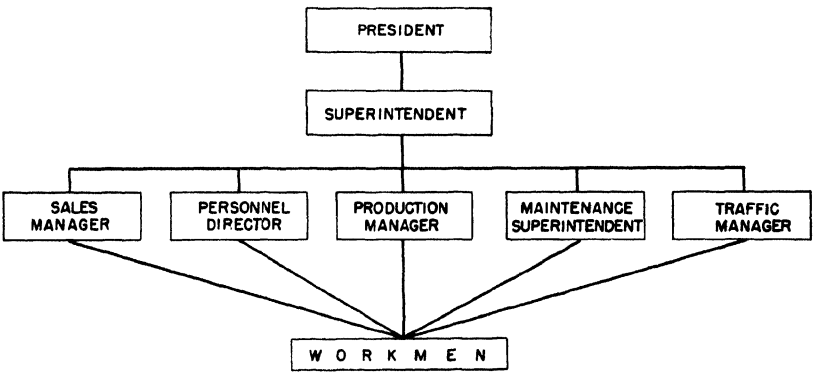



*Figure 5-7. Functional Organization.*

The pure functional plan as originally advocated by Taylor is seldom found today.[6] One is more likely to find it used in large enterprises as a plan of organization for the top officials but not for middle management or at the supervisory level of the foreman. Although the functional plan is not common, an understanding of it will serve to clarify the operation of the line-and-staff plan, which is a combination of the line and functional plans. Furthermore, the principle of functional organization is often used to handle emergency personnel problems that are imposed by federal and state regulations. On such occasions the personnel department is delegated functional authority over line officers.

[6] Functionalized management was originated by Frederick W. Taylor. It was Taylor's idea to extend the principle of functionalization all the way down to the worker. This concept has never met with wide acceptance except as contained in the principles of line-and-staff organization.

## Line-and-staff organization

This plan is actually a combination of the line and functional principles of organization. A study of Figure 5-8 indicates that the line principles of organization have been preserved; the special staffs are added for the purpose of advising the line officers. It will be noted that the line of authority is direct from the president to the three middle-management officials—the comptroller, production manager, and sales manager. The line principle is maintained for each of the foremen in the production department.

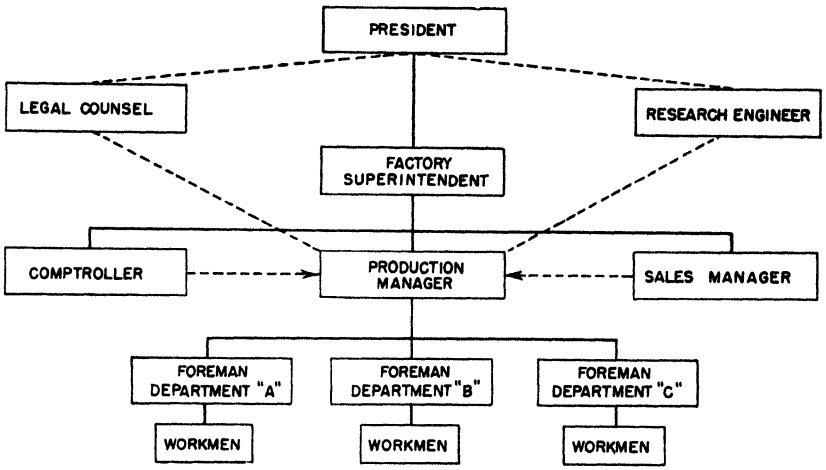


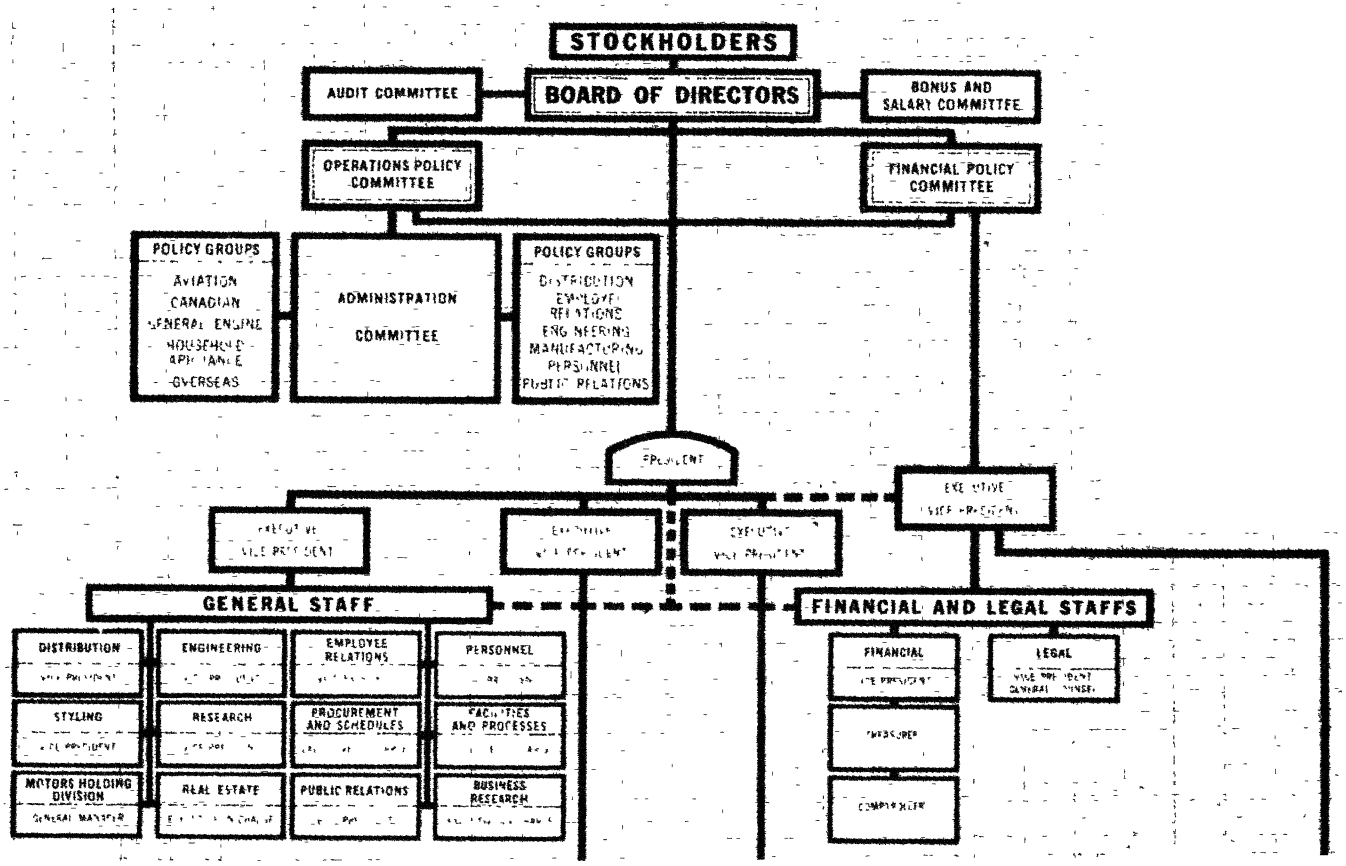

*Figure 5-8. Line-and-Staff Organization Plan.* Solid lines show line of authority; broken lines show staff functions.

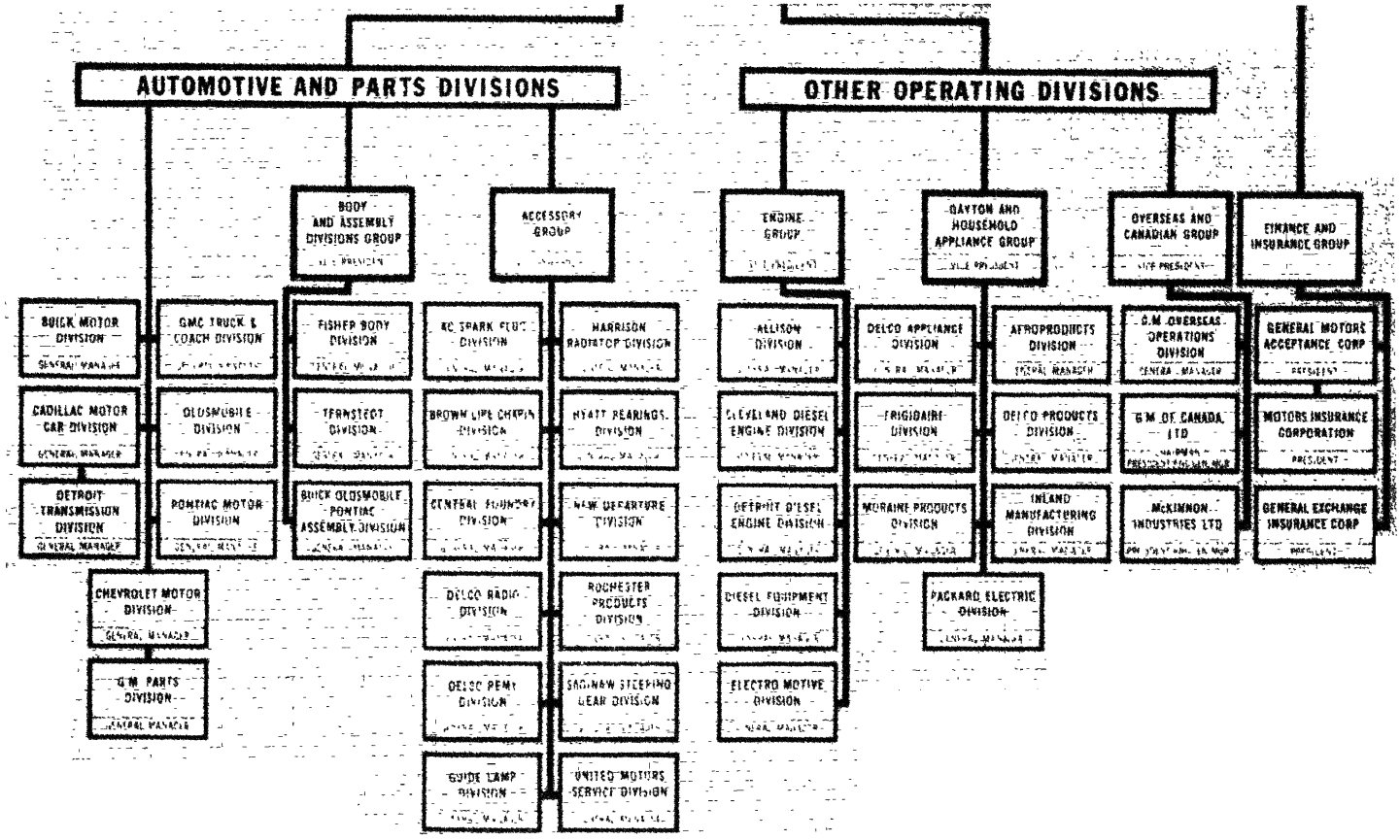
In addition to these, however, two additional staff members—research engineer and legal counsel—serve in an advisory capacity to the president and the production manager. This relationship is indicated by broken lines in the illustration.

A much more detailed line-and-staff organization is seen in Figure 5-9, where committees are effectively utilized in a staff or advisory capacity.

Probably the most significant advantage of the line-and-staff plan is that it retains the principle of directness and yet creates some of the advantages of specialization obtained through the use of staff members. The line officers are helped by having at their disposal the services of staff specialists.

From the fact that this plan is commonly used in large business and industrial organizations, it should be obvious that the disadvantages


STOCKHOLDERS
AUDIT COMMITTEE
BOARD OF DIRECTORS
BONUS AND SALARY COMMITTEE
OPERATIONS POLICY COMMITTEE
FINANCIAL POLICY COMMITTEE
POLICY GROUPS
AVIATION
CANADIAN
GENERAL ENGINE
HOUSEHOLD APPLIANCE
OVERSEAS
ADMINISTRATION COMMITTEE
POLICY GROUPS
DISTRIBUTION
EMPLOYEE RELATIONS
ENGINEERING
MANUFACTURING
PERSONNEL
PUBLIC RELATIONS
PRESIDENT
EXECUTIVE VICE PRESIDENT
GENERAL STAFF
FINANCIAL AND LEGAL STAFFS
DISTRIBUTION
ENGINEERING
EMPLOYEE RELATIONS
PERSONNEL
STYLING
RESEARCH
PROCUREMENT AND SCHEDULES
FACILITIES AND PROCESSES
MOTORS HOLDING DIVISION
GENERAL MANAGER
REAL ESTATE
PUBLIC RELATIONS
BUSINESS RESEARCH
FINANCIAL
LEGAL
VICE PRESIDENT GENERAL COUNSEL
TREASURER
COMPTROLLER


AUTOMOTIVE AND PARTS DIVISIONS
BODY AND ASSEMBLY DIVISIONS GROUP
ACCESSORY GROUP
BUICK MOTOR DIVISION
GENERAL MANAGER
GMC TRUCK & COACH DIVISION
FISHER BODY DIVISION
AC SPARK PLUG DIVISION
HARRISON RADIATOR DIVISION
CADILLAC MOTOR CAR DIVISION
GENERAL MANAGER
OLDSMOBILE DIVISION
TEMPSTEEL DIVISION
BROWN LIPE CHAPIN DIVISION
HYATT BEARINGS DIVISION
DETROIT TRANSMISSION DIVISION
GENERAL MANAGER
PONTIAC MOTOR DIVISION
BUICK OLDSMOBILE PONTIAC ASSEMBLY DIVISION
CENTRAL FOUNDRY DIVISION
NEW DEPARTURE DIVISION
CHEVROLET MOTOR DIVISION
GENERAL MANAGER
DELCO RADIO DIVISION
ROCHESTER PRODUCTS DIVISION
G M PARTS DIVISION
CENTRAL MANAGER
DELCO REMY DIVISION
SAGINAW STEERING GEAR DIVISION
GUIDE LAMP DIVISION
UNITED MOTORS SERVICE DIVISION
OTHER OPERATING DIVISIONS
ENGINE GROUP
DAYTON AND HOUSEHOLD APPLIANCE GROUP
OVERSEAS AND CANADIAN GROUP
FINANCE AND INSURANCE GROUP
ALLISON DIVISION
DELCO APPLIANCE DIVISION
AFROPRODUCTS DIVISION
G M OVERSEAS OPERATIONS DIVISION
GENERAL MOTORS ACCEPTANCE CORP
PRESIDENT
CLEVELAND DIESEL ENGINE DIVISION
FRIGIDAIRE DIVISION
DELCO PRODUCTS DIVISION
G M OF CANADA, LTD
MOTORS INSURANCE CORPORATION
PRESIDENT
DETROIT DIESEL ENGINE DIVISION
MORAINE PRODUCTS DIVISION
INLAND MANUFACTURING DIVISION
McKINNON INDUSTRIES LTD
GENERAL EXCHANGE INSURANCE CORP
DIESEL EQUIPMENT DIVISION
PACKARD ELECTRIC DIVISION
ELECTRO MOTIVE DIVISION

are neither numerous nor serious. Possibly the most important disadvantage is the fact that staff specialists are inclined to exert pressure on subordinate officials to follow their advice. This leads to uncertainty among the less experienced line members as to whether they should obey their immediate superiors or conform to the dictates of the staff officers.

## Organization Charts

The organization of a business may be shown graphically in a chart. Such an organization chart is designed to give management a plan that reveals the various functions of the business and at the same time shows the relationships between different personnel who are assigned authority. Some charts show individuals and/or departments; others show only the functions to be performed. Often a chart will show both individuals and functions, or departments, individuals, and functions. A chart may be made for an entire business, for each department, or for each unit of the business.

Briefly, an organization chart helps management in much the same way that a blueprint guides the engineer in the construction of a road or building project.

### Limitations of charts

Despite the simplicity of charts, they have certain limitations. The process of charting an organization is a good test to determine the soundness of an organization plan, but having a chart does not guarantee that the organization actually functions accordingly.[7] It must be recognized that because of differences in personalities, work capacities, and individual job requirements, it is often impossible to anticipate in advance how well a plan of organization will function. It is a good practice to have those who are responsible for making the plan function take part in preparing the chart.

## Other Methods of Control

In addition to organization charts as a method of obtaining co-ordination and control, business enterprises frequently use other devices. Among these are (1) orders and instructions, (2) business reports, and (3) business records.

[7] One writer found in an analysis of 31 large industrial organizations that few of the companies surveyed had comprehensive organization charts. For a more detailed description see Holden, Paul E., Fish, Lounsbury S., and Smith, Hubert L., *Top-Management Organization and Control*, p. 93. Stanford: Stanford University Press, 1948.

### Orders and instructions

These may be issued orally or in writing. A written order is a means of facilitating the designation of authority and responsibility. The order should be specific, clear, and concise. For example, an order may be issued changing the responsibility of all supervisors responsible for personnel handling mail-order shipments in a department store. Each supervisor is expected to notify the employees under his supervision of the exact nature of the change in routine procedure. Effective orders stimulate in employees the desire to co-operate.

Written instructions often are issued in the form of bulletins and manuals for use of employees. For example, a manufacturing company might issue to its salesmen a sales manual containing all the necessary instructions and directions covering the procedures and forms for preparing sales tickets, memoranda, shipping instructions, and credit procedures. Each salesman is expected to follow these instructions, which become the standard operating procedures.

### Business reports

A business report is a detailed analysis of a statement of fact or opinion containing an account of certain factors, situations, conditions, or other information for use by responsible authorities. Its purpose is to provide reliable and complete information that may be needed as the basis for a managerial decision. Reports vary according to the type of activity. However, all good reports have some common characteristics:

1. The facts presented must be complete, accurate, timely, and pertinent to the purpose for which the report is intended.
2. Conciseness adds to the effectiveness of the report.
3. The facts should be arranged in a logical order.
4. Reports should be made promptly.

Business reports may serve to provide information necessary for planning future activities and determining policies or they may have value in giving information for operative control or administrative supervision.

### Business records

A business record is another device for recording information to facilitate the performance of a function or to classify and preserve facts for subsequent use. Records may be classified according to function:

Accounting records show financial information about the business; sales records reveal the amount of merchandise sold; and personnel records contain facts about employees, the number employed, and the nature of the work performed. Correspondence is also a common form of business record that may be about any activity pertaining to the enterprise. To provide uniformity, records are often kept according to a system, as for example the recording of accounting information in special books. Special forms may be used to facilitate keeping the data commonly needed in the business.

## Management Courses in Business Administration

The fundamental principles of management have not changed greatly since the days of Frederick W. Taylor, who pioneered in the field of scientific management. Business has become more complex in almost every way. The larger the establishment, the more complicated are its operations. Although the organization of a business is often the result of gradual development, the need for well-trained personnel is as important to small firms as to large ones. When enterprises become large as a result of natural growth, the owners and managers gradually delegate more authority to subordinate officials. Hence, it is important that the organization have among its roster of employees persons qualified to accept greater responsibilities. Because of the increasing cost of manpower and the desire of business owners to find more efficient ways to utilize human resources, more attention is now being paid to the study and analysis of management in business, industry, and government. A vast wealth of material on the subject of personnel management and industrial relations is now available in printed form.

### Value of management courses

Courses in management provide students with a knowledge of the principles underlying the organization, operation, and control of an enterprise. A well-rounded business education should include an understanding of business principles by which the industrial structure of the nation is organized. For example, a salesman who understands his firm's organizational problems and how that business operates becomes a better and more dependable employee. In a factory, the cost accountant who does not understand shop management, methods of inventory, and production control as managerial functions and responsibilities is handicapped.

It is now possible to study the background of the purposes of busi-

ness and organization as a part of the preparatory training for a career in business just as the prospective attorney prepares to assume the practice of law or the physician the practice of medicine. There are phases of management that have become highly specialized because of the enactment of federal legislation governing labor unions and employers. Such subjects as labor relations, labor laws, labor economics, business organizations, and employment techniques equip the student with a background knowledge that proves valuable to him as he progresses toward managerial positions. What the business student learns in school about organization and management should be regarded as the foundation.

## Opportunities in Management

Students in business administration should realize that the field of management is not a single type of employment confined to one particular kind of job. On the contrary, it is a broad field covering work in all phases of human relations in business, industry, and governmental personnel operations.

In city, county, state, and federal agencies persons are needed with training in management for such positions as personnel supervisor, budget analyst, personnel classification analyst, training specialist, personnel director, and administrative assistant. Appointment to these and other government positions for state and federal agencies is by civil service. Many of the positions require both experience and special training in one or more phases of personnel management.

A limited number of opportunities are found in school systems, colleges, health centers, and hospitals for those with management education. These positions involve financial management, office management, purchasing management, and personnel administration.

In industry there is a field of managerial occupations generally described as industrial management. A preliminary report based on a study of industrial management issued by the Industrial Relations Center at the University of Minnesota lists 18 different jobs in the area of management, including such titles as director of industrial relations, director of personnel research, personnel director, wage and salary administrator, employment manager, and training director.[8] The majority of these positions require both experience and training in management and organization.

[8] Kriedt, Philip H., and Bentson, Margaret, "Jobs in Industrial Relations." *Release No. 2,* University of Minnesota Industrial Relations Center, 1947.

## Terms for Study

Administration
Branch managers
Control
Co-ordination
Delegated authority
Enterprise
Execute
Executive
Factory operations
Flexibility
Functional organization
Line-and-staff organization
Line function
Line organization
Management
Manpower utilization
Middle management
Operating management
Organization
Personnel management
Scientific management
Staff function
Subordinate executive
Synchronize
Top management
Traffic

## Questions

1. What is meant by management?
2. What are the purposes of business management?
3. Name the four elements that comprise management.
4. How does management differ from organization?
5. What is administrative management?
6. What are the reasons why the subject of management has received so much attention during the past few years?
7. What are the general objectives of management?
8. In what way are the objectives of management related to the levels of management?
9. Which positions in a business organization are classified as top management?
10. What are some of the positions in the middle-management group?
11. Why are departments needed in business organization?
12. Explain the fundamental purposes of business organization.
13. How is business organization related to business management?
14. What are the three common plans of business organization?
15. How does the line plan differ from the functional organization plan?
16. What are the advantages and disadvantages of the line-and-staff plan?
17. Compare the function of a staff member with that of a line member in an organization.
18. What is the purpose of an organization chart?
19. What does an organization chart show?
20. Name some other methods of control in a business organization.
21. How do business reports differ from business records?
22. What are some of the occupational opportunities in the field of management?
23. How do courses in management help to prepare an individual for positions in business administration?
24. In what other fields besides business is management important?

## Problems and Projects

1. Prepare a list of the different positions in business management found at the three levels. Opposite each position title write a brief description of the general duties for the position.

2. Select a business in your community that employs between 15 and 100 persons. Interview the owner, general manager, or one of the top executives to ascertain how the internal organization is established. On the basis of this information, prepare an organization chart that gives a complete picture of the internal structure at the various levels of administration and supervision.

3. Write a business report to accompany the organization chart in the previous problem. The report should contain an explanation of the business, its location, the length of time it has operated, its principal owners, its plan of organization, and any interpretative facts about the organization chart needed to explain it. Limit this report to not more than 400 words and not fewer than 150.

4. Outline the chief distinctions between the line, functional, and line-and-staff plans of organization. Include the principal advantages and disadvantages of each plan.

5. Choose a local business concern known for its reputation as a successful enterprise. Visit the firm and ask the head of the business how he is able to maintain an efficient organization. Find out what educational and personal requirements the business uses in selecting its junior-executive personnel for future managerial positions. Plan in advance the main questions to be asked. After the interview, prepare a written report to be given before the class.

6. Prepare a written statement of approximately 100 words analyzing the difference between the terms *organization* and *management.*

7. Assume you are planning to organize a retail business with approximately five employees. Explain how you would determine which plan of organization would be best for your business and what facts about the business you should know in advance in order to plan the organization structure.

8. It is your responsibility to prepare an organization chart for a local business firm. You are not familiar with the concern but the owner has asked you to assist him. Describe how you would obtain the necessary information about the business in order to submit your organization chart.

9. Prepare a written analysis contrasting the functions of top management with those performed by operating management.

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CHAPTER VI

# THE SMALL BUSINESS

EACH YEAR IN THE UNITED STATES about 500,000 persons start some kind of business of their own. Restaurants, grocery stores, filling stations, beauty shops, garages, clothing stores, and novelty shops are among the more popular ventures. These do not require too much capital and often the owner has only limited experience. Such enterprises as drugstores, automobile agencies, wholesale firms, and jewelry stores take more capital and are more difficult to start.

*Courtesy Rochester, N. Y., Chamber of Commerce*

*Figure 6-1. Typical Neighborhood Small Businesses.*

Often a very simple idea can be developed into a very successful business. Henry John Heinz, the founder of the H. J. Heinz Company, began his business career in 1869 by growing horse-radish on his small farm in Sharpsburg, Pennsylvania, and selling it from door to door. Because his product received immediate consumer acceptance, he found a market for all that he could grow and prepare. Later he added pickles to his line. Today the H. J. Heinz Company is famous for its 57 varieties of canned and pickled foods. The organization employs more than 1,200 salesmen, and its operations are international. All this started with a single idea.

The case of Henry J. Heinz is not the only one that can be cited. J. C. Penney started his first store in 1913. Today he has some 1,400 establishments scattered over the United States. Frank W. Woolworth, founder of the Woolworth five-and-ten-cent store chain, failed in his first store. However, that did not stop him; he went ahead to build one of the greatest of retail chains. For every one like Penney and Woolworth who succeeded, there are hundreds who have failed.

Small businesses contribute much to the economic life of this nation. These firms furnish employment to more than eight million people. They help to keep big firms alert to changing business conditions. By introducing new ideas, improvements in service, and more efficient methods, small business helps to check the growth of monopolies and combinations. The local merchant has a knowledge of his community's needs and an interest in its welfare. In many lines small business now does a better job of serving the consumer, for the small businessman realizes that if he fails to give good service his competitor will take away his customers.

## What Is Small Business?

The term *small business* is such a common one that sometimes its meaning is taken for granted, yet it is bound to have a different meaning to many people. One way to describe the term is to say that it is the title applied to a single retail store, a restaurant, an automobile agency, a barber shop, a real-estate broker, or any entrepreneur who assumes the risk and management of an enterprise. Small businesses are not necessarily limited to one field, nor are they all owned by single proprietors. Many corporations and partnerships engaged in manufacturing, wholesaling, mining, construction, and other ventures are also small businesses.

The Census Bureau and other divisions of the Department of Commerce use the title *small business* to describe manufacturing concerns with 100 employees or less, wholesalers with annual net sales of not more than $200,000, and retail or service establishments with annual receipts of $50,000 or less. According to their classifications, about 98 percent of all the business units in the United States employ fewer than 50 people.[1] Small business also includes the self-employed person, such as the piano tuner, the parking-lot owner, the theater-ticket broker, and many others who are not always identified with manufacturing,

[1] Committee for Economic Development, *Meeting the Special Problems of Small Business*, p. 13. New York: Committee for Economic Development, 1947.

wholesaling, retailing, and service industries. It is obvious that the field of small business represents a large and highly diversified group of occupations and pursuits.

## Characteristics of small business

Three fundamental characteristics help to distinguish small business from medium-sized and large business. First, management is independent. Usually the managers are also the owners. This offers unity and simplicity of organization and operation not found in the corporation that has hundreds of stockholders. The small enterprise is most typically a single proprietorship or a partnership. To the owner his business is both an investment and a source of employment. If he fails, both are lost. Not many small enterprises are incorporated. Probably fewer than 10 percent have corporate status, and many of those are owned by a very few stockholders who take an active part in the affairs of the firm. There is scarcely any absentee ownership in the field of small business.

Second, small business is typically local in character. Both the employer and the employees live in the same community. This does not necessarily mean, however, that the markets served are always local. Small importing and exporting firms, canning factories, packing plants, and produce houses may be cited as exceptions. Because ownership is local, the proprietors as well as the employees are a part of the community.

Third, capital to start the business is nearly always supplied by one or a few persons who are the owners. A corporation can raise additional capital by selling bonds or issuing new stock. The average small business is limited to short-term loans from commercial banks, to profits put back into the business, and to capital from new partners. Many proprietors prefer to raise additional funds from bank loans rather than accept new partners.

## Causes of failure

Studies have been made to determine why some businesses fail and others succeed. When a business fails, it is said to be insolvent. Insolvency comes when a firm fails to make a profit and is not able to pay its debts.

Authorities are agreed that insolvency is due, not to any one cause, but to several. It is no more possible to say that any one thing is the only cause for failure than to state that a business is successful solely because of its location, or its leadership, or its financial resources.

Since the mortality rate among small businesses is high, it is important to note some of the causes. Among the more common ones are (1) inadequate capital, (2) inexperience of the owner, (3) business depression, (4) inefficient management, (5) poor location of store, (6) excessive overhead, (7) overbuying, (8) lack of education, (9) unwise credit policy, and (10) inadequate accounting records. This list is by no means a complete one; it is merely representative of the more common causes.

*Courtesy Pittsburgh Plate Glass Company*

*Figure 6-2. An Individual Proprietorship.*

Too many people who are not qualified start a business. Many failures could be eliminated if the individual made a more careful analysis of business facts before investing his money.

## Organizing a Small Business

Starting a business involves a number of different problems. The first thing is to decide what kind of a business to go into. The second is where to open the business.

For various reasons not all persons are qualified or interested in the same type of business. People differ in personality, personal interests, individual preferences, education, and ability. It is safe to say that no one should choose a particular venture simply because he has heard

from someone else that a lot of money was made by a friend who owns a certain store, or because the business looks easy and simple to run. Every idea should be thoroughly investigated and all the facts obtained and carefully weighed before a decision is made. As a final bit of evidence, the individual should take stock of his own personal resources and capabilities. A good way to start is by answering the following questions:

1. How much capital does the proposed business require?
2. Do I have the proper education, experience, and personality for this business?
3. Is there much competition in the field?
4. Are other firms in the same business successful?
5. Is there a sufficient demand for the goods or services to be supplied by this business?

### Estimating capital needs

The amount of money invested in a venture is the capital. When profits are earned and allowed to remain in the business, the capital is increased by that amount. How much does it take to start a business? This depends on several factors.

In the first place, the type of business selected will have a bearing on the amount of capital required. Figures show that starting a retail jewelry store requires a large sum, since both stock and fixtures are expensive and the rate of stock turnover is low. Starting a radio-repair shop does not require so much capital, since the fixtures needed are not so expensive as for many other kinds of enterprises.

Second, there must be enough capital to buy the required equipment, supplies, and goods, and to pay the cost of salaries, lights, heat, rent, and incidental items. One writer suggests that the amount of working capital to start with should be sufficient to allow for at least one serious blunder.[2]

Third, credit is related to the amount of capital requirements. How good is the firm's credit rating with the local banks or the manufacturers? If the firm must pay cash for its stock and fixtures at the time of delivery, more cash is necessary than if credit terms can be arranged in advance. There is also the question of how much credit the proprietor can afford to extend to his customers.

Figuring the cost of equipment is usually not a difficult matter. Sal-

[2] Wessels, O. Richard, *Small Business as a Career,* p. 23. Syracuse: Syracuse University Press, 1946.

aries, wages, and general operating expenses are relatively easy to compute, but the amount of sales must be estimated. This is the unknown factor and one that is not easy to calculate. In some kinds of business the rate of stock turnover is greater than in others. By "rate of stock turnover" is meant the number of times the owner sells his complete stock of goods during a given period. Suppose you went into the clothing business and bought $3,000 worth of men's clothes to open your store. If you sold the entire stock within three months and bought another $3,000 worth, repeating this process for two more periods of three months each, your business would have a turnover of four times during the first year. Actually, business is not conducted with such precision. No business ever completely sells its entire stock before buying again; stock is replenished gradually.

## Making a personal inventory

A successful career in business is a combination of many elements, as we pointed out in the first chapter. Obviously, a well-rounded general education, coupled with special training in business administration and an understanding of how business fits into the larger pattern of living, is essential.

A pleasing personality is particularly important because small-enterprise contacts are personalized—the owner usually deals directly with the trade. Leadership, ability to assume responsibility, knowledge of the business, and common sense must also be evidenced in small-business management.

## Competition

There is no mystery attached to competition in small business. If two or more entrepreneurs offer the same article or service to the buyer, each is competing against the other for the customer's money. When competition is keen in any line of business, the ultimate advantage is generally in favor of the consumer. Usually one of two things happens where there is strong rivalry: the quality of the goods or services is improved, or the price is reduced. Both of these practices are intended to induce the consumer to buy. In its extreme form, competition becomes cutthroat in practice.

*Price a Factor in Competition.* Pricing of goods or services is one of the most difficult problems of small business. In order to determine what price to charge, a proprietor must adopt some general price policy that he believes will bring him the largest possible profit and still allow him to remain in business. In setting this policy, he must take into ac-

count such facts as the severity of competition, the location of his business, and the prevailing price-maintenance regulations with which he must conform; and finally he must decide whether he prefers to operate on a small margin of profit with a high sales volume or to use a higher mark-up with a consequently lower volume of business.

*Labor a Factor in Competition.* The typical small business is often more dependent upon labor and less upon machinery as a means of meeting competition than is the large scale enterprise. Because the business is small, the employees frequently must be versatile in performing several different jobs. Where the small firm cannot compete with big business on mass production, this disadvantage may be offset by a more intimate personal relationship and a greater variety of activities that the employee may share with the owner.

## Choosing the form of organization

The simplicity of single ownership makes this form well adapted to small enterprises. On the other hand, there is no logical reason why the partnership or corporate organization is not a satisfactory form of operation for small-scale ventures, under certain conditions.

In a recent report that came as the result of Congressional hearings on the problems of small business, the Temporary National Economic Committee came to the following conclusions concerning small business: [3]

> In summary, the need for guiding principles for organizing and operating business units is obvious. In establishing a job printing concern or a delicatessen, maximum results depend upon knowledge of many elements from location advantages to delivery facilities.... Answers differ by kinds of business, types of operation, and many other factors. And the prospective proprietor is anxiously in need of enlightenment. At present he is using the trial and error process, and the odds are heavily against him.

Deciding which form of organization to use must be done very early in the formulation of plans. Two factors are worthy of special attention. The first relates to the intended scope of the venture; that is, how large is the undertaking to be? This factor generally determines how much working capital is needed. Is it necessary to take in a partner to obtain additional funds or personal talents? If more than one partner is necessary, would there be an advantage in forming a corporation?

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[3] Temporary National Economic Committee, *Investigation of Concentration of Economic Power, Monograph 17: Problems of Small Business.* Washington: Senate Committee Print, 76th Congress, 3rd Session, 1941.

The second factor concerns the amount of business risk the owner is willing to take. For example, starting an amusement park, even on a small scale, involves more than the usual amount of risk. A rainy season could easily cause the attendance to drop off and result in bankruptcy. A person wishing to start this kind of business would like to avoid the increased risk that must be assumed under a single proprietorship or partnership. The corporate form would seem to be the most desirable type of organization. On the other hand, incorporating a filling station could be too costly in proportion to the advantages gained. Either a partnership or sole proprietorship would seem to be the more satisfactory form to choose.

## Management

The foremost problem of small business is *management.* In the first place, the owner must know enough about buying, selling, production, bookkeeping, and advertising to operate efficiently and economically. As one proprietor put it, "I am my own salesman, bookkeeper, buyer, cashier, and clerk." The typical small enterpriser cannot afford to employ specialists for these functions. He must either supervise others or do the work himself.

It is said that every small enterprise begins with a *time* handicap. It takes time to develop an efficient staff, time is needed to establish steady and satisfied customers; building a good reputation requires time. One characteristic of American business is that customer buying habits are fairly uniform. If a new product is immediately accepted in one community, it is quite likely to be accepted in another, except where climate or custom may limit its use.

### Purchasing

When a proprietor overstocks, he ties up critical capital that could be used more advantageously. Furthermore, he should get value for money spent. This is accomplished by keeping informed of all the available sources, qualities, and kinds of merchandise that are on the market.

Small business proprietors buy in small quantities commensurate with their cash or credit. They keep merchandise inventories as low as possible during a period of a declining market and thus avoid taking a loss on goods for which the current market replacement price is lower than the original purchase price. Conversely, they study the market in order to anticipate a rising trend in prices. Buying excessive merchandise on an upward market is regarded as speculation.

### Selling

Another function equally as important as purchasing in small-business management is selling. It has been stated, "Sales are the lifeblood of a business." When sales decline, income decreases, and a reduction in income usually means lower profits. Later chapters on the selling function and advertising will discuss this function more fully.

### Keeping records

The average small business should not be expected to keep so many kinds of accounting records as a very large concern. A firm should keep only the facts necessary to furnish management with accurate and complete information on the financial condition. A discussion of accounting records as a tool for business management is contained in the chapter on accounting in business. As for small businesses, the necessary financial records should show the following facts:

1. Amount of original investment
2. Amount of money owed by the business
3. Total of all credit sales
4. Total of all cash sales
5. Value of equipment, furniture, building, and other items
6. The amount of depreciation taken on each item
7. Amount of overhead expenses
8. Ending inventory
9. Amount of taxes due or basis for same

## Sources of Business Information

Some large organizations have their own research departments, library staffs, and testing laboratories to gather and prepare vital information for business managers. On the other hand, small businesses are not able to afford research specialists. However, there are numerous sources of information available to small-business enterprisers. Much of this material is offered at a reasonable price or at no cost at all.

Federal departments, government commissions, and various federal agencies publish studies and bulletins on the operation of small business. The Senate Small Business Committee has held numerous hearings on the subject of small-business problems. Among the special bulletins are those issued by the United States Department of Commerce pertaining to the following:

INDUSTRIAL (SMALL BUSINESS) SERIES

*Establishing and Operating a Metal Working Shop,* No. 16.
*Establishing and Operating a Shoe Repair Business,* No. 17.

*Establishing and Operating Your Own Business,* No. 19.
*Establishing and Operating a Small Sawmill,* No. 20.
*Establishing and Operating a Grocery Store,* No. 21.
*Establishing and Operating a Service Station,* No. 22.
*Establishing and Operating an Automobile Repair Business,* No. 24.
*Establishing and Operating a Beauty Shop,* No. 25.
*Establishing and Operating a Real Estate and Insurance Brokerage Business,* No. 26.
*Establishing and Operating a Painting and Decorating Contracting Business,* No. 27.
*Establishing and Operating an Electrical Appliance and Radio Shop,* No. 28.
*Establishing and Operating an Apparel Store,* No. 32.
*Establishing and Operating a Dry Cleaning Business,* No. 33.
*Establishing and Operating a Laundry,* No. 37.

MISCELLANEOUS SERIES

*Credit Sources for Small Business,* Economic (Small Business) Series, No. 46.
*Distribution Cost Analysis,* Economic (Small Business) Series, No. 50.
*Small Business and Government Regulation,* Economic (Small Business) Series, No. 58.
*Record Keeping for Small Stores,* Senate Committee Print No. 2, 79th Congress, 1st Session.

## State government sources

Several states, including California, New York, Indiana, Michigan, and others, issue various types of reports on banking, commerce, farming, labor, and manufacturing. Much of this is free. For example, two states have shown special interest in small business. California, through the State Department of Education, has prepared a bulletin, *How to Organize and Operate a Small Business.* This is an analysis of the problems of organizing a small concern.

The New York State Department of Commerce has issued a series of 10 booklets pertaining to problems of small business under the following titles:

*Starting Your Own Small Business in New York State*
*Financial Services for a Small Business*
*Picking a Location for a Small Business*
*Insurance for a Small Business*
*Purchasing and Inventory Control for a Small Business*
*Record Keeping for a Small Business*
*Advertising for the Small Business*
*Use and Control of Credit in a Small Business*
*Regulations Affecting the Small Business*
*Publications for a Small Business*

Further listings of useful materials are reviewed in the chapter on statistics and research in business.

## Management for Specialized Business Enterprises

### Restaurant management

Of all the classes of small- and medium-sized enterprises, restaurants are among the most representative and second only to grocery stores and filling stations in number. This has not always been true, however. Though innkeeping has long been an honored and popular occupation, the custom of eating out has become popular only within the last 25 years.

*Growth of Restaurant Business.* As late as 1910 there were only 60,000 restaurants, lunchrooms, and cafés in the United States, all of which, for purposes of this discussion, come under the general classification of restaurants. By 1929, the total number of eating places had more than doubled. Between 1929 and 1939 the total increased again from 134,293 to 169,792. During the same period employment figures for these establishments likewise increased.[4] By the close of 1949 the restaurant business had become a $5,000,000,000 industry, even though the number of establishments had declined to 140,000. This twentieth-century custom of eating out is undoubtedly the reason why the restaurant business is one of the largest in the retail field.

*Types of Restaurants.* There are, of course, many types of restaurants to fit individual tastes and purses. Besides the general type that specializes in table service, there are coffee shops, cafeterias, sandwich shops, waffle shops, tearooms, lunch counters, hamburger stands, and soda fountain lunch counters. Some restaurants are organized to serve customers more quickly than others; with a limited menu it is possible to give quick service. For example, the sandwich shop, waffle shop, lunch counter, or drive-in offers a short-order type of menu, including such items as sandwiches, salads, soup, and pastry. Restaurants of this type are popular with those who want their food served quickly.

Hotel dining rooms, steak houses, and specialty restaurants cater to those who prefer to be more leisurely at mealtime and place less emphasis on quick service. In cafeterias the guests take their trays and help themselves to the food displayed on serving tables. Certain kinds of food are served by attendants as the customer passes by. The advantage of the cafeteria is that the individual can see and select the food. Service is quick. Then, of course, there are tearooms, many of which specialize in dainty foods that are especially appealing to women guests.

[4] U. S. Bureau of the Census, *Statistical Abstract of the United States,* p. 965. Washington: Government Printing Office, 1948.

*Organization.* By far the largest number of restaurants are individually owned. For a restaurant, as for any other establishment, organization of some kind is necessary. The organization of a restaurant is based on five general functions: (1) food purchasing, (2) food preparation, (3) food service, (4) housekeeping, and (5) administration and record keeping for information and control.

In small concerns, the owner must perform several of these. He acts as the buyer, plans the menu, supervises the cooking, and directs the work of the housekeeping activities, which include maintaining a clean and sanitary establishment. Obviously, it is difficult under these conditions for the owner to assume so many different responsibilities and perform them well, but the business may not be large enough to justify hiring individuals for each of these jobs.

In large restaurants the situation is different. A qualified specialist is assigned to each function as his chief responsibility. The manager or owner then has more time for supervision and the improvement of service.

*Factors of Operation.* The restaurant business is highly competitive and extremely sensitive to changing economic conditions. Rising wholesale prices of food cannot always be passed on to consumers by increasing the price of meals. Therefore, the owner needs to follow market conditions closely to buy efficiently. When supplies are limited, prices tend to rise; when the market is oversupplied, prices tend to decline.

In the management of a restaurant, one of the important factors is a knowledge of operating costs for the business. This information can be obtained only by keeping adequate records, which reveal facts about income, expenses, and amount of food purchased. These records should reflect every important operation. In a study of five different types of restaurants, large and small, over a period of one year, George L. Wenzel found that owners are not well informed about operating facts. For instance, one owner estimated he was serving 500 guests daily, whereas investigation showed that only 242 guests were served daily.[5]

Wenzel also found that few managers kept any record of the amount of business each waitress handled. In other instances he reported that managers were not aware of food costs in relation to other operating expenses. According to his studies, the average restaurant should strive

[5] This is one of the many instances reported in the investigation. See Wenzel, George L., *Handbook of Restaurant Costs,* pp. 10-11. Austin, Texas: Texas Restaurant Foundation, 1947.

for a goal of 40 percent spent on food cost, 25 percent for payroll, 5 percent on rent, 15 percent for other expenses, and 15 percent remaining for net profit.[6]

By maintaining records it is possible to effect savings, improve service, and increase sales in this business, the same as in others.

Another important factor is to understand consumer likes and dislikes. Comish tabulated the opinions of 1,500 restaurant guests to determine why customers cease to patronize eating places. The results of his findings were as follows: [7]

| *Reasons* | *Percentage* |
|---|---|
| Poor quality of food | 22.56 |
| High prices | 20.55 |
| Slow service | 19.37 |
| Indifferent service personnel | 9.87 |
| Poor atmosphere and appearance | 7.75 |
| Haughtiness of waitresses | 5.62 |
| Errors and short changing | 3.62 |
| Wrong management policies | 2.81 |
| Misrepresentation of goods | 2.50 |
| Attempted substitution of foods | 2.12 |
| Argumentative attitude | 1.06 |
| Ignorance of foods and menu | .75 |
| Tricky menu pricing | .50 |
| Miscellaneous reasons | .92 |

*Opportunities in the Restaurant Business.* To the person who wants to go in business for himself, the restaurant business offers unlimited possibilities, but previous experience in the business is very important. In addition, one needs to have an interest in foods, the ability to meet people, and a well-rounded background in accounting, advertising, salesmanship, sources of supplies, buying practices, and personnel supervision. It is very important to know the local and state health regulations and laws concerning sanitary requirements.

The volume of profit depends upon sales volume. In a restaurant doing approximately $10,000 annual business, the owner's salary and profit may amount to no more than $130 a month. If the owner's family are employed part time in the business so that they may receive the amount that would otherwise be paid out as wages to others, the family income would be about $240 a month. Under good manage-

[6] *Ibid.*, pp. 7-8.

[7] Comish, Newell H., "Why Customers Quit Patronizing Dining Rooms and Restaurants." *Restaurant Management,* December, 1948, Vol. LXIII, No. 6, pp. 46-48.

ment, a restaurant doing an annual volume of $25,000 should return to the owner salary and profit of approximately $450 a month.

### Real-estate management

The two ways to begin a career in the real-estate business are (1) to become a salesman in a good real-estate firm and work until you learn the business, and (2) to obtain a formal education for a general business career and then specialize in subjects related to real estate, such as banking, finance, salesmanship, insurance, public speaking, and English. In some states, it is necessary to have experience in a firm in order to obtain a license to operate your own establishment.

*Specialized Field.* The real-estate business is composed of a number of specialized fields. The largest specialization is brokerage, experience in which is basic to other specializations. Other areas include property management, building and land development, appraising, and finance. This discussion is confined to the fields of brokerage and property management, which are the two largest and most important phases of the real-estate business. This does not mean, however, that one must start out to become either a broker or a property manager. A common practice is to begin as a real-estate salesman.

*The Real-Estate Broker.* Real-estate transactions are generally made through a real-estate broker. His primary function is to locate a buyer for property owned by someone else. He also serves in helping the owner of real estate locate a tenant or arrange for a property mortgage. For performing any of these functions he is paid a fee, usually a flat fee or an amount based on a percentage of the purchase price. Obviously, the amount of money a broker may earn depends on the number of transactions he handles successfully.

There are about 250,000 real-estate brokers in the United States, not all of them full-time. It has been estimated that about 75 percent of all the business is handled by approximately 100,000 brokers. In the 33 states and the District of Columbia where licenses are required, it is calculated that there is about one broker for every thousand people; in the remaining states there are about two brokers (including salesmen) for every thousand people.

*Work of the Broker.* Real-estate brokerage involves more than serving as a sales agent. The broker handles a variety of technical details incidental to the sale of the property. He may assist in preparing the deed, in checking the tax records, in obtaining signatures, or in handling papers for a loan. The broker must be able to serve as a counselor to his client. A vast amount of real estate is owned by one person and

occupied by another. The owner purchased the property for investment income.

*Qualifications of the Broker.* The personal qualifications are the same as for any businessman who sells a service or commodity, —namely, intelligence, integrity, salesmanship ability, imagination, willingness to do hard work, knowledge, initiative, diplomacy, and sincerity. Legal requirements are now imposed by 33 states and the District of Columbia to obtain a license. A great variety of requirements have been set up by the various states as prerequisites for licenses. Many states require an examination; some place stress on personal recommendations of three citizens. The broker must know his commodity. He is expected to be an expert on values and the utility of property. He is expected to know how to get listings, to obtain prospects, and to close the sale. These are a part of the salesmanship techniques he must have.

*Property Listings.* A client's authorizing a broker to sell, lease, or rent property is known as a listing. The ordinary listing merely appoints the broker to serve as an agent for the expressed purpose of locating a tenant or buyer. There are two kinds of listings, exclusive and open. Each has advantages and disadvantages for both the broker and client.[8]

An exclusive listing is one in which the owner agrees in writing to allow only one broker the exclusive right to offer the property for sale or rent. The length of time during which an exclusive listing is in effect varies according to the type of property and the urgency of the situation. The broker prefers an exclusive listing because he feels certain of a commission if the property is sold. Then, too, he can afford to spend time and money in promoting the transaction, since there are no competing firms to benefit from his advertising. When a broker receives a contract for an exclusive right, he is granted the right to receive a commission on the sale of the property if it is sold by anyone, including the owner.

Under an open listing, which is seldom in writing, it is understood by the broker that other real-estate firms may also have the privilege of soliciting buyers or tenants for the property. The first broker who sells or rents the building receives the commission.

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[8] *The Real Estate Handbook* describes two other types of listing, multiple and option. In the strict sense of the word an option is not a listing. Multiple listing is often used in large cities. Many small brokers prefer not to use it. For a detailed description see: Holmes, Lawrence G., and Jones, Carrie M. (editors), *The Real Estate Handbook*, pp. 34-35. New York: Prentice-Hall, Inc., 1948.

*Property Management.* Property management is a second specialization in the real-estate business. As the name might imply, a property manager is one who administers or directs the supervision of property for the owner. The property manager performs any or all of the following functions:

1. Secures the most desirable tenants at the best possible rate for the landlord.
2. Collects the rent.
3. Keeps proper accounting records.
4. Maintains supervision over physical care of premises.
5. Purchases supplies and equipment necessary for operational maintenance as authorized within the terms of the agreement.

The first responsibility of a manager is to earn and maintain for his client a maximum income from the property. Second, he is expected to see that the property is maintained so that the value will not decrease. The successful property manager recognizes that his responsibility is accomplished by the application of sound management principles and policies. It is important to have a policy on such matters as pricing of space, terms of leases, purchasing of supplies and materials, physical care of building, expenditure of funds to maintain police or building security, and service to tenants. These management policies should be consistent with the type of building, the kind of tenancy, the building location, prevailing rents, type of neighborhood, and prevailing competitive conditions. Since the manager is expected to know more about real estate than the owner, he proposes to the owner such policies as are advantageous to his best interests. At the same time, it is desirable not to overlook the interest of the tenant.

*Opportunities in Real-Estate Brokerage and Management.* The real-estate business is not unlike any other insofar as financial income and business opportunities are concerned. Owners of large brokerage firms are known to make large sums of money. A few brokers made handsome profits by engaging in the promotion of real-estate subdivisions as building sites for new communities. The real-estate business is one that varies with economic conditions. During periods of high prosperity or in areas influenced by boom conditions, the business can be lucrative. Many real-estate brokers and property-management specialists also sell various types of liability and casualty insurance. It is impossible to state accurately what an individual broker or property manager may earn; this depends upon the size of the business, the ability of those in the firm, economic conditions, and many other factors.

## Hotel management

The typical hotel is no longer just a lodging place; it is a business that offers many kinds of personalized services to its guests. These services include food and drink, laundering and dry cleaning, entertainment, arranging for theater tickets, providing secretarial service, and making travel reservations. Hotels, like people, have both character and reputation. Their character is what they are really according to the kind of service rendered; their reputation is what people think of their services.

Although it is true that the chief source of hotel income is renting rooms, a considerable portion of revenue comes from other sources. For example, an analysis of income for a group of twelve hotels, each having less than 300 rooms, shows the following distribution of income:[9]

| | |
|---|---|
| Income from rooms | 50.8% |
| Food and beverage | 31.2 |
| Other departments | 15.7 |
| Sundry sources | 2.3 |
| | 100.0% |

These figures may be surprising, for most people think of a hotel as simply a place to sleep. For the past two decades the trend among hotels has been to provide a wider variety of services, and there is no indication that this trend will change, as long as the public accepts what is offered. At the same time, for many reasons hotel management has become more complex.

*Types of Hotels.* There are about 30,000 hotels in the United States, ranging in size from 40 to 3,000 rooms. About 10 percent of these are classified as residential hotels. These places cater to guests who desire extended residence. Rates are quoted by the week, month, or year. The apartment hotel is a typical example of this type.

About 15 percent of the hotels are resort centers, patronized by those seeking relaxation, recreation, and entertainment. This type is open only during certain seasons of the year.

The commercial hotel is the third type. There are about 22,000 in the United States. This type caters only to transient guests, that is, to those who seek accommodations for a short time, usually from one to five days. Management problems of the commercial hotel differ from those of the resort or residential type. There is greater emphasis

[9] Figures based on a report made by L. L. Purjet, Assistant General Auditor, National Hotel Company, Galveston, Texas, in a lecture delivered at the Texas Hotel Short Course, 1948, University of Houston, Houston, Texas.

on service in the commercial and the resort hotel than in the residential type. Commercial hotels require a larger staff to render the added service.

All three types quote rates on either the American or European plan. The difference in the two plans is that the American plan includes both meals and lodging, whereas rates under the European plan cover only lodging. Some transient hotels offer both plans, but the European plan is more common among commercial hotels.

*How Hotels Are Organized.* The hotel is a departmentalized business. Each department performs a special function and requires especially trained persons. The size of the organization is generally determined by the number of rooms, but in almost every hotel there are at least four departments: (1) front office, (2) housekeeping, (3) engineering and maintenance, and (4) food. The food department is required only if a restaurant or coffee shop is operated by the hotel.

The organization of a hotel may be diagrammed as in Figure 6-3.

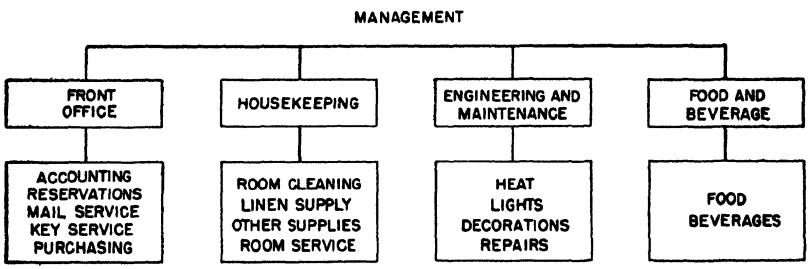


*Figure 6-3. A Departmental Organization Chart for a Hotel.*

*Work of Hotel Manager.* The over-all policies are administered by the manager, whose responsibility it is to provide satisfactory service to guests so that the hotel may operate at a profit. Certain specific duties the manager performs include hiring personnel, determining room rates and credit policies, directing publicity and advertising, and supervising the purchase of supplies and equipment. The position of manager is one that requires a broad experience in the business and the ability to direct others. One very important requirement is the ability to meet people and remember names. Few things please a guest more than being addressed by name even though it has been weeks or months since he last visited the hotel.

A good manager knows how to analyze operating costs. This entails a careful evaluation of expenses. Since room rentals are the most important source of revenue for most hotels, the success of the hotel depends on the percentage of rooms occupied each day. For one group

of 6,000 hotels in the United States, the percentage of hotel occupancy in 1948 was 88 percent. This dispels any notion that all hotels rent every room each night. In 1938 the percentage of occupancy was 55 percent.

## Retailing

Because of the importance of retailing, a full chapter will be devoted to this subject. The fundamental information about small retail stores will be found there.

*Courtesy Pittsburgh Plate Glass Company*

*Figure 6-4. A Modern Hardware Store.*

### Terms for Study

American plan
Capital
Commercial hotel
Committee for Economic Development
Competition
Credit manager
Ethics
European plan
Exclusive listing
Liquidation
Merchandise inventory
Monopoly
Open listing
Personnel supervisor
Property listings
Property management
Rate of stock turnover
Real-estate broker
Referee in bankruptcy
Retailing
Salesmanship
Sales volume
Small business
Tenant

## Questions

1. Why is the single proprietorship a more common form of organization in small business than the other forms of organization?
2. How does the United States Department of Commerce classify small business?
3. Is the degree of risk related to the problem of choosing the form of organization in small business?
4. What characteristics of small business are not found in large enterprises?
5. What is the most common source of capital when organizing a small enterprise?
6. Name the common causes of business failure.
7. Is competition considered a serious cause of business failure?
8. Why is credit important in starting a business?
9. What is meant by the statement, "The foremost problem of small business is management"?
10. What personal and business characteristics should a restaurant owner have?
11. Is there an important relationship in business between risk and profit?
12. During a period of declining market, should the owner endeavor to maintain a high or low stock inventory? Why?
13. What information should accounting records furnish the business owner?
14. Why is the restaurant business considered to be hazardous?
15. Why is it important for the business owner to know the likes and dislikes of his customers?
16. What are the functions performed by the real-estate broker?
17. Explain the difference between an exclusive listing and open listing in real-estate transactions.
18. Why would a multiple-listing plan be used more commonly in large cities than in small ones?
19. Describe the work of the property manager.
20. What is the difference between a commercial hotel and a residential hotel?
21. What are some of the personal services rendered by hotels?

## Problems and Projects

1. Assume you are interested in starting a business of your own after graduation. Make a list of everything you could be doing in preparation for the venture as a means of analyzing your situation. Divide your list according to such topics as *education, finances, interests, personal qualifications,* and *miscellaneous items.*

2. From among the many small businesses in your community, select one with which you are familiar or about which you can obtain data. Make a complete study of the reasons why the business is successful, considering every factor, from the qualifications of the owner to the kind of business represented. Arrange for a conference with the proprietor to obtain authentic facts.

3. Using the facts found by the United States Bureau of the Census, classify the different kinds of business and show the number of each kind.

4. Prepare a complete outline of how you should study a particular type of business to determine if it is one that you would like to organize.

5. Select the two largest restaurants in the community and draw up an organization chart for each on the basis of an interview with the proprietors. Compare the two.

6. Either from a local real-estate broker or from the real-estate department at the state capitol, find out what the requirements are to be licensed by the state and by the city. If neither the state nor the city requires a license, ascertain if the real-estate brokers have a voluntary organization among themselves or have adopted a code of ethics.

7. Frequently there are reports on large and small businesses in issues of *Fortune* magazine. Select a business and analyze its growth. Present your report to the class.

8. The class has voted to explore all possible sources of information during the semester about small business. Committees have been formed to study different phases of the term project. Conduct this project during the semester, gathering all available material about small business for a class library. Committee members are responsible for writing letters to sources of information and making calls for appointments. Prepare a complete report, each committee being responsible for a phase.

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## Chapter VII

# ACCOUNTING IN BUSINESS

The significant role that accounting plays in business operation and its use by business management are presented in the first part of this chapter. This is followed by a discussion of the nature of accounting work, an explanation of the financial reports of a business enterprise, and a presentation of accountancy as a possible business career.

### The Importance of Accounting in Business

Accurate records of business transactions must be maintained in order for a business enterprise to be successful. There must be a complete accounting for all business activities, such as purchases and sales of merchandise; purchase, depreciation, and sale of equipment; receipts and disbursements of cash; and sums due from customers and owed to creditors. The task of keeping these detailed records constitutes the work of the bookkeeper; his is a rather routine task. The accountant's work, on the other hand, is that of summarizing, analyzing, and interpreting these records; his work usually begins where the bookkeeper's ends.

#### Accounting and management

Accounting is frequently termed a tool of management, and this indicates, partially at least, its function in business. As a business enterprise becomes more complex, the need for scientific accounting records becomes proportionately more important and necessary in order to figure the actual costs, expenses, and profit. Competition among businesses and increased taxation of profits by federal, state, and local governments, along with several other contributing factors, have reduced the margin of profit to the point where efficiency is a requisite to survival. Efficient management demands accurate and adequate records. Carelessness and neglect in keeping records and inability to interpret accounting records properly are two hallmarks of incompetence in management.

Accounting deals with the financial records of the business that form the basis of many administrative decisions. It is important that simple,

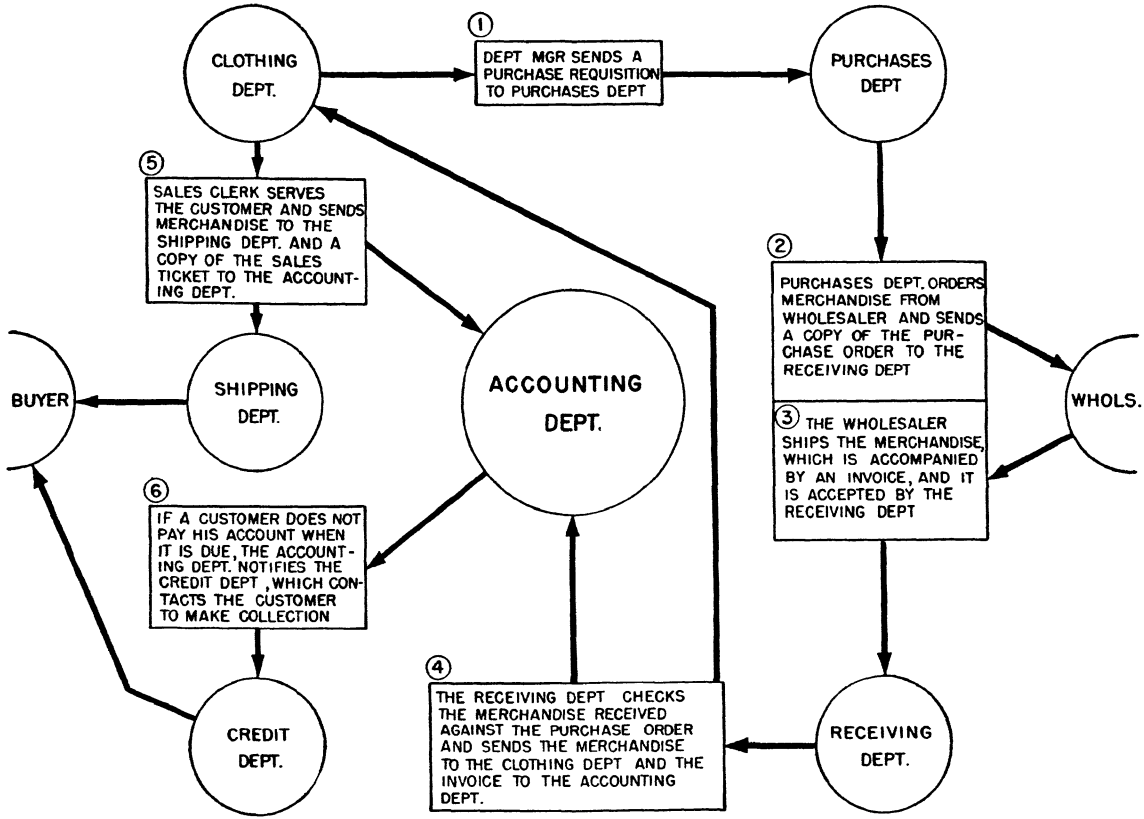



*Figure 7-1. How the Accounting Department Serves Other Departments.*

clear, and informative accounting statements be presented to management in order that management will be able to interpret and use such data to the advantage of the business. In many large organizations the management of branch offices is conducted from the central office through the analysis and interpretation of the financial statements. These statements are the basis of financial decisions by the officers, by the board of directors, and by the owners.

The accounting department is closely associated with the other departments of a business organization, since it is responsible for all the records of each department. For example, the records of all transactions performed by the purchasing department are forwarded to and kept by the accounting department. The merchandise manager, before reorganizing the sales force or modifying sales policy, would consult the chief accountant for records of sales. He would be interested in an analysis showing detailed information about volume of sales by the various salesmen, by products, by departments, and by territories.

The production foreman supplies the accounting department with cost figures. He in turn is dependent upon the accounting department for records pertaining to raw materials. Without proper information about materials and inventories he may find himself faced with either a shortage or a surplus. His problem is an important one, for he is responsible for maintaining a sufficient inventory of materials to keep the factory in operation at all times, and at the same time he must avoid an overinvestment of funds in such inventories.

The work of the credit manager is very definitely integrated with and dependent upon the records of the accounting department. Before merchandise can be sold on credit, the purchasing firm must be endorsed by the credit manager or one of his assistants. The granting of additional credit to a customer is dependent not only upon his financial standing but also upon his record for prompt payments. The credit manager's work in connection with collecting past-due accounts and discontinuing credit extension to certain customers is dependent upon the records kept by the accounting department.

Some of the ways in which the accounting department is dependent upon and of service to certain other departments of a business enterprise are shown in Figure 7-1. In a similar manner the work of the comptroller, the general manager, and the company president is integrated with that of the accounting department.

### Accounting reports serve outside groups

In addition to supplying information for management, the financial statements serve at least three groups outside the business enterprise: creditors, owners, and the government.

*Creditors.* The accounting reports that are normally prepared at the close of the business year are the most reliable source of information pertaining to the financial condition of the business. Should a firm want open-line credit with a bank, its financial statements would be analyzed by the loan department of the bank in considering the advisability of granting such a loan.

How does a creditor measure a business firm's ability to pay what it contracts to pay? The old classification, the three C's of credit, takes on real meaning here. Of the three—character, capacity, and capital—the latter becomes most intimately related to accounting where credit is concerned. Financial reports, of course, may reveal a firm's capacity as well as its capital, but creditors usually place most confidence in the bearing that statements have on a firm's capital. Credit losses are unusually high in cases where adequate accounting data are not available.

Financial statements also serve as the basis for the firm's credit rating with such agencies as Dun & Bradstreet. The investing public—those who buy and sell securities—also depend upon the firm's accounting reports for an evaluation of the desirability of investing in the firm's securities.

*Owners.* The stockholders are interested in knowing the degree to which the business is succeeding. If they are adept at reading and interpreting reports, they can know far more than just the gross or net earnings reported. Prospective purchasers of new issues of stock are also interested in a firm's financial reports.

*Government.* A company's profit as shown by its income-and-expense statement is the basis for income-tax calculations. Governmental regulation of depreciation and obsolescence allowances and of rates permitted utilities and common carriers is also based upon the firm's accounting records.

## The Nature of Accounting Work in Business

There are many single-entry accounting systems in use today, but double-entry systems are more common. The single-entry systems usually consist of a combined cash journal, employing sheets with a great many money columns. The columns of figures are totaled and serve as the source of most of the information needed to prepare the financial

statements. The double-entry system usually employs several types of journals and ledgers. Books of original entry are called *journals,* and the books of final entry are called *ledgers;* the process of transferring information from the journals to the ledgers is known as *posting.* The reason for making entries in both the journal and the ledger is to make it easier to locate errors and to afford a scientific means of auditing the entry of transactions. Figure 7-2 will serve to show the differences in a chronological record, as found in a journal, and a grouping or summarization of all entries pertaining to one account, as recorded in a ledger.

Many of the different types of records kept by the accounting department of a business organization are shown in the accompanying chart.

RECORDS KEPT BY THE ACCOUNTING DEPARTMENT

- Accounting Department Records
  - Books of Original Entry
    - Cash Receipts Journal
    - Cash Payments Journal
    - Sales Journal
    - Purchases Journal
    - General Journal
  - Books of Final Entry
    - General Ledger
    - Accounts Receivable Ledger
    - Accounts Payable Ledger
  - Supplementary Record Books
    - Petty Cash Record
    - Check Register
    - Insurance Register
    - Notes Payable Register
    - Perpetual Merchandise Inventory

The fundamental accounting equation is:

$$\text{Assets} = \text{Capital}$$

*Assets* are all items of value that are owned by the business. Examples of assets are cash, equipment, merchandise, accounts with customers, and notes due from customers. The term *capital* refers to the ownership or proprietorship of the business. If the total assets of a business equal $10,000 and it has no debts, the capital or proprietorship of the business is $10,000.

As a general rule most businesses owe debts to creditors; in accounting, these debts are called *liabilities.* Examples of liabilities are bills

GENERAL JOURNAL — PAGE 40

| DATE 1950 | DESCRIPTION | POST REF | DEBIT AMOUNT | CREDIT AMOUNT |
|---|---|---|---|---|
| July 1 | Cash | 1 | 256 40 | |
| | Sales | 86 | | 256 40 |
| | Sold merchandise for cash | | | |
| 2 | Equipment | 18 | 88 27 | |
| | Cash | 1 | | 88 27 |
| | Paid cash for equipment purchased | | | |

LEDGER

Cash — PAGE 1

| DATE 1950 | | POST. REF. | DEBIT AMOUNT | DATE 1950 | | POST. REF. | CREDIT AMOUNT |
|---|---|---|---|---|---|---|---|
| July 1 | | 40 | 256 40 | July 2 | | 40 | 88 27 |

Equipment — PAGE 18

| DATE 1950 | | POST. REF. | DEBIT AMOUNT | DATE | | POST. REF | CREDIT AMOUNT |
|---|---|---|---|---|---|---|---|
| July 2 | | 40 | 88 27 | | | | |

Sales — PAGE 86

| DATE | | POST REF. | DEBIT AMOUNT | DATE 1950 | | POST. REF. | CREDIT AMOUNT |
|---|---|---|---|---|---|---|---|
| | | | | July 1 | | 40 | 256 40 |

*Figure 7-2. Examples of Journal and Ledger Entries.*

owed for merchandise purchased, notes owed to creditors, mortgages on real property, and, in the case of corporations, bonds that have been floated in order to raise money. When there are liabilities, the fundamental accounting equation becomes:

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

In other words, the capital (net worth) of the business is equal to the difference between the value of the total assets (things owned) and the total of the liabilities (debts owed).

Business transactions might increase or decrease the value of the assets, liabilities, or capital of the business. A business transaction may affect only the assets or only the liabilities, or it may affect both. Another transaction may affect either the assets or the liabilities and the capital.

For example, if the business pays $400 cash for equipment, the asset *equipment* is increased $400 and the asset *cash* is decreased by $400. The liabilities are unchanged and the capital remains the same. On the other hand, if the business pays $400 cash in settlement of a note it owes, the asset *cash* is decreased by $400 and the liability *notes payable* is decreased by $400; the capital is unchanged.

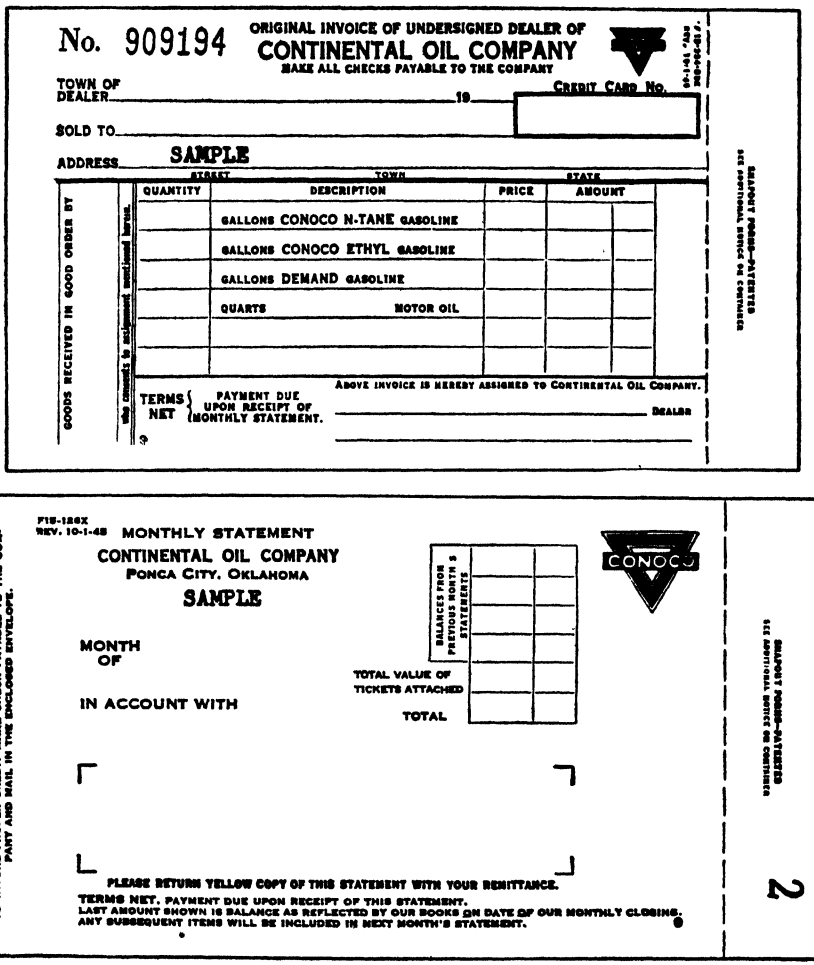
One of the distinct trends in recent years pertaining to the keeping of accounts-receivable records by large businesses is the filing of original sales invoices to replace the formal ledger.

Years ago it was common practice for the small independent merchant to use a wire spindle on which he filed the sales tickets of the few customers to whom he extended credit. When the customer came in to pay his account, the merchant took from the spindle the sales tickets representing sales to that customer and added them up to determine the total amount due. After the customer had paid his bill, the merchant would give him these sales invoices, which were the only record he had of the amount owed him by the customer.

In a modified form this same principle is now being used by large department stores, oil companies, and other retail establishments. Retail-store customers receive the sales slip at the time of purchase; this handing of the sales slip to the customer makes him legally liable for payment of the charge. Since he is not a business organization, he cannot be expected to keep the sales slip and pay the amount due at a designated time. Therefore, the store keeps the record for him and, at the end of a month or a cycle billing period, sends him a statement of his account, which includes all of the charges for the period, credits

for merchandise returned, credits to his account because of cash payments, and his new balance.

This can be illustrated by a description of the methods used by the Continental Oil Company of Ponca City, Oklahoma. When deliveries are made on a credit basis to holders of their credit cards, three copies of the invoice are prepared. The customer receives the second carbon copy at the time of purchase; the original (white) and the first carbon copy (yellow) are transmitted to the headquarters office and placed in the customer's folder. This makes unnecessary both the making of journal and ledger entries and the periodic preparation of formal statements of account.




*Courtesy Continental Oil Company*

*Figure 7-3. Invoice Used When Purchase Is Made, and Statement of Account.*

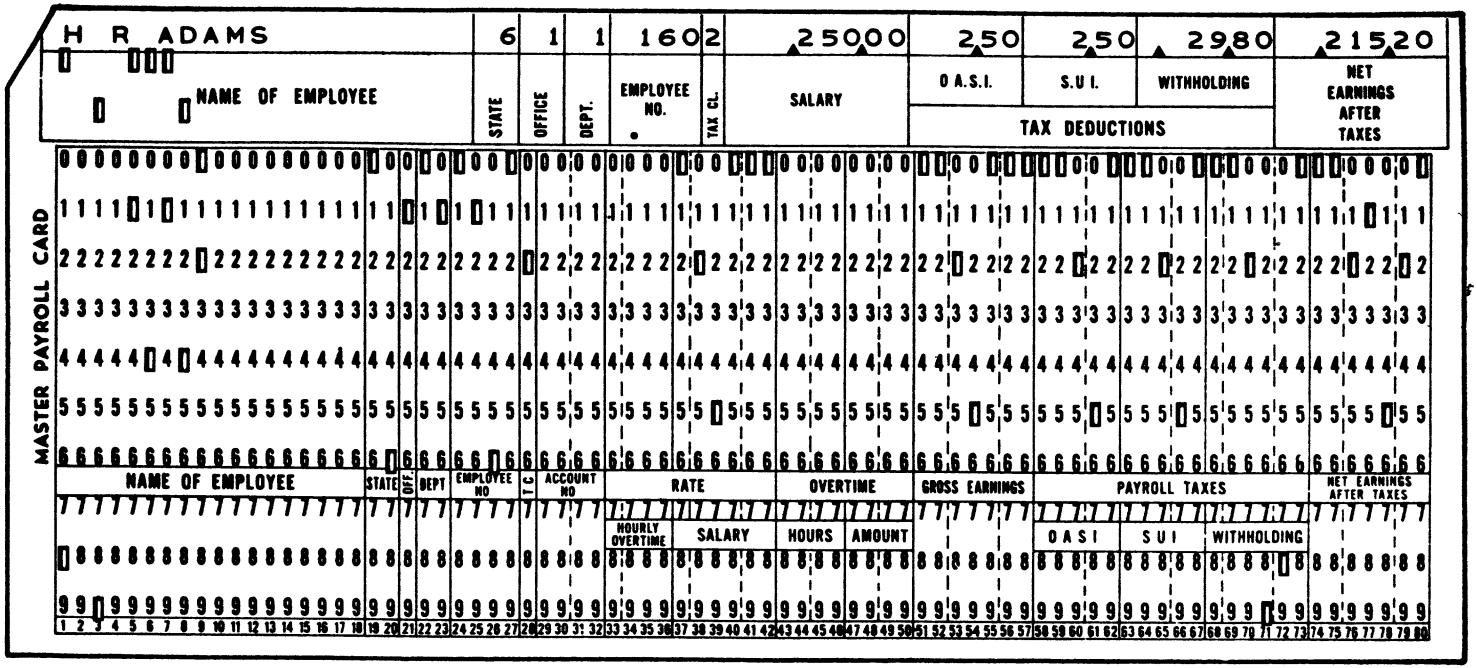
At the end of the month or cycle billing period, the total value of invoices received during the accounting period is determined and entered upon the statement, which is sent to the customer; the original (white) copies of the invoices are attached to support this total. This abbreviated statement shows the old account balances, credits for cash payments, and the new balance due. Most firms stagger this billing so that the clerical work involved is not concentrated at the end of the month.

*Courtesy Remington Rand Inc.*

*Figure 7-4. The Kolect-A-Matic System.* This simplified invoice accounting plan was devised by the Systems Division of Remington Rand Inc.

Manufacturers and wholesalers use similar techniques but the mechanics are slightly different, because their customers, in order to take advantage of discount terms, usually remit by invoice rather than at the end of each month. Statements are sometimes used, but they are usually open-item statements. Differently colored tabs and guides are used to indicate the aging of accounts; these are particularly valuable to the credit and collection divisions of the companies.

Modern, up-to-date filing and housing systems have been devised by office-equipment companies to facilitate this method of keeping records.




*Courtesy International Business Machines Corporation*

*Figure 7-5.* The punch card serves as the basis for accounting work done by sorting and tabulating machines.

## Machine accounting

The development of sorting, tabulating, and accounting machines by such firms as the International Business Machines Corporation and Remington Rand Inc., has also made a definite contribution to accounting. The basic instrument is the punch card. Information is taken from the original document and transferred to the card by punching holes in the proper positions on the card. There is more than one type of card, and the various headings printed upon it would vary with the type of business and the use to be made of the data to be placed upon the card. A sample card is shown in Figure 7-5.

The second basic machine is called the card-sorting machine. Before the cards can be used for the preparation of any report, they must be organized properly for the purpose of that report. The sorting machine is used for this purpose; it can be wired so that it will do the particular grouping and classifying desired.

The third basic machine is the accounting machine. An accounting machine will list and classify information, perform addition and subtraction operations, and print the totals and balances. This particular machine will also print names and addresses or other alphabetic data that have been punched into the cards. The "brains" of the machine is an electrically wired panel that can be arranged in many different ways, giving the machine a high degree of versatility.

Through the use of sorting and accounting machines many records may be kept and reports prepared in but a fraction of the time formerly required when all this work was done by hand. The maintenance of subsidiary ledgers and the preparation of payrolls, even to the writing of the payroll checks, are examples of what these machines will do. The amount of an employee's earnings and the amounts to be deducted for social security, retirement, sickness benefits, and income taxes are all calculated by the machine.

The machines of the International Business Machines Corporation are leased rather than sold to users. The cost of maintenance and service of the machines is included in the lease price.

An accountant installs and supervises systems of accounting records. He periodically checks the records and reports for the purpose of verifying their accuracy and validity. He must record, analyze, classify, verify, and interpret business transactions. He counts cash funds, checks inventories, and verifies securities. For management and ownership he prepares and interprets statements showing the financial condition of the business and the results of business operations.

The accountant serves as consultant in regard to many types of tax problems: franchise, social security, sales, income, and property taxes. He determines production costs and prepares statistical reports that relate to financial operations. Governmental organizations and agencies employ accountants for budgetary-control supervision and for audits.

## Financial Statements

From a managerial point of view, record-keeping departments are justified not only because they keep routine financial data recorded and classified systematically but also because they provide basic sources of financial information that is indispensable to intelligent and profitable managerial decisions. This vital financial information usually takes the form of financial statements.

### The balance sheet

One of the most common reports, and one that is vitally important to management, creditors, and so forth, is the balance sheet. It is a statement of the financial condition of the business as of a specific date; the completion of an additional day's transactions might result in significant changes in this report. It is similar to the report of a physician on the physical condition of a patient, whose health might be entirely different a day or month later.

The balance sheet consists of three main divisions of real accounts:

1. *Assets*—things of value owned by the business.
2. *Liabilities*—debts owed to creditors.
3. *Proprietorship*—the owners' equity in the firm.

Usually each of these three main divisions is broken down into several subdivisions, as illustrated by the balance sheet shown on page 161.

*Current Assets.* Current assets include cash, accounts receivable, and all other assets that will be converted into cash, through the normal operations of the business, within a short period of time. Merchandise on hand, for example, is a current asset because it was bought for sale and will soon be converted into cash. Accounts and notes owed to the firm will soon be collected and are also current assets.

*Fixed Assets.* The term *fixed assets* is used to identify such items as buildings, equipment, and other things of value that are required to operate the business but that normally are not offered for sale by the firm. They will not be turned into cash within a short period of time; in fact, they may never be sold for cash. Funds of the business are tied up in these assets, which are therefore called fixed-

R. A. SIMPSON

Balance Sheet—July 31, 19—

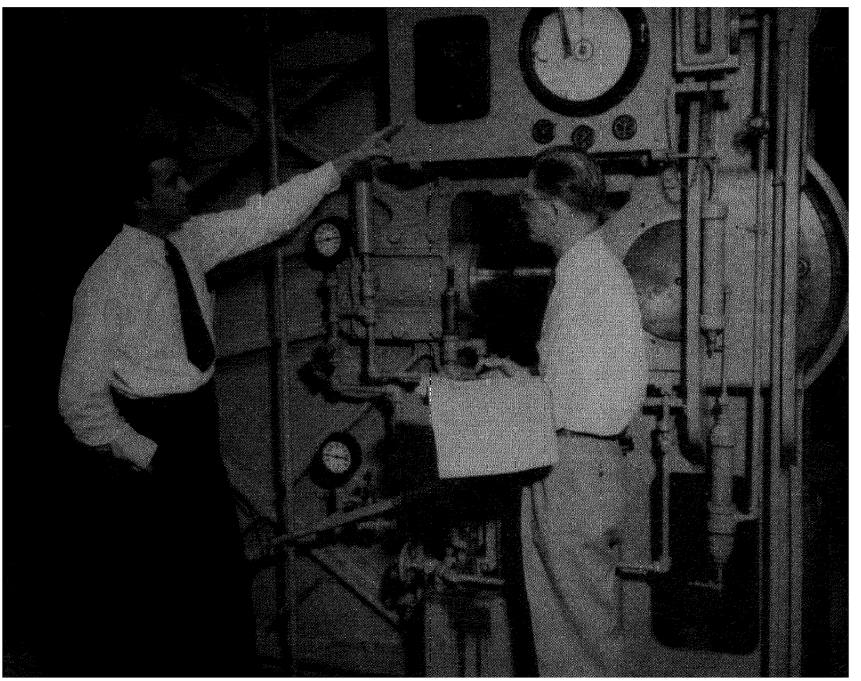
ASSETS

| | | | |
|---|---|---|---|
| *Current Assets.* | | | |
| Cash | | $ 5,000 | |
| Accounts Receivable | $ 6,500 | | |
| Less Reserve for Bad Debts | 460 | 6,040 | |
| Notes Receivable | | 950 | |
| Accrued Interest Receivable | | 10 | |
| Merchandise Inventory | | 32,325 | |
| Total Current Assets | | | $ 44,325 |
| *Fixed Assets:* | | | |
| Equipment | $ 4,600 | | |
| Less Reserve for Depreciation | 1,100 | $ 3,500 | |
| Buildings | $42,000 | | |
| Less Reserve for Depreciation | 17,000 | 25,000 | |
| Land | | 3,800 | |
| Total Fixed Assets | | | 32,300 |
| *Deferred Charges to Expense:* | | | |
| Supplies Inventory | | $ 500 | |
| Prepaid Insurance | | 1,600 | |
| Prepaid Interest | | 45 | |
| Total Deferred Charges to Expense | | | 2,145 |
| *Investments:* | | | |
| Bonds of Y Corporation | | | 4,000 |
| Total Assets | | | $82,770 |

LIABILITIES AND OWNERSHIP

| | | | |
|---|---|---|---|
| *Current Liabilities:* | | | |
| Accounts Payable | | $ 8,000 | |
| Notes Payable | | 1,200 | |
| Accrued Interest Payable | | 68 | |
| Accrued Salaries Payable | | 900 | |
| Accrued Utilities Payable | | 42 | |
| Total Current Liabilities | | | $10,210 |
| *Fixed Liabilities:* | | | |
| Mortgage Payable | | | 11,000 |
| *Deferred Credits to Income:* | | | |
| Prereceived Interest | | | 18 |
| Total Liabilities | | | $21,228 |
| *Proprietorship:* | | | |
| R. A. Simpson, Capital (Jan. 1, 19—) | | $46,890 | |
| Net Profit (6 months) | | 14,652 | |
| R. A. Simpson, Capital (June 30, 19—) | | | 61,542 |
| Total Liabilities and Capital | | | $82,770 |

These fixed assets decrease in value through use and the passage of time; this decrease in value is usually called depreciation. Since it may be desirable to show fixed assets on the books at their cost value as well as at their present value, the amount of the depreciation recorded each year may be kept separate from the purchase price of the asset. These amounts are accumulated in accounts known as depreciation reserves. The book value of an asset is determined by subtracting the balance in the depreciation-reserve account from the balance in the fixed-asset account.



*Courtesy Armstrong Cork Company*

*Figure 7-6.* One important phase of accountancy—the value of factory equipment—involves conferences between property accountants and engineers.

*Deferred Charges to Expense.* This term is used to describe accounts that are assets at the time the balance sheet is prepared but that will become expenses within a short period of time. Such items as office and janitorial supplies are examples of deferred charges to expense. They are assets at the time the balance sheet is prepared *because they have value* and could be sold for cash. They will become expenses within a relatively short period of time because they will soon be consumed.

Another example of a deferred charge is that of prepaid expenses, such as insurance or interest. Insurance firms offer a saving of one-sixth the cost of insurance if it is bought and paid for in advance for a three-year period and a saving of one-fifth its cost if purchased for a five-year period. In order to take advantage of these savings, most firms buy their insurance for a period of three or five years. Insurance premiums are always paid in advance. At the end of one year only one-third of the amount paid for insurance, in the case of a three-year policy, is actually an expense of that year, and two-thirds should be charged against future periods. The amount that is prepaid is an asset to the business. It is called a deferred charge to expense because as it expires in future periods it will be charged as an expense.

*Investments.* Sometimes a business has excess cash on hand that is not needed for the operation of the business or for capital assets. Instead of lying idle, these funds might be invested in stocks or bonds of municipalities or corporations. Ordinarily proprietorships and partnerships do not have money to invest in other businesses, but corporations frequently do, not because of any inherent differences in the type of business but as a result of size.

*Liabilities.* The debts of the business are called liabilities and represent the amount owed the creditors of the business. The term *current liabilities* is similar to *current assets* and refers to debts that will require payment within a short time. *Fixed liabilities* are those that will remain as debts of the firm for a relatively long time, usually longer than one year; mortgages and bonds are examples. *Deferred credits to income* are in a sense similar to deferred charges to expense, the chief difference being that they are debts rather than assets. They represent amounts that have been received in advance of being earned. Since they have not been earned, they are for the present liabilities; with the passage of time they will be earned and will become income. Items that show as deferred credits to income in one firm's records will be carried as deferred charges to expense in the accounting records of a customer of that firm.

*Proprietorship. Proprietorship* is synonymous with *ownership* or *net worth.* The proprietorship is the owners' equity in the business and is equal to the difference between assets owned and debts owed. In the case of a single owner and in the case of partnerships, the amounts of the owners' investments and withdrawals are shown in each owner's account. The amount of the profit earned during a period of six months or a year is added to the amount of the owners' investments. However, in the case of a corporation, the amount of the ownership is

shown as capital stock and the amount of profits earned is carried in one or more surplus accounts.

### Income-and-expense statement

A second quite common and valuable report is the income-and-expense statement. This is sometimes referred to as the profit-and-loss statement or the operating statement. It is a detailed statement of the results of the operations for a period of time and shows:

1. the amount of income earned during that period;
2. the cost of merchandise sold;
3. the amount of the expenses; and
4. the amount of the profit or loss for the period.

Each of these main divisions is usually broken down into several subdivisions, as illustrated by the income-and-expense statement shown on page 165.

Someone has aptly drawn this parallel between a balance sheet and a profit-and-loss statement: A balance sheet represents a photograph of the financial condition of the business. On the other hand, the profit-and-loss statement is similar to a motion picture showing how changes in value took place during the period.

*Income.* In a retail selling business most of the income earned results from the sale of merchandise. This income is reported in the first section of the statement. Miscellaneous incomes are usually reported toward the end of the statement.

*Cost of Goods Sold.* When all the merchandise that has been purchased during a given year is sold during that year, the amount of the purchases is the same as the cost of goods sold. This is seldom the case, however, so the amount of the cost of goods sold must be calculated. The formula for making this calculation is:

$$\text{Beginning Inventory} + \text{Purchases} - \text{Ending Inventory} = \text{Cost of Merchandise Sold}$$

When separate accounts are kept for freight on merchandise received and for purchases returned, the amount of the purchases must be adjusted by these amounts before it is added to the beginning inventory. This is clearly illustrated in the statement shown on page 165.

*Profit.* Gross profit is the difference between the selling price and the cost price of the merchandise sold. This figure is determined by subtracting the cost of goods sold from the income from sales. Net profit is the difference between gross profit and total operating expenses. It is usually referred to as *net profit from operations* and is ad-

R. A. SIMPSON

Statement of Income and Expenses—Jan. 1, 19—, to June 30, 19—

| | | | |
|---|---|---|---|
| *Income from Sales:* | | | |
| Gross Sales | | $125,600 | |
| Less Sales Returns and Allowances | | 1,000 | |
| Net Income from Sales | | | $124,600 |
| *Cost of Goods Sold:* | | | |
| Mdse. Inventory (Jan. 1, 19—) | | $ 45,680 | |
| Purchases | $60,495 | | |
| Less Pur. Ret. and Allowances | 630 | | |
| Net Purchases | $59,865 | | |
| Plus Freight In | 980 | | |
| Total Purchases | | 60,845 | |
| Total Mdse. Available for Sale | | $106,525 | |
| Mdse. Inventory (June 30, 19—) | | 32,325 | |
| Cost of Goods Sold | | | 74,200 |
| Gross Profit on Sales | | | $ 50,400 |
| *Operating Expenses:* | | | |
| *Administrative Expenses:* | | | |
| Salaries | $15,655 | | |
| Bad Debts | 313 | | |
| Depreciation on Building | 1,050 | | |
| Depreciation of Equipment | 220 | | |
| Expired Insurance | 630 | | |
| Supplies Used | 660 | | |
| Utilities | 80 | | |
| Miscellaneous General | 910 | | |
| Total Administrative Expenses | | $ 19,518 | |
| *Selling Expenses:* | | | |
| Salesmen's Salaries and Commissions | $12,780 | | |
| Advertising | 2,500 | | |
| Miscellaneous | 1,200 | | |
| Total Selling Expense | | 16,480 | |
| Total Operating Expenses | | | 35,998 |
| *Net Profit from Operations* | | | $ 14,402 |
| *Financial Income:* | | | |
| Interest | | $ 190 | |
| Purchases Discount | | 610 | |
| Total Financial Income | | | 800 |
| *Gross Income* | | | $ 15,202 |
| *Financial Expense:* | | | |
| Interest | | $ 550 | |
| Total Financial Expense | | | 550 |
| *Net Profit* | | | $ 14,652 |

justed by the amounts of financial income and expenses to produce the final net profit.

### Preparation and interpretation of reports

In a small business financial statements are prepared by the bookkeeper and interpreted by the owner. In a large business, however, these statements are prepared by accountants and interpreted by the chief accountant and the administrative officers. To aid in the interpretation of financial statements, several ratios are usually calculated.

*Current Ratio.* One of the most commonly used is the current ratio. It is found by dividing the amount of current assets by the total of current liabilities. The current ratio is a measure of the solvency of the business and is considered an indication of the ability of the firm to pay its debts. What constitutes a desirable current ratio is dependent upon the nature and type of business. In a business where the turnover of merchandise is slow (e.g., a jewelry store) there will be a greater need for cash and a large current ratio than in a business where the turnover is rapid (e.g., a supermarket). It is obvious that this ratio would not be the same for two types of businesses as dissimilar as a department store and a public utility. In the balance sheet of R. A. Simpson shown on page 161 the current ratio is:

$$\frac{\$44{,}325}{\$10{,}210} = \frac{4.3}{1}$$

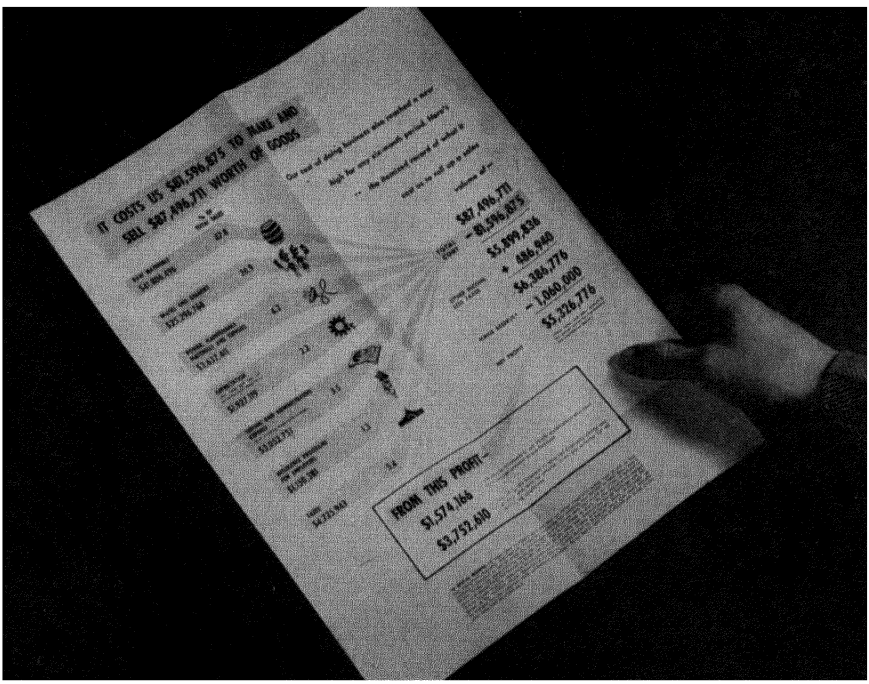
*Working Capital.* Working capital is closely related to the current ratio; it is the same information stated in terms of dollars rather than as a ratio. It is the excess (in dollars) of current assets over current liabilities. The working capital is indicative of the ability of a firm to meet its operating expenses and purchase additional merchandise that is needed for resale. The maintenance of a satisfactory working-capital balance relieves much of the pressure on regular business operations. In addition, it affords a business the opportunity to take advantage of attractive buying propositions that might be impossible if sufficient capital were not available. The working capital of R. A. Simpson is $34,115 ($44,325 − $10,210).

*Acid-Test Ratio.* A slight modification of the current ratio is the acid-test ratio, which is found by dividing the sum of cash and current receivables by the amount of current liabilities. It indicates a firm's ability to meet its current debts on short notice. This ratio should be at least 1 to 1. From the balance sheet of R. A. Simpson we get:

$$\frac{\$11{,}990}{\$10{,}210} = \frac{1.2}{1}$$

*Inventory Turnover.* It is usually undesirable to have large sums of money invested in merchandise. The efficient merchandise manager studies the inventories to find merchandise that is not moving and makes special plans for selling it. The usual method of determining merchandise turnover is to divide the inventory into the cost price of the merchandise sold; it is customary to use the average inventory for this calculation. Reference to the income-and-expense statement for R. A. Simpson shows that his inventory-turnover ratio is 1.9. The average inventory is $\$39{,}002\left(\frac{45{,}680 + 32{,}325}{2}\right)$. Dividing this into the cost of goods sold ($74,200) gives 1.9.

Other ratios with which students of accounting become familiar are: ratio of current to fixed assets, ratio of net profit to sales, and ratio of inventory to accounts and notes receivable.[1]




*Courtesy Armstrong Cork Company*

*Figure 7-7. Employees' Financial Statement.* Reports are frequently prepared for special uses. This one is designed to show employees how much it costs to make and sell goods. Such reports may also be prepared for stockholders.

[1] For a detailed treatment of ratios used in accounting, see Finney, H. A., *Principles of Accounting: Introductory,* 3rd ed., Chapter 30, pp. 456-481. New York: Prentice-Hall, Inc., 1948.

## Accountancy as a Career

Every business student should study some accounting. A knowledge of accounting is of great value in understanding the financial condition and financial operation of any business. In addition, a mastery of the basic principles of accounting will aid the student in his study of economics, finance, and business management. As one advances to semiexecutive and executive positions in business he will find many opportunities to use his knowledge of accounting principles and applications.

### Fields of accounting

Accounting practice can be divided into three areas: private, public, and governmental. In private business the accountant usually starts as a junior accountant or clerk. In proprietorships, partnerships, corporations, schools, and hospitals, accountants may serve as business managers, financial managers, comptrollers, treasurers, auditors, cost analysts, credit managers, and tax specialists.

The public accountant offers his services to the general public for short periods of time for the purpose of installing accounting systems, preparing income-tax returns, or auditing accounting records. The public accountant is truly a professional man.

The accountant in governmental service is usually employed through a Civil Service Commission or State Merit System examination and is assigned to some governmental agency or bureau. Governmental employment offers jobs as accountants, cost analysts, auditors, and income-tax specialists. The classifications for these jobs in the employ of the federal government are GS 7 to 18. The pay for these classifications ranges from $3,825 as the beginning salary for GS 7 to $14,000 as the maximum available under GS 18.

### Specialization in accounting

In addition to the three main fields of accounting there are more highly specialized areas. Specialization in accounting, just as in any other field, enables one to earn higher salaries, on the average, than those earned by the general practitioner. It is possible to specialize in accounting in several important fields, namely:

1. System installation
2. Cost accounting
3. Governmental accounting
4. Research
5. Teaching
6. Budgetary control
7. Auditing (manufacturing, retailing, institutions, government)
8. Taxation (income, estate, social security, sales, property)

Probably the last three fields listed offer the greatest opportunities for the present and the immediate future.

The three main fields of accounting described on page 168 are summarized in the following chart.

FIELDS OF ACCOUNTING

| | | | | |
|---|---|---|---|---|
| ACCOUNTING | Private | Accountant<br>Chief Accountant<br>Cost Accountant<br>Business Manager<br>Cashier<br>Treasurer<br>Comptroller<br>Auditor<br>Budget Officer<br>Tax Specialist | | *Serving:*<br>Proprietorships<br>Corporations<br>Institutions |
| | Public | Accountant<br>Analyst<br>Specialist<br>Auditor<br>Tax Specialist<br>Statistical<br>System Installation | | *Serving:*<br>Proprietorships<br>Partnerships<br>Corporations<br>Municipalities |
| | Governmental | Federal<br>State<br>City | Under<br>Civil<br>Service | Statistician<br>Junior Accountant<br>Senior Accountant<br>Comptroller<br>Tax Specialist<br>Treasurer<br>Auditor |

## Employment and promotional opportunities

Accountancy offers opportunities for employment immediately upon graduation from college; for those who possess desirable executive qualities, it serves as an excellent steppingstone to executive positions. Accounting positions are generally found in all areas of the country and the person who succeeds in this type of work, if he has broad training and experience, can receive promotions within the accounting department or by transferring to other departments of the business organization. Some of the positions toward which experience in accounting leads are: chief accountant, cost accountant, company auditor, tax

consultant, treasurer, and comptroller. Positions outside the accounting department to which accountants might advance are: cashier, purchasing agent, sales analyst, budget officer, office manager, credit manager, vice-president, and president. Most business organizations prefer to start young men and women who have had accounting training as assistants to experienced or senior accountants, and to advance them according to their ability and their value to the company. The promotion opportunities are summarized in Figure 7-8.

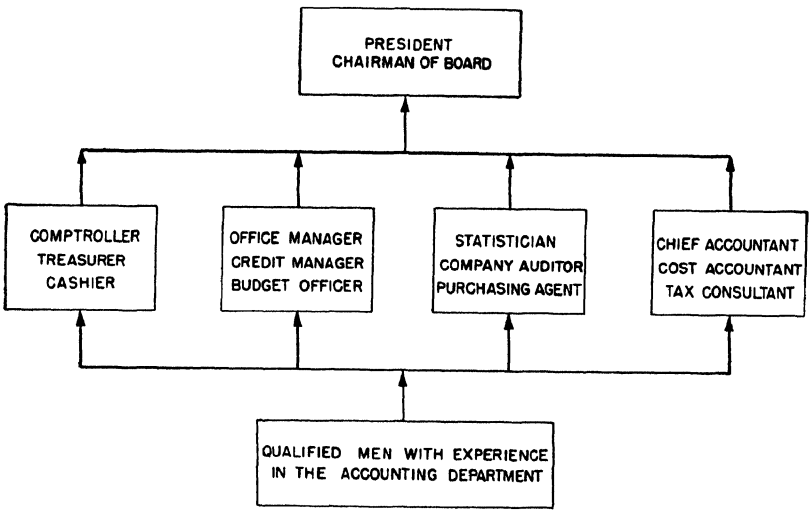



*Figure 7-8. Promotion Opportunities for Accountants.*

## Personal qualifications and preparation necessary for success

The prospective accountant should be one who likes to work with details, who likes to study mathematical records, and who has a knack for comparing names and numbers quickly and accurately. Inasmuch as some office workers resent having their work interrupted by an auditor, it is necessary for the public accountant to have a pleasing personality and to possess tact in dealing with the client and his employees. The ability to use good English is considered essential for preparing the final written reports. The accountant must be physically able to work long and irregular hours without becoming nervous; he must possess good health and especially good eyesight. Since the accountant works with the intimate facts of the business, he must possess a high degree of personal integrity and must be able to treat confidential information as such.

Most colleges of business administration offer a sufficient number of

advanced courses in accounting to enable the student to devote a large percentage of his entire study program to the accounting field. In order to major in accounting and to prepare for the C.P.A. examination, one must study one or two accounting courses each semester, or quarter, after taking elementary accounting. For this reason it is desirable for the student to begin his study of accounting as early as possible. Specialized courses include accounting systems, cost accounting, corporation accounting, auditing, income taxation, petroleum or mine accounting, governmental accounting, and C.P.A. problems.

The prospective accountant will need a knowledge of business law, especially that which pertains to contracts and negotiable instruments. He would also do well to take several courses in economics, management, finance, business mathematics, and statistics. In addition, practical experience is invaluable for seasoning the young person trained for accounting work.

The Certified Public Accountant is among the top group of his profession. This title means that the holder has met certain requirements for education and experience, and that he has passed a state proficiency examination. Requirements vary in different states, but in general a candidate must meet the following qualifications: [2]

1. He must be a United States citizen.
2. He must be at least twenty-one years of age.
3. He must sit for and pass the C.P.A. examination given in the state in which he wishes to be certified.
4. He must have practical experience in the field of accounting.[3] (Usually three years of experience is required.)
5. He must be a high-school graduate and, in some states, must be a graduate of some recognized college of business administration.

There is relative uniformity in the examinations given, since most states use those prepared by the American Institute of Accountants.[4] The candidate is examined in business law, auditing, accounting

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[2] The Vocational Division, Business Education Service, United States Office of Education, publishes a mimeographed pamphlet entitled *Requirements for the CPA Certificate,* which lists the names and addresses of the secretaries of the Boards of Accountancy for the various states and territories.

[3] One may sit for the examination without having had the required experience. If he successfully passes the examination, certification will be withheld until he fulfills this requirement.

[4] Only exceptions in 1948 were Maryland, Pennsylvania, and Wisconsin. Jasko, William J., "C.P.A. Requirements and Examinations." *Collegiate News and Views.* December, 1948, Vol. II, No. 2, p. 3.

theory, and accounting practice. It is not necessary to have a C.P.A. certificate to practice private accounting, but without it one cannot practice as a public accountant and certify accounting statements.

## Terms for Study

Account
Account balance
Accounting ratio
Assets
Balance sheet
Bank reconciliation
Business transaction
Certified Public Accountant
Debit
Fiscal period
Goodwill
Income
Intangible asset
Journal
Ledger
Liabilities
Posting
Prove cash
Registered accountant
Reserve
Surplus
Trial balance
Turnover
Valuation reserve
Working capital
Work sheet

## Questions

1. Why is the accounting department of a business enterprise important to business management?
2. Give an example to show how the work of the accounting department is integrated with the work of other departments.
3. What groups outside the business organization are interested in the information shown in the financial reports prepared by the accounting department?
4. What are some of the different types of work done by accountants?
5. What three general types of records are kept by the accounting department?
6. What information is shown on the balance sheet and the income-and-expense statement? In what ways do these two statements differ from each other?
7. What is the formula for determining the cost of merchandise sold?
8. What is the relationship between the current ratio and working capital?
9. What are some of the advantages of machine accounting methods?
10. Into what fields may accounting practice be classified?
11. What are the opportunities for specialization in accountancy?
12. Of what value to a practicing accountant is the title "C.P.A."?
13. What are the promotion opportunities in business for one who is experienced in accounting work?
14. What personal characteristics are desirable for one who desires to specialize in accounting work?
15. How can government agencies profitably use accounting information?
16. Explain the meaning of the term *tax accountant.*

## Problems and Projects

1. From a current issue of a magazine or daily newspaper, clip three accounting reports that you think might have been prepared by an accountant. Prepare a statement on each, indicating what you believe the accountant is attempting to explain in the report.

2. What beginning salary might one expect to earn if he accepts a position with a public accounting firm in the locality in which you live? What might one expect to earn in the same community after five years of accounting experience?

3. If the value of the total assets of a business is $24,600 and the equity of the owners is $17,450, what amount is owed to the creditors?

4. Using the following data, prepare an income-and-expense statement covering the past six months of operations for the Gilchrist Magnet Company. Assume that there is no merchandise on hand at either the beginning or the end of the six-month period; in other words, the cost of goods sold will be the amount of merchandise purchased. Use the current date.

Income from sales, $194,000; Merchandise purchased, $118,000; Salaries and wages, $20,000; Administrative expense, $13,460; Selling expense, $18,720; Fuel and power, $5,750; Depreciation on equipment, $1,500; Supplies used, $680; Miscellaneous expense, $3,490.

5. Using the following information, prepare a statement of assets, liabilities, and ownership for the Gilchrist Magnet Company. Use the current date.

Cash on hand, $60,480; Buildings, $80,000; Present value of equipment $20,000; Accounts due the firm, $18,420; Notes due the firm, $1,100; Merchandise on hand, $38,900; Insurance paid in advance, $1,200; Notes owed by the firm, $12,800; Mortgage owed on the building, $47,200; Proprietorship of Mr. Gilchrist, $160,100.

6. Secure and examine a recent "Annual Report to the Stockholders" of some corporation. What different items are discussed in it? Does the balance sheet appear to be simple and clear enough that a stockholder who has had little or no accounting training can understand it? Does the report explain what was done with the profits made during the year?

7. Examine the "Rules of Professional Conduct" for members of the American Institute of Accountants. (The Institute, 13 East 41st Street, New York 17, N. Y., has a printed pamphlet containing these rules.) Do these rules seem to you to indicate that the members of the Institute constitute a truly professional group? Which seems to you to be the most forceful statement in the rules?

8. Determine the C.P.A. requirements for the state in which your home is located and for the state in which you are attending school, or the state in which you wish to live when graduated. What are the differences between these requirements? When and where are the examinations given in these states?

9. Secure a copy of the printed financial statement of one of the banks in your city. What is the ratio of quick assets to current liabilities? Do you think that the figure shown there for the value of the furniture and fixtures is approximately their true value or a greatly depreciated one? If the latter, what is the justification for this practice? Prepare a trial balance for the bank from the data supplied on the financial statement.

## Selected Readings

American Institute of Accountants, *Public Accounting As a Career.* New York: The Institute, 1945.

Byrnes, Thomas, and Baker, K. L., *Do You Want to Become an Accountant?* New York: Frederick A. Stokes Company, 1940.

Finney, H. A., *Principles of Accounting: Introductory,* 3rd ed., Chapters 1 and 30. New York: Prentice-Hall, Inc., 1948.

Jackson, J. Hugh. *Accounting Principles,* Chapters 1-3. Los Angeles: Charles R. Hadley Company, 1945.

Kennedy, D. D., Esterly, G. R., and Von Minden, W. J., *Introductory Accounting,* Chapters 1-3 and 6-8. New York: Ronald Press Company, 1942.

Noble, Howard S., *Accounting Principles,* 5th ed., Chapters 1-4. Cincinnati: South-Western Publishing Company, 1949.

Paton, William A. (editor), *Accountants' Handbook,* 3rd ed. New York: Ronald Press Company, 1943.

Scudder, Lawrence, *Accountancy as a Career.* New York: Funk and Wagnalls Company, 1939.

CHAPTER VIII

# STATISTICS AND RESEARCH IN BUSINESS

MOST JOBS IN BUSINESS require at least a slight acquaintance with statistics. To read and interpret articles in such periodicals as *Time, Business Week,* and *Nation's Business,* one must know how to interpret charts, graphs, and statistical maps. This chapter shows the importance of statistics to business operation and business management. The various methods of measurement commonly used in business and graphical methods of presenting statistical data are discussed and illustrated. The chapter concludes with a section on statistics as a career.

## Significance of Statistics and Research in Business

Business executives are constantly dealing with problems pertaining to prices of raw materials, costs of labor, overhead, sales volume, and advertising expenses. They cannot rely upon guesswork; their decisions must be based upon facts. These facts must be gathered and organized in such a way that they may be correctly interpreted by those responsible for the various phases of business operations. The science of gathering, measuring, and analyzing data stated in terms of numbers is known as statistics; it is frequently referred to as being a tool of management.

Accounting deals exclusively with facts that are stated in terms of dollars and pertain to business transactions. Accounting records may be the source of some of the data which are treated in a statistical manner for the use of business management. However, much of the information measured and analyzed numerically for business purposes is not reported in dollars, nor does it always pertain to business transactions. In other words, statistical data cover a much broader area than accounting data.

As an example, let us consider one of the problems of management, choosing a desirable location. Some types of retail business, particularly those that deal with nonspecialty and relatively inexpensive consumer items, are especially interested in being located in an area where the pedestrian traffic is heavy. Before deciding upon a location, one might study pedestrian traffic along those streets where there are possibilities

of securing locations. Counting the number of people passing different locations at different times during the day and under different types of weather conditions would be one way to accumulate relevant data. Until these facts are properly organized and interpreted they are of little value; this is definitely a statistical problem.

Management is dependent upon numerical data pertaining to sales and purchases of merchandise. The merchandise manager uses statistical procedures in getting and classifying formal information that may be used in determining future sales policy. It was pointed out in the last chapter that the merchandise manager is interested in accounting data pertaining to sales. He may also want a statistical analysis of total sales in order to determine the trend of sales activities. This work might be done by the statistical department, in the case of a large organization, or by a member of the sales department who understands how to prepare statistical analyses, in the case of a small business.

In the discussion of the significance of accounting in business it was explained that the production manager is normally interested in accounting facts in order to exercise adequate control over raw-material inventories. He is also interested in information pertaining to the number of men employed, the number of hours worked, and their production rates. This is essential if he is to maintain a close control of operations and be able to anticipate future production operations accurately.

Some phases of management are dependent upon information regarding business activities outside the business enterprise. In order to make accurate estimates of future demands for products, management must know something of the probable future of business conditions throughout the nation or throughout the world. In such instances preparation of these statistical reports would probably be done by an agency outside the business. This agency might be the federal government, which might make an analysis of specific conditions covering a wide area, or it might be a private agency that sells its services to several individual firms. In either case it is important that these studies be made and that persons trained in statistical research perform this work. Successful business operation is as dependent upon adequate statistical information as it is upon accurate accounting records.

Many businesses are so small they do not warrant the full-time services of a person trained in statistics and business research; nevertheless, there are times when statistical work must be done. Many such firms have one or more people on their staffs who are qualified to do

statistical research but whose collateral duties are in other departments. Large businesses employ one or more persons whose full-time work is statistical in nature, and a few businesses, such as insurance companies, have fully staffed statistical departments.

### Market research

Market research has become especially important in recent years. It is concerned with analyzing marketing methods and consumer buying habits. Some companies do their own market research; others employ advertising agencies to perform this service in connection with planning the company's advertising program. Subsequent chapters on distribution will develop more fully the use of statistics in marketing.

## The Nature of Statistics and Research

The job of the statistical research worker is fourfold: (1) collection, (2) tabulation, (3) analysis and interpretation, and (4) presentation of factual data.

There are several methods used in collecting data: by actual count, through the use of questionnaires, and by means of interviews. In the case of a study of pedestrian traffic past available store locations or of vacancies in residential property, it is a matter of making an actual count. In the case of gathering data relative to consumer preferences in purchasing or using certain products, either the questionnaire or the interview could be used. The interview usually yields more valid and reliable data. Regardless of the technique used, the researcher is concerned with methods of measurement and the accuracy and reliability of the data with which he deals. Most research is done on a sampling basis, a method by which a limited number of cases will give reliable information. Purpose to be achieved, probable cost, time required, and facilities available will be limiting factors in deciding how extensive the sampling is to be.

Tabulation of the data is the second step in the statistical process. If the facts have been gathered in the proper manner, it is a simple though somewhat tedious process to combine them into an orderly picture for analysis. Machine methods of tabulation have reduced the time element to hours where days were required when this work was done by hand. The final tabulation is carried out by clerks who set up the compiled results in the manner best designed to fulfill the requirements of the project.

After the data have been tabulated, the experienced statistician proceeds with the analysis and interpretation of the factual material. Actually, the statistician has planned, or aided in planning, the whole research process. If the preparation has been complete and accurate, the analysis becomes a matter applying experience and knowledge in such a way that all the facts will fit together in much the same way as the pieces of a picture puzzle.

The final step in the statistical procedure is the choice of a method of presentation. The method chosen should be simple, concise, orderly, and one that clearly presents the conclusions reached. Frequently numerical tables or statistical charts are used; they usually present the facts in such a way as to enable the reader to gain an immediate comprehension of their relationships and significance. Various types of charts and graphs will be presented and discussed later in the present chapter.

### Private publications

Many universities with established programs in business administration maintain Bureaus of Business Research. These bureaus are usually staffed by one or more full-time professors and several graduate assistants, all of whom are trained in statistics and research. These bureaus perform specific research services for business institutions and organizations.

For example, the Bureau of Business and Social Research of the University of Denver, as a service for the Denver Realty Board, makes a study each year of the vacancies in residential and commercial property in the city of Denver. Trends in property sales, rental, and construction are also analyzed. Their findings are reported in the form of an $8\frac{1}{2} \times 11$ printed pamphlet of approximately 15 pages; every member of the Realty Board is supplied with a copy.

For another example, the Bureau of Business Research of the University of Oklahoma publishes each month the *Oklahoma Business Bulletin* as a service for Oklahoma businessmen. It gives a summary of general business conditions for the state as a whole and for representative cities. The major divisions discussed are production, trade, employment, construction, agriculture, and finance. The typical bulletin is an $8\frac{1}{2} \times 11$ tabloid of 8 printed pages and includes, on the average, approximately 20 tables, charts, and graphs.

A number of periodicals, trade journals, institutional bulletins, reports, and services are published by private agencies. Some of them are statistical reports, some are reports on general business conditions

and trends, and others are economic-financial forecasts. Among those usually found in the business section of most large libraries are: [1]

ISSUED ANNUALLY

*Moody's Manual of Investments, American and Foreign*
*The Economic Almanac*
(National Industrial Conference Board)
*Trade and Securities Statistics*
(Standard and Poor's Corporation)
*The World Almanac*

ISSUED QUARTERLY

*The Review of Economic Statistics*
(Harvard University)
*Journal of the American Statistical Association*
*Harvard Business Review*
*Journal of Business of the University of Chicago*

ISSUED MONTHLY

*Dun's Statistical Review*
*Dun's Review*
*The Conference Board Business Record*
*Current Statistics*
*Cleveland Trust Company Business Bulletin*
*Fortune*
*Nation's Business*

ISSUED WEEKLY

*Confidential Barometer Letter*
(Babson's Statistical Service)
*Brookmire Bulletin Service*
(Brookmire Economic Service)
*Weekly Market and Business Review and Forecast*
(Fitch Publishing Company)
*Moody's Stock Survey*
(Moody's Investors Service)
*Barron's National Business and Financial Weekly*
(Barron's Publishing Company)
*Business Week*
*Kiplinger Washington Letter*
*Printers' Ink*

## Government statistics

The federal government is the leading collector and publisher of statistical data and reports. In addition to the statistical data accumulated for the exclusive use of the government, much information is made available to business executives through published governmental reports. The Federal Reserve Board, the Treasury Department, the Labor Department, and the Department of Commerce are all vitally interested in business and financial data. There are many reports published by the Department of Commerce, because the Bureau of the Census and the Bureau of Foreign and Domestic Commerce are in this department. Publications of the United States Government are so numerous that an index of all bulletins, reports, and documents issued by

[1] For detailed descriptions of these references see Coman, Edwin T., Jr., *Sources of Business Information*, Chapters 4, 5, and 6, pp. 50-110. New York: Prentice-Hall, Inc., 1949.

the various branches of government is printed each month. It is called the *Monthly Catalogue of Useful Public Documents* and is issued by the United States Superintendent of Documents. Some of the regularly issued government publications are:

PUBLICATIONS OF THE UNITED STATES BUREAU OF THE CENSUS:

*Census of the United States.* In addition to statistics pertaining to population, with which most people are somewhat familiar, its reports cover unemployment, business, manufacturing, distribution, agriculture, and state and local governments.

*Census of Manufactures.* Published biennially. Contains detailed statistical reports for different industries, such as textiles, paper products, and food products. Includes statistics for the various industries in each of the 48 states.

*Census of Business.* This treats, on an area basis, retail trade, wholesale trade, service businesses, construction, and distribution of manufacturer's sales.

*Statistical Abstract of the United States.* Published annually. Contains a summary of statistics of the industrial, social, political, and economic organizations of the United States.

PUBLICATIONS OF THE UNITED STATES BUREAU OF FOREIGN AND DOMESTIC COMMERCE:

*Commerce Yearbook.* Replaced by *Foreign Commerce Yearbook.* Series of annual compilations of foreign economic statistics. (*Commerce Yearbook* alternated each year between statistics on the United States and foreign countries.)

*Domestic Commerce.* Published monthly. Includes articles on business trends, census releases, and reports of important legislation that affects markets and prices.

*Survey of Current Business.* Published monthly. Presents articles and statistics on current business situations for the major fields of activity in trade and industry. Summarizes data relating to trends in economic conditions. A supplement to this periodical is published weekly.

*Foreign Commerce Weekly.* Gives a series of reports and discussions on world trade and commerce.

*Market Research Sources.* Published biennially. A guide to sources of information on domestic marketing. Gives recent publications on marketing.

*Consumer Market Data Handbook* and *Industrial Market Data Handbook.* Published every ten years. Present statistical data on general consumer market, farm market, and industrial market upon which the public can base economical marketing or sales operations.

*Monthly Labor Review.* Published monthly by the Bureau of Labor Statistics. It deals with trends and status of employment and unemployment,

labor legislation and court decisions, wages, retail prices, and wholesale prices.

*Federal Reserve Bulletin.* Published monthly by the Federal Reserve Board. It presents articles pertaining to business conditions and has approximately 55 pages of statistical tables dealing with finance, industrial production, construction, employment, and costs of living.

## Methods of Measurement

There are several different ways of organizing data so that they can be interpreted and used by management. The method to be used is determined by the purposes for which the data are to be applied. Some of the most commonly used measures are: averages, index numbers, time series, and correlation.

### Averages

There are many ways in which businessmen make use of averages. For example, management is interested not only in knowing the total sales or the amount of the profit for each month, quarter, or year, but also in comparing these figures with those for previous periods. For instance, assume that the total sales of all products for the year are below those of the previous year. At the same time, it is recognized that the sale of Product *R* ($200,000 for the current year) has been unusually good. As a basis of comparison, the following data pertaining to sales for the past five years were assembled:

| *Year* | *Total Sales All Company Products* | *Sale of Product* R |
|---|---|---|
| Current year | $3,300,000 | $200,000 |
| Last year | 3,500,000 | 160,000 |
| 2 years ago | 3,100,000 | 180,000 |
| 3 years ago | 3,300,000 | 220,000 |
| 4 years ago | 2,900,000 | 165,000 |
| 5 years ago | 3,200,000 | 135,000 |
| 5-year average | $3,200,000 | $172,000 |

These figures make it possible to compare this year's record with other years during the past 5-year period and with the average for the period as well. Some of the pertinent facts that are clearly and readily seen are:

1. Total sales for this year are below those of last year.
2. Total sales for this year were exceeded only once during the 5-year period.
3. Total sales for this year exceed the yearly average for the 5-year period by $100,000

4. This year's sales of Product *R* were exceeded only once during the 5-year period.

5. This year's sales of Product *R* exceed the average by $28,000.

The average shown here is known as the *arithmetic average* or *arithmetic mean.* It is calculated by adding a series of numbers and dividing the total by the number of items in the series. In the example, the average was taken for the previous 5-year period, not including the current year. The sum for total sales was $16,000,000. When this was divided by 5, the yearly average was found to be $3,200,000. The sum for Product *R* sales was $860,000; when this was divided by 5, the average was found to be $172,000. The arithmetic mean is the average most commonly used in business.

Another type of average sometimes used in business is the *median.* This is determined by arranging a series in ascending or descending order; the middle number is the median number in the series. There are as many numbers in the series smaller than the median as there are larger. Using the same series of numbers used in solving for the arithmetic mean, we find the median thus:

| | *Total Sales* | |
|---|---|---|
| | $3,500,000 | |
| | 3,300,000 | The middle number in this series |
| MEDIAN → | 3,200,000 | is $3,200,000, which is exactly the |
| | 3,100,000 | same as the arithmetic average. |
| | 2,900,000 | |

| | *Sale of Product* R | |
|---|---|---|
| | $ 220,000 | |
| | 180,000 | In this case the middle number is |
| MEDIAN → | 165,000 | $165,000 whereas the arithmetic av- |
| | 160,000 | erage was $172,000. |
| | 135,000 | |

In these two cases, both the mean and the median are significant, and either one could be used. On the other hand, consider the following example, pertaining to the cost of 5 different possible plant sites any one of which would meet the needs of the business:

| | | |
|---|---|---|
| | $147,000 | |
| | 32,000 | |
| MEDIAN → | 27,000 | |
| | 21,000 | |
| | 18,000 | |
| 5) | 245,000 | ($49,000 ← ARITHMETIC AVERAGE |

It appears that in this case the median ($27,000) would be far more significant than the arithmetic average ($49,000). There is no property valued at $49,000, only one that exceeds that amount, and it exceeds $49,000 by a considerable sum. In contrast, there is one piece of property that is valued at the median price of $27,000, and there are as many pieces of property priced at figures larger than $27,000 as at smaller figures. In this illustration there is a tendency for the prices to be grouped about the median, whereas there is no tendency for them to be grouped about the mean.

A third measurement of averages sometimes used is the *mode*. It is the point of greatest concentration—the figure that occurs the greatest number of times in a series. Consider the hourly wages paid a group of men who are performing similar work but who, because of differences in seniority and skill, receive different wage rates. The wage distribution is as follows:

| *Hourly Wage* | *Number Earning That Wage* | *Calculation of Arithmetic Mean* |
|---|---|---|
| $1.12 | 3 | $(1.12 \times 3) = 3.36$ |
| 1.08 | 6 | $(1.08 \times 6) = 6.48$ |
| 1.04 | 10 | 10.40 |
| 1.00 ← MODE | 16 | 16.00 |
| .96 ← MEDIAN | 12 | 11.52 |
| .92 | 12 | 11.04 |
| .88 | 10 | 8.80 |
| .84 | 8 | 6.72 |
| .80 | 2 | 1.60 |
| | 79 | 79 ) 75.92 ( .961 ← ARITHMETIC AVERAGE |

In this problem the arithmetic mean is found by multiplying the hourly rates by the number of men earning each, adding all these figures together, and dividing by the total number of wage earners. The arithmetic mean is found to be 96.1 cents, the median is found to be 96 cents, and the mode—that is, the point of greatest concentration—is found to be $1.00.

These examples illustrate the fact that different types of averages show different values. The person who is responsible for choosing the types to be used must understand their characteristics and must select those that would be most significant in terms of the problems at hand. Likewise the person who interprets averages must be familiar with the way in which they are calculated and must understand the data used in determining them.

## Index numbers

In many situations figures that show relationships are much more significant than absolute figures would be. One of the most common ways in which to show relations is by means of index numbers. An index number is a method of measuring changes that have occurred in groups of related data on different dates or for different periods of time. Index numbers are probably used in business more frequently than any other statistical device. They are used to measure a variety of business activities, such as agricultural and mineral production, manufacturing, wholesale and retail trade, employment, construction, finance, and general business activity.

A common use of index numbers is in relation to the cost of living. The base period frequently used for comparative purposes is the 5-year period from 1935 through 1939; the figure for this base period is 100. Suppose it is desired to compare monthly living costs for a family of 3 at the beginning of a certain year with living costs for the period 1935 to 1939. If only 4 items were to be used as the basis for making this comparison, the following data might be assembled:

| | *Average monthly costs for the period 1935-1939* | *Monthly costs for January of the year in question* |
|---|---|---|
| Food | $42 | $84 |
| Apparel | 18 | 36 |
| Rent | 36 | 60 |
| Misc. Items | 24 | 36 |
| | 4 ) 120 ( 30 | 4 ) 216 ( 54 |

Assigning a value of 100 to the base period, we would have a corresponding index number of 180 for January of the year in question. The solution is as follows:

$$\frac{30}{100} = \frac{54}{x}; \; 30x = 5{,}400; \; x = 180$$

In some cases weighted index numbers are used. Each factor is assigned a weight that reflects its relative importance. In the example just considered, for instance, the cost of food might be regarded as having more significance in determining the cost of living than is indicated by the amount spent for it. It could therefore be assigned a

weight of 5, whereas rent might be given a weight of only 4, miscellaneous items a weight of 3, and apparel a weight of 2. A weighted index number could then be found as follows:

| | *Average monthly costs for the period 1935-1939* | *Monthly costs for January of the year in question* |
|---|---|---|
| Food | $\$42 \times 5 = \$210$ | $\$84 \times 5 = \$420$ |
| Apparel | $18 \times 2 = 36$ | $36 \times 2 = 72$ |
| Rent | $36 \times 4 = 144$ | $60 \times 4 = 240$ |
| Misc. Items | $24 \times 3 = 72$ | $36 \times 3 = 108$ |
| | $14 \overline{)462} (33$ | $14 \overline{)840} (60$ |

Assigning a value of 100 to the base period, we would have a corresponding weighted index number of 182 for January of the year in question. The solution is as follows:

$$\frac{33}{100} = \frac{60}{x}; \; 33x = 6{,}000; \; x = 182$$

These illustrations are simplified in order to show the principles involved. In actual practice the calculation of index numbers is usually far more complicated. In the first place many more factors are employed, and in some cases the process of assigning appropriate weights is a complex one. In preparing the Index of Wholesale Commodity Prices, which is issued each week by the United States Bureau of Labor, more than 800 different items are considered.

## Time series

One of the major problems faced by management is that of fluctuating prices. Prices of raw materials, production costs, and sales volume all fluctuate from time to time. Planning to meet these changes must be based upon facts. An analysis of facts to show changes over a period of time is known as a *time series*. Several of the more common types of time-series movements are:

1. *secular trends* (long-term movements steadily upward or downward);
2. *cyclical fluctuations* (fluctuations that recur over a period of years); and
3. *seasonal fluctuations* (regular movements, similar in nature for certain seasons of the year).

*Secular Trends.* The secular-trend curve is used by businesses to estimate the future demand for their products. In order for the prediction to be reliable, it is necessary to trace the trend over a relatively long period of time. The trend as shown by the curve based on past history is projected into the future. It is understood that there will be minor fluctuations above and below the line, which has been smoothed out; the line is indicative of an average of those fluctuations—in other words, of a trend. The secular-trend curve is particularly valuable to indicate continuous growth. It is illustrated in Figure 8-1, which illustrates trends in steel production capacity.

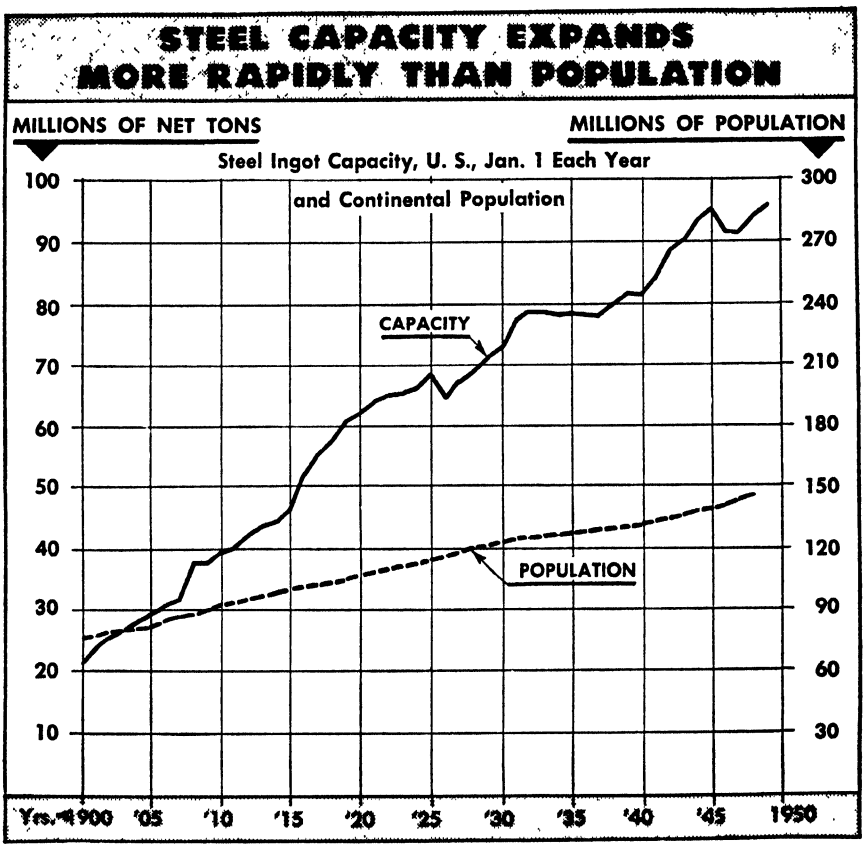


*Figure 8-1. Continuous Growth in Steel Capacity.* (SOURCE: *Steel Facts,* February, 1949, No. 94, p. 3.)

*Cyclical Fluctuations.* This term refers to the successive recurrence, over a period of several years, of business prosperity and depression; it is frequently referred to as the *business cycle.* It is almost impossible

for any business enterprise to be unaffected by changes in the business cycle. Hence managers of business enterprises would do well to study business trends closely and plan accordingly to the best of their ability. The Wholesale Price Index is shown in Figure 8-2.

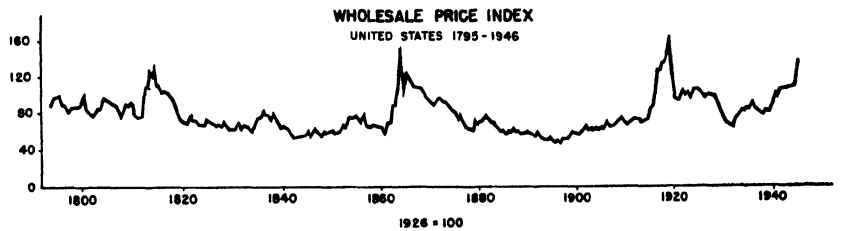


*Figure 8-2.* 1795-1797—Warren and Pearson, Converted from 1910-1914:100 to 1926:100; Standard and Poor's *Trade and Securities* statistics. 1798-1889—Prepared by Warren and Pearson. 1890-1946—Prepared by U. S. Bureau of Labor Statistics.

*Seasonal Fluctuations.* Another type of business fluctuation is that which occurs periodically during the calendar year. Peak seasons vary with different types of business. The peak season for department stores

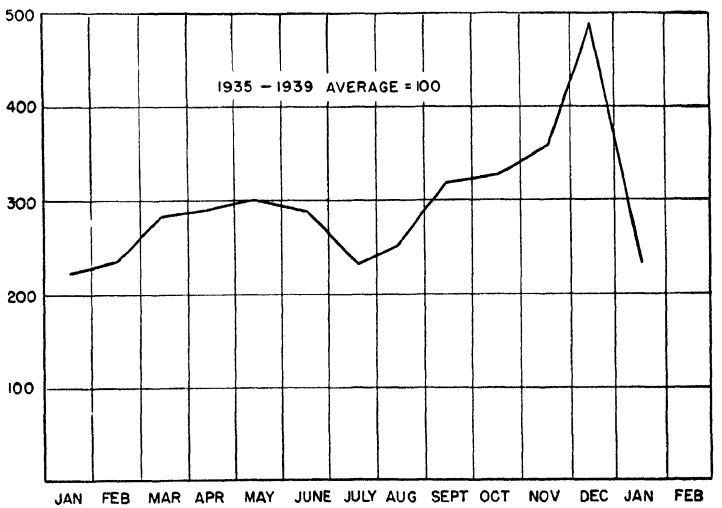


*Figure 8-3. Department-Store Sales for 1948.* (SOURCE: *Federal Reserve Bulletin,* February, 1949, Vol. 35, No. 2, p. 175.)

and many other types of retail business is just prior to Christmas, and the entire fall season is well above the average for the year. Retail sales usually slump during January and June. Seasonal fluctuation is well

illustrated by Figure 8-3, which shows the monthly sales for department stores in 1948. The figures used are index numbers with the period 1935-1939 assigned a base of 100.

### Correlation

Another method of statistical measurement used in business, and one that is especially valuable when forecasting future business trends, is known as *correlation.* If there is a close relationship between two groups of data, a correlation is said to exist. The closer or greater the relationship, the higher the degree of correlation. This relationship might be either positive or negative. For example, as the total volume of manufacturing increases the number of gainfully employed workers grows larger. In other words, there is a direct relationship between the volume of production and the number of workers employed. This is a positive relationship, because as one increases, so does the other. The correlation is therefore referred to as positive.

As the amount of money available for investment increases, the earning power of money (usually expressed in terms of interest rates) decreases. When the money supply is more plentiful, increased competition among loaning institutions forces interest rates down. As money to loan becomes more scarce, the competitive bidding among those wishing to borrow money brings about higher interest rates. In other words, the availability of money has a direct effect upon prevailing interest rates; there is a relationship between the two. Since one decreases as the other increases, the correlation is referred to as negative. Likewise, a decrease in the number of bushels of corn produced would probably cause an increase in the price of corn, other things being equal. Here again there is a definite relationship between the two and therefore a degree of correlation; and it is negative, because as one increases the other decreases.

Statistical methods of measuring degrees of correlation require the use of complex mathematical formulae and must be reserved for a formal course in business statistics.

## Presentation of Statistical Data

Top management of most organizations does not wish to be burdened with unorganized data or to waste valuable time attempting to interpret data. After the data have been collected, tabulated, and organized, it is important that they be presented clearly and concisely. The devices commonly used for this purpose are *numerical tables,*

*charts, maps,* and *graphs.* There are several kinds of graphs; those used most frequently are bar, line, and circle graphs. Some data may be presented in various ways, but usually one method of presentation is more effective than others. This can be clearly illustrated by presenting the same data in different ways.

The distribution of the sales price of oranges grown in California might be shown in a numerical table or in a circle graph. In tabular form, the data might appear as in Table XVI-3. As a circle graph, the data might appear as in Figure 8-4.

Although the same information is presented in each case, the circle graph presents it in a more forceful manner. These data will be discussed from the marketing point of view in Chapter XVI.

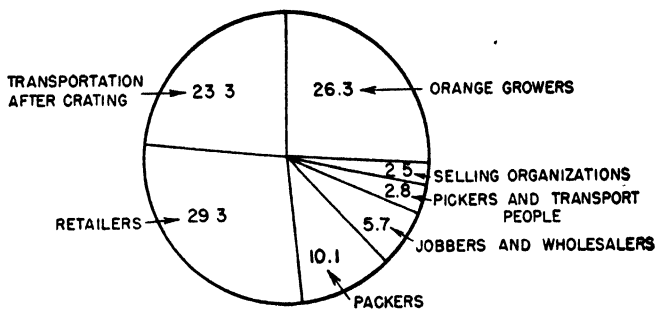


*Figure 8-4. Distribution of the California-Orange Dollar.*

As another example, suppose it is desired to present data relative to bank credit for United States banks. The information might be presented in a numerical table as follows:

BANKING STATISTICS FOR THE UNITED STATES

| | *In Billions of Dollars on January 1* | | | |
|---|---|---|---|---|
| *Item* | *1943* | *1945* | *1947* | *1949* |
| Total Deposits | 100 | 152 | 168 | 172 |
| Demand Deposits | 49 | 67 | 83 | 87 |
| Time Deposits | 28 | 40 | 54 | 58 |
| Currency Outside Banks | 14 | 23 | 27 | 26 |

As a line graph, this information is shown in Figure 8-5. Although both of these presentations are clear, the line graph seems clearer and more easily read and interpreted.

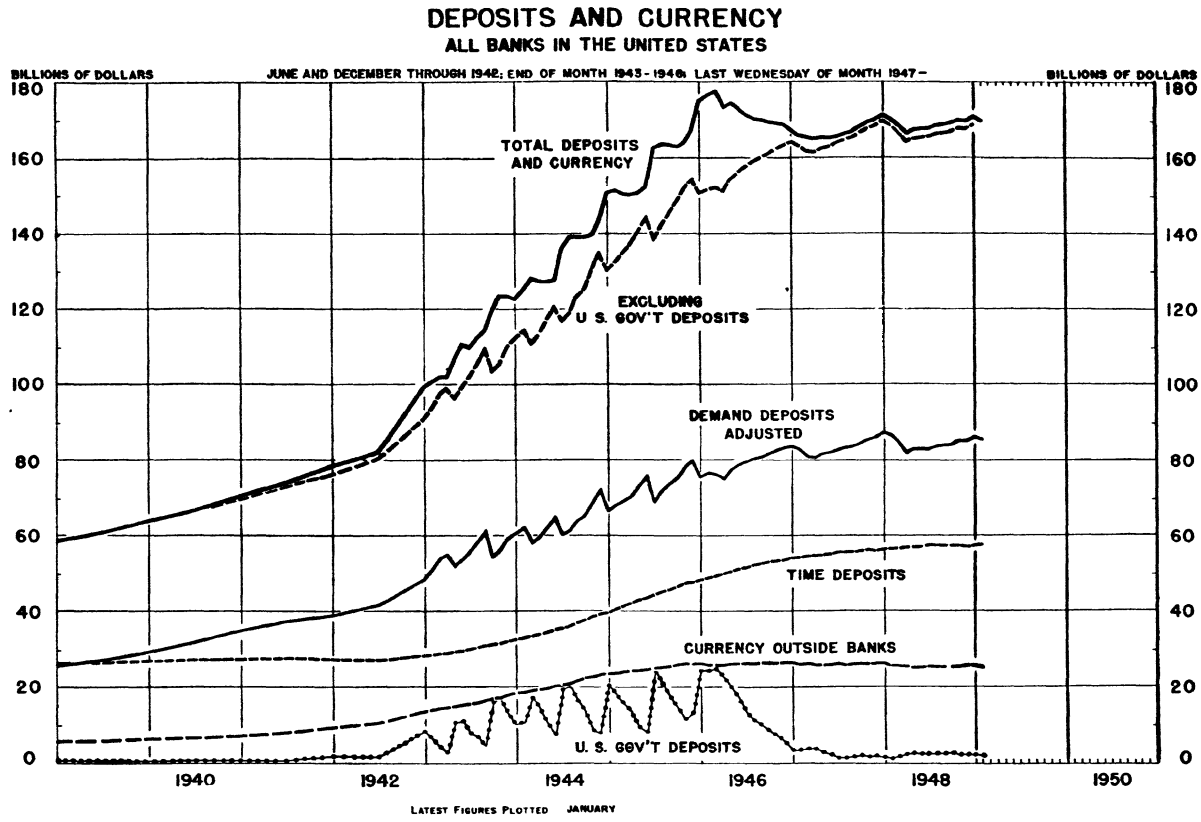


*Figure 8-5. Banking Statistics for the United States.* (SOURCE: Board of Governors of the Federal Reserve System.)

## Use of line graphs

The line graph is especially useful for presenting figures that cover a period of time. Figures 8-1, 8-2, 8-3, and 8-5 are all examples of line graphs. Another exceptionally good example is the Consumers' Price Index, which is published regularly by the Bureau of Labor Statistics. The graph in Figure 8-6 shows the sharp upward sweep of consumers'

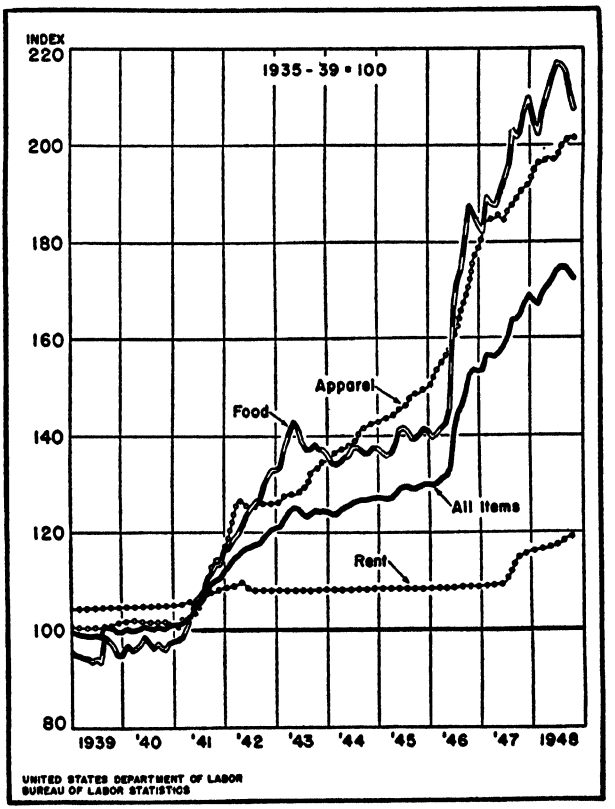


*Figure 8-6. Consumers' Price Index.* (SOURCE: U. S. Department of Labor, Bureau of Labor Statistics, *Monthly Labor Review,* February, 1949, Vol. 68, No. 2, p. 167.)

prices that followed governmental decontrol of prices in mid-1946 and the halting of that incline in 1948. It also shows the substantial rent increase permitted by the Housing and Rent Act of 1947 and the second increase that was allowed when Congress extended the Rent Control Act for another year beginning April 1, 1948.

## Use of bar graphs

The bar graph is used for comparing two or more sets of figures; the bars may be vertical or horizontal. Sometimes two sets of bars are shown side by side and different shadings are used to distinguish them. This is illustrated in Figure 8-7, which contrasts income and expenditures of the United States Government.

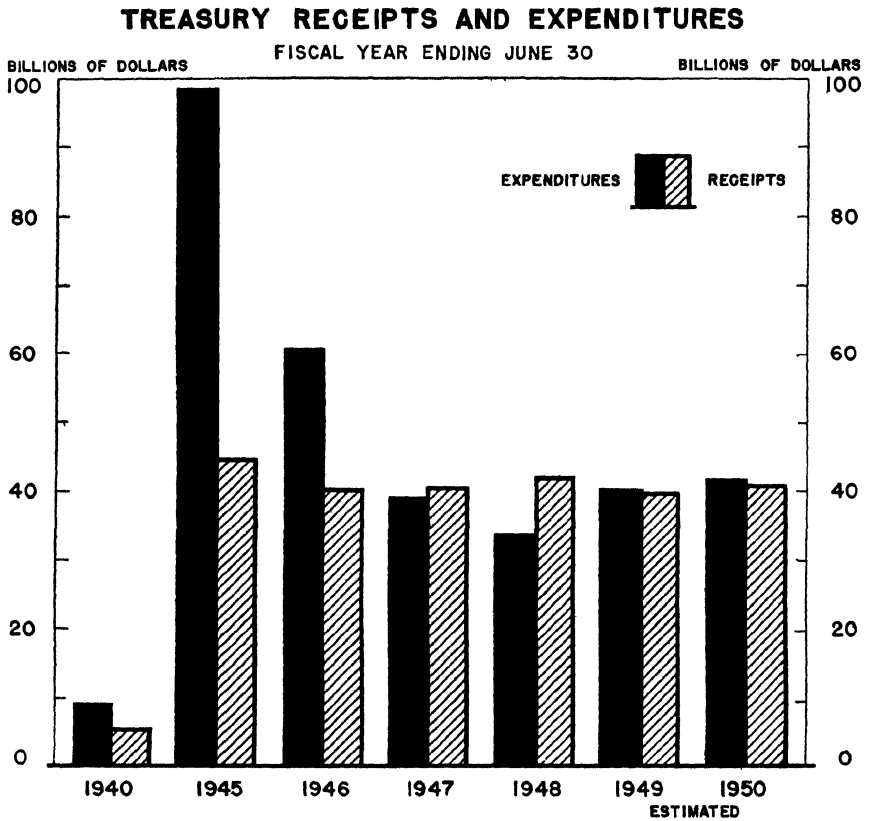


*Figure 8-7.* Bar graph where multiple bars are used and distinguished by different shadings. (SOURCE: *Federal Reserve Bulletin,* February, 1949, Vol. 35, No. 2, p. 109.)

Another variation in the use of the bar graph is that of using different shadings to show a breakdown of the total figures being presented. Figure 8-8 is interesting because it shows a breakdown of the total labor force into four divisions. The total labor force for the year 1948 averaged 62.7 million. The average civilian employment for the year was 59.4 million.

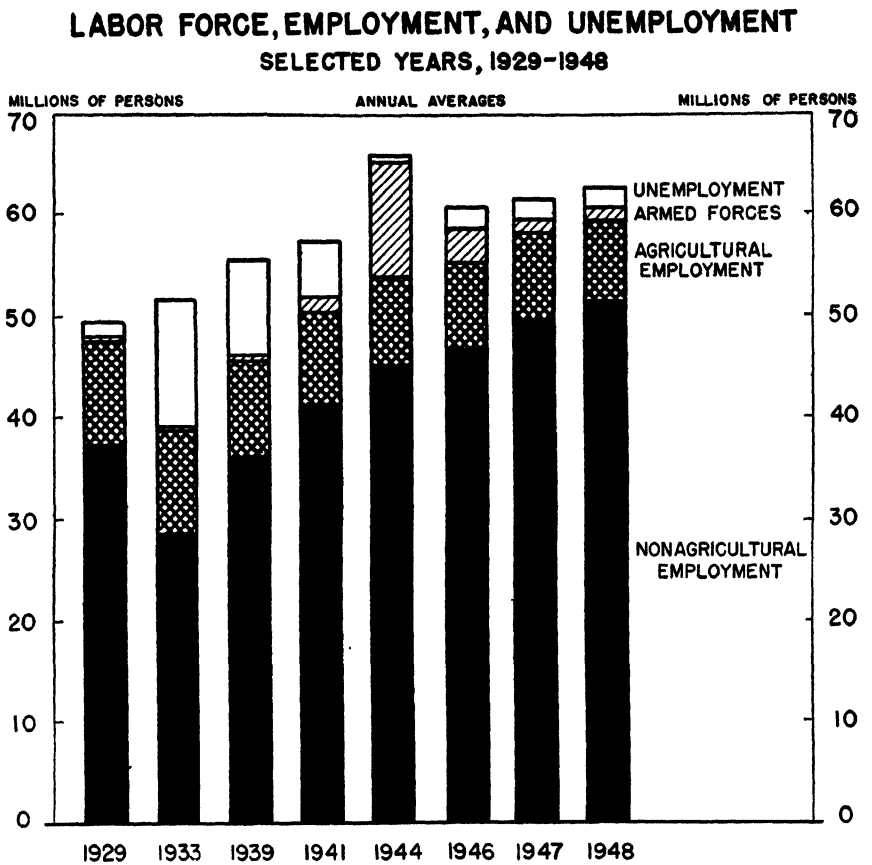


*Figure 8-8.* Bar graph where different shadings are used to show a breakdown into component parts. (SOURCE: *Federal Reserve Bulletin,* March, 1949, Vol. 35, No. 3, p. 220.)

## Use of pictographs

A variation of the bar graph is called the *pictograph.* Sometimes instead of solid bars small drawings of the items about which data are being given are placed one beside another to make up bars. The bar graph is also shown as a pictograph, in some instances, by using pictures in addition to the bars; the pictures give a little more life to the bar graph. This second type of pictograph is illustrated in Figure 8-9.

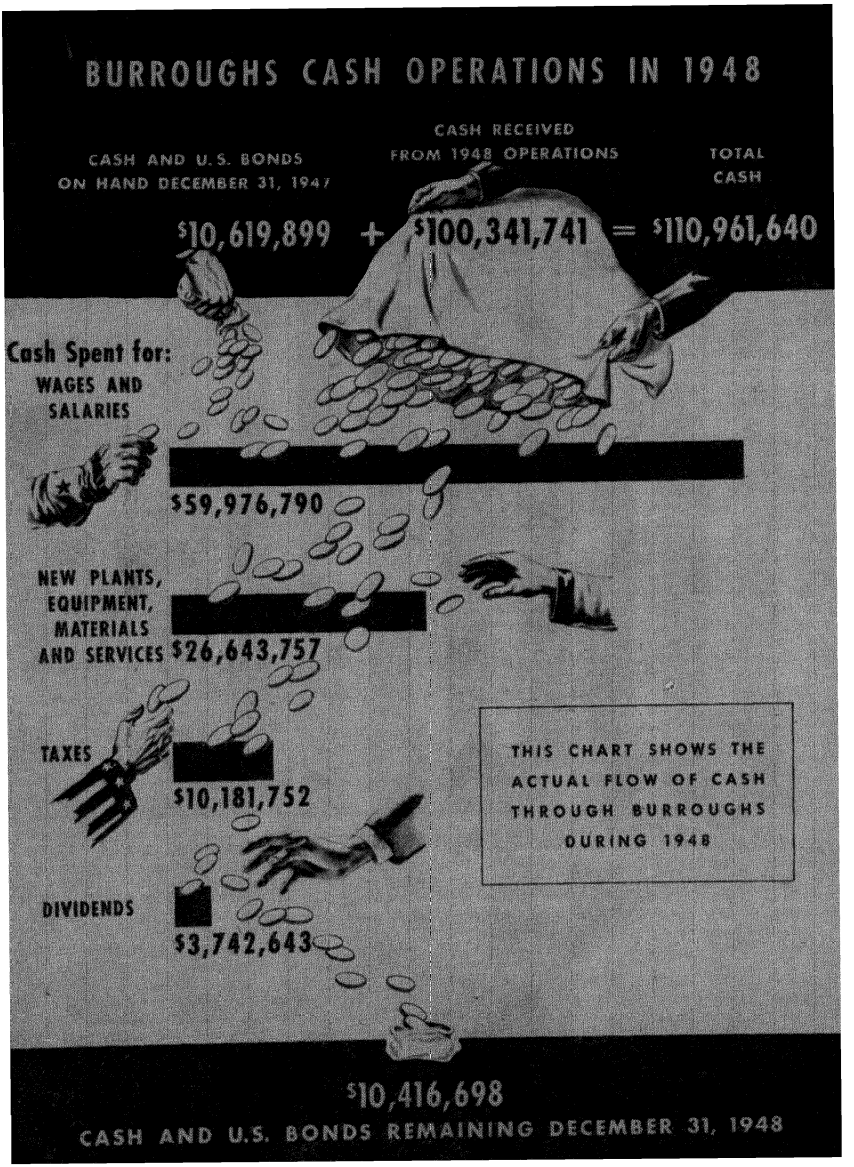


*Figure 8-9.* A variation of the bar graph shown as a pictograph. (SOURCE: *1948 Annual Report to the Stockholders.* Burroughs Adding Machine Company, p. 7.)

## Use of circular graphs

Perhaps the simplest type of statistical graph is the *circular* or *pie graph.* It is especially valuable for presenting a breakdown of items expressed in dollar values or to show percentages. The complete circle represents 100 percent and each part or segment shows a percentage of the whole. One example of the circle graph was presented in Figure 8-4. Income and expenditures of both business and governmental organizations are frequently presented as pie graphs. Figure 8-10 shows

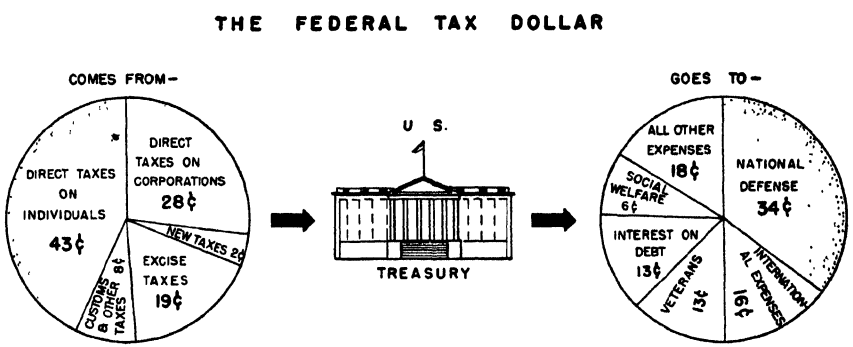


*Figure 8-10. United States Treasury Receipts and Expenditures.* (Adapted from *Taxes,* February, 1949, Vol. 27, No. 2, p. 88.)

the source of receipts and the items of expenditure for the United States tax dollar. This is actually an adaptation of the circle graph, but the two circle graphs form the body of the chart.

## Use of statistical maps

Frequently statistical data pertaining to one state, an area of several states, or the country as a whole are presented right on a map of the geographic area being discussed. An outline map of the United States is frequently used, the figures being given for each individual state or symbols being used to represent designated numbers of the items being pictured. Another plan is to group states into three or four divisions; by shading the states in each group differently, comparisons may be made readily.

## Statistics as a Career

Since 1935 there has been an increasing recognition, in business and government, of economic problems that can best be studied through statistical procedures. This has resulted in a marked growth in the use and application of statistics.

The present demand for statisticians and statistical workers is greater

than the supply. Graduates of collegiate schools of business administration who are trained in statistics experience little or no difficulty in securing desirable positions. There is also a shortage of individuals who are qualified to teach statistics in colleges and universities. Probably the supply of statisticians will be insufficient to meet the demand during the next half-century because the field of statistics is not sufficiently glamorous to attract large numbers of individuals. The conclusion of the Committee on Applied Mathematical Statistics of the National Research Council, as reported in 1947, was that the unprecedented growth of interest in the use of statistical methods during the decade from 1937 to 1947 precipitated a shortage of adequately trained statisticians in both academic and nonacademic areas.

Manufacturers, retailers, and advertising agencies spend millions of dollars each year to determine consumers' preferences, habits, opinions, and attitudes as a basis for making business decisions; both sampling and polling methods are used extensively. Statisticians with training and experience in scientific sampling find the fields of advertising and market research an important source of employment. There is a shortage of actuaries in the field of insurance; it is estimated that during the next few years the 350 insurance companies in this country will need several hundred additional actuaries.

Leaders in the use of statistical methods in industry anticipate the development of what might be called industrial-operations analysis. This work would call for mixed scientific groups consisting of actuaries, chemists, engineers, mathematicians, physicists, psychologists, and statisticians, who will work as teams, using mathematical and statistical methods. They will engage in studies of every phase of the industrial process from the procurement of raw materials to the sale of finished products.

Initial employment in the field of statistics might be as a statistical clerk, statistical draftsman, assistant statistician, or statistical analyst. It might be work in some related field, such as that of computer, accountant, tabulating-machine operator, or research assistant. There are also secretarial positions that require a knowledge of statistics. The statistician's salary is not unusually high, but employment is steady, and increases in salary are commensurate with the increasing value of the statistician to the growth and development of the business.

Positions in governmental agencies under civil-service tenure vary from junior statistical clerk to principal statistician. Promotions into other fields are also common; one may become head of the departments of accounting or finance, director of statistical research, or administra-

tive consultant. Advancement depends upon native ability, breadth of training, and experience.

### Personal qualifications and preparation necessary for success

It is obvious from what has been said thus far that statistical work is largely mathematical. Measurement of data must be accurate and orderly, and the statistical worker must like to work with figures. Artistic ability and originality are necessary in order to determine the types of charts or graphs that should be used. A certain amount of manual dexterity is essential, because the statistical worker is frequently called upon to prepare charts and graphs requiring lettering and other drafting techniques. He must be able to operate calculating machines and to perform moderately complex statistical computations. He must develop a knack for reading and understanding charts and tables, and learn to distinguish between essential and unimportant data. Above all, he must possess the kind of mind that is apt at visualizing relative values from masses of data.

Statistics is a tool in research. It is necessary to know how to gather data and present them in such a way that the results will be reliable, valid, and objective. To be reliable the results must be such that they can be depended upon; to be valid the material must be accurate; and to be objective the results must be free from personal judgments.

### Advantages and disadvantages of statistics as an occupation

There are certain factors about statistical work that make it attractive to those who possess the necessary qualifications. Some of these are:

1. Security arising from steady and permanent employment.
2. Opportunities for learning about the innermost functions of the business.
3. Seemingly unlimited possibilities of advancement.
4. Personal satisfaction that results from having directed original research that will benefit others.
5. Employment is usually not so adversely affected during periods of economic depression as most other jobs in business are.

On the other hand there are disadvantages that cause statistical work to be undesirable to many people. These are:

1. Service is almost wholly in the employment of others.
2. The work is confining in nature and done almost completely inside and at a desk.

3. The routine work frequently lacks variety and tends to become tedious and monotonous.

## Terms for Study

Chart
Correlation
Data
Economic-financial forecasting
Fluctuate
Index numbers
Line graph
Mean
Median
Mode
Pictograph
Reliability of data
Secular trend
Statistical abstract
Statistics
Tabulation
Time series

## Questions

1. In what sense is statistics considered to be a tool of management?
2. What is the difference between accounting data and statistical data?
3. What are some of the sources of business information that are useful to business management?
4. What are the four steps in performing statistical research?
5. How is an arithmetic mean calculated?
6. How is a median determined?
7. Under what circumstances might the median be a more meaningful figure than the mean?
8. What type of data are presented in time-series graphs?
9. Indicate an instance when a business firm would have use for a correlation coefficient.
10. Suggest five different types of data that can be presented forcefully by means of graphs. Indicate what type of graph you would use in each instance.
11. What types of charts or graphs are best when it is desirable to present percentages of a whole?
12. What types of graphs would be the best for comparing monthly sales for the current year with monthly sales during the previous year?
13. How promising are the job opportunities for those who trained in statistics?
14. What personal traits are necessary for success in statistical work?
15. How do you account for the rapidly increasing need today for statistical data?
16. How would you explain the reluctance of most people to engage in statistical calculations?
17. What relationships do you see between statistical controls and profit?
18. How are office machines related to the development of statistical data?
19. In what ways is our daily living affected by routine statistical computations outside the field of business?
20. "Statistics is a means of communication." Explain.

## Problems and Projects

1. Compare accounting and statistics with regard to (a) the nature of the work done and (b) the personal traits essential for success in each field. Would a person who would succeed in one be likely to succeed in the other?

2. Find the arithmetic mean and the median for the following figures, which represent monthly sales for one department store expressed in round numbers to the nearest $50,000:

| | | | | | |
|---|---|---|---|---|---|
| January | 800,000 | May | 900,000 | September | 1,150,000 |
| February | 850,000 | June | 750,000 | October | 1,250,000 |
| March | 1,000,000 | July | 750,000 | November | 1,450,000 |
| April | 950,000 | August | 800,000 | December | 1,500,000 |

3. Prepare a bar graph and a line graph using the data supplied in Problem 2. Which seems to present the clearer picture? Which months are characterized by peaks and depressions resulting from seasonal fluctuations?

4. From current issues of business periodicals select several examples of the different methods commonly used to present statistical information. Clip or reproduce these, mount on 8½ × 11 paper, and write a paragraph commenting on each diagram. Suggest in each case other satisfactory ways in which the same information could be presented.

5. The average monthly cost of food for a family of four for the years 1944 to 1948 inclusive was: 1944—$52; 1945—$54; 1946—$60; 1947—$74; 1948—$82. The average cost for this food for the period 1935 to 1939 was $40 a month. Assigning a base of 100 to the 1935-1939 average, compute the corresponding index numbers for each of the years from 1944 to 1948 inclusive.

6. B. B. Smith's sales for last year, by departments, were:

| | | | |
|---|---|---|---|
| Cosmetics and jewelry | $1,500,000 | Household supplies | 1,000,000 |
| Men's clothing | 2,000,000 | Basement | 500,000 |
| Women's clothing | 2,500,000 | | |

Compute the percentage of total sales made by each department and show this information in a pie chart.

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CHAPTER IX

# OFFICE MANAGEMENT AND SECRETARYSHIP

THE OFFICE ORGANIZATION is essentially the brain of a business. The brain is a service unit; therefore, the office renders service to all departments of the business.

It was shown in Chapter V that business management is concerned with the handling of men, materials, and machines for the purpose of producing and distributing specific commodities at a minimum cost to the firm. In office management, the commodity is clerical service, and office management is concerned with the direction and supervision of office workers in such a way as to give efficient clerical service at a low cost.

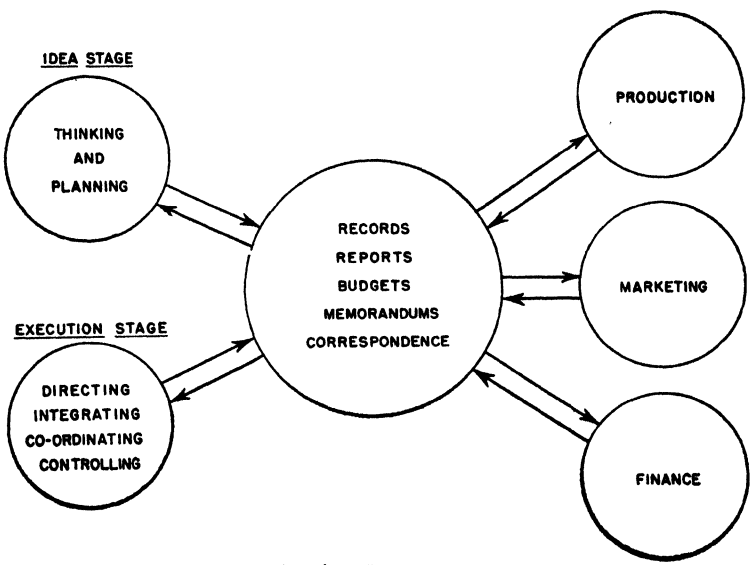



*Figure 9-1. Service Functions of the Office.*

When we analyze the function of the office in terms of its relation to management, we see its importance to the smooth functioning of the business as a unit. The major functions of modern business (production, marketing, and finance) must be co-ordinated into one unit. The management processes of planning, directing, co-ordinating, and controlling require many clerical activities. Also, integration of man-

agement activities requires an interchange of information; this always involves records, intercommunication, and systemization. Figure 9-1 shows in chart form the function of the office in furnishing information for carrying on modern American business.

## Major Areas of Office-Management Problems

When we look at the methods of handling men, materials, and machines to produce clerical service at a minimum cost to the firm, we see several major areas in which office problems arise. In the first place, business records serve as the basis of office management. Office records and communications, especially correspondence and filing, make up a large part of the work of the office, so this first area has been designated as *office operation*. People are needed to prepare and to care for all the necessary records and correspondence, so there are problems in the area of *personnel*. These people need materials and equipment with which to work, so the office manager is concerned with the building and layout of the office, office equipment, appliances, and supplies. In addition, it is necessary to have an organization plan and a system that provides control over the work and personnel of the office. These areas are shown in Figure 9-2.

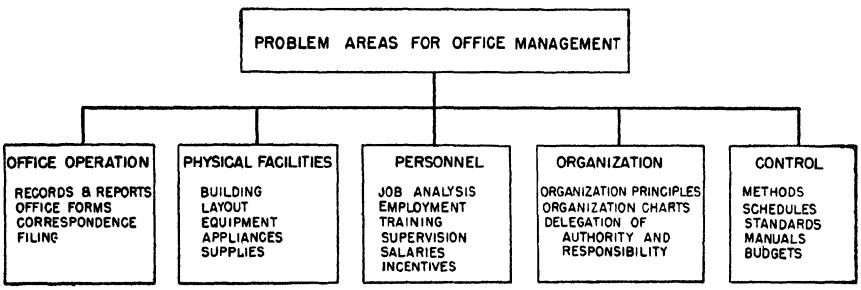


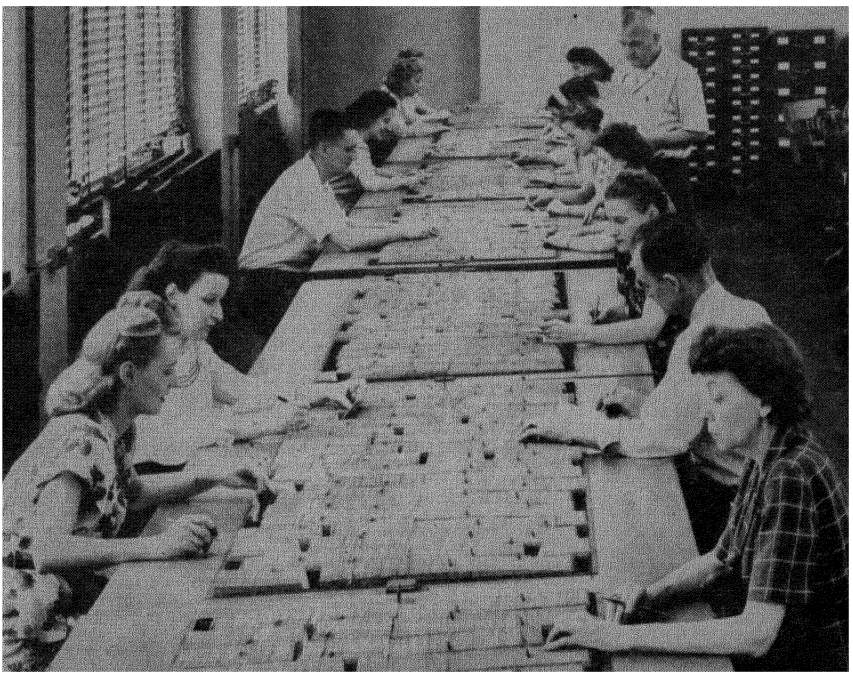

*Figure 9-2. Areas in Which Office Management Functions.*

### Office records and reports

*Records.* Records are written statements of fact or opinion retained for future reference. They serve several purposes, among which are the following:

1. To provide facts for managerial decisions and planning;
2. To serve as bases for making comparisons;
3. To provide information for making reports;
4. To supply information required by the government; and
5. To show areas of strength, weakness, and waste.

In order to serve all these purposes several types of records must be kept: production, marketing, financial, and personnel records. In production, records must be kept of raw-material purchases, work hours for each laborer, and supplies used; machine costs, maintenance, and depreciation; and inventories and number of units produced. In marketing, records of salesmen's salaries and commissions, records of the



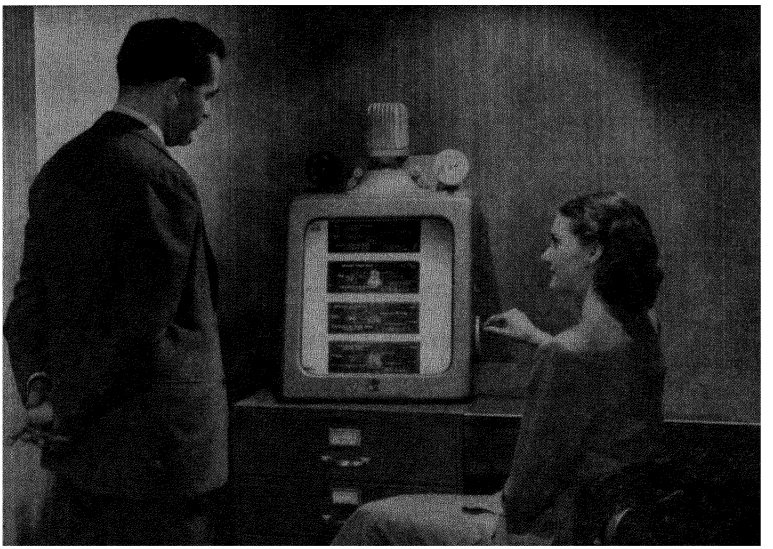
*Courtesy Automobile Manufacturers Association*

*Figure 9-3. Stock Control through Card Files.* One particularly important control system that functions through records is seen in this department devoted to card files for replacement parts used in the automobile industry.

sales volume for each salesman and district, and records of merchandise returned by customers must be available. In finance, records must show the amount of bonds outstanding and their interest rates, the amount of credit accepted and granted by the firm, and all items that affect the financial status of the company. There must be records pertaining to all personnel: personal data, qualifications, rate or rank, salary, length of service with the company, and promotions offered and accepted. The office manager must decide just what records are needed and how effective they will be, and he must determine their approximate cost. Records must be kept simple, concise, and clear.

*Office Forms.* Office forms are used in transmitting information from one department to another and from one business to another. The factors that determine the nature of the form are the purpose it is designed to serve and the way in which it is to be used. These two factors, along with the period of time the records will be retained, combine to determine the size and quality of the paper on which the form is to be printed. The office manager must know the percentage of rag content needed in the paper on which the different forms are to be printed, and must know the standard sizes for different types of office forms. Firms that keep large quantities of record forms for long periods of time would use microfilm for taking pictures of those records because of its convenience for future use and in order to save storage space. Various plans for microfilming have been developed by equipment manufacturers. One common type photographs letters by placing them individually over an exposure area in a table with an ingenious camera arrangement below that takes pictures of each page and records them on a film strip. The film strip in turn can be shown in a hooded area for reading purposes.

Special adaptations for microfilming checks have been quite successfully developed. For example, the Film-A-Record shown in Figure 9-4 is one of the most efficient devices.



*Courtesy Remington Rand Inc.*

*Figure 9-4. Microfilming Checks.* Storage space required is reduced 98 percent by the use of Film-A-Record. This photographic process uses film strips made into rolls that can be neatly stored in large quantities in small trays.

Forms usually consist of sheets of paper on which information and instructions are printed; blank spaces are usually provided for writing additional information. They are used to standardize records, to accumulate data, to reduce the amount of writing needed, and to reduce errors. Forms eliminate much repetition, provide for uniformity and simplification in clerical procedures, and facilitate the use of machinery and equipment. Approximately two-thirds of the time spent by office workers is spent in dealing with business forms.

Each office form should be identified or labeled in such a way as to indicate clearly the purpose it is designed to serve, and the items included on it should be arranged logically and neatly. If multiple copies are to be prepared, this can be done through the use of sheets arranged in a specific order and gummed to form a pad, distribution being facilitated through the use of varicolored papers.

Consideration must be given to the size of the form, quality and weight of paper, and size of print. Whether it is desirable to have the forms punched or perforated must be decided in view of their use and the methods of filing to be employed. In the case of a new form, it is desirable to order only a few months' supply so that its actual use can aid in standardizing the form before large quantities are produced. Otherwise, new forms are likely to become obsolete. The objective to be accomplished through the use of the form must be kept uppermost in mind: however, the cost of preparation is also an important factor.[1]

### Mail, correspondence, and filing

*Mail.* The prompt and efficient handling of company mail can contribute materially to efficient office operation. Centralization of mail handling and fixing responsibility for it are accepted principles that should be observed. Incoming- and outgoing-mail routines differ, and they must be developed to meet the needs of each particular business. The steps involved, however, are fairly uniform, as practiced in modern business. For example, although the routines for performing the steps vary, handling incoming mail includes:

1. Receiving the mail.
2. Sorting by class and type.
3. Opening the mail either by hand or by machine.

[1] See Ross, John, "Ten Rules for Forms Designers." *The Office,* May, 1949, Vol. 29, No. 5, p. 66. See also Gaines, Beatrice, "Techniques of Forms Control." *Modern Management,* February, 1949, Vol. 9, No. 2, p. 15; and MacDonald, John H., *Office Management,* 3rd ed., Chapter 17, pp. 420-440. New York: Prentice-Hall, Inc., 1947.

4. Sorting by content and by department.
5. Stamping date and time of receipt.
6. Attaching related data.
7. Delivery to division or departments concerned.

For outgoing mail, the customary procedure includes these steps:

1. Collecting and delivering to the mail room.
2. Folding and enclosing in envelopes.
3. Sealing, stamping, and canceling.
4. Delivering to post office or to place convenient for collection by postal authorities.

Certain phases of office work can best be performed by mechanical devices, and the office manager or one of his assistants must know when it is desirable to install these machines. There is increased use of postage meter machines because they save time, speed up mail handling (since metered mail is canceled by the machine and does not have to be canceled by the local post office), eliminate the use of company postage by employees for their personal mail, and provide automatic accounting for the total amount of postage used.

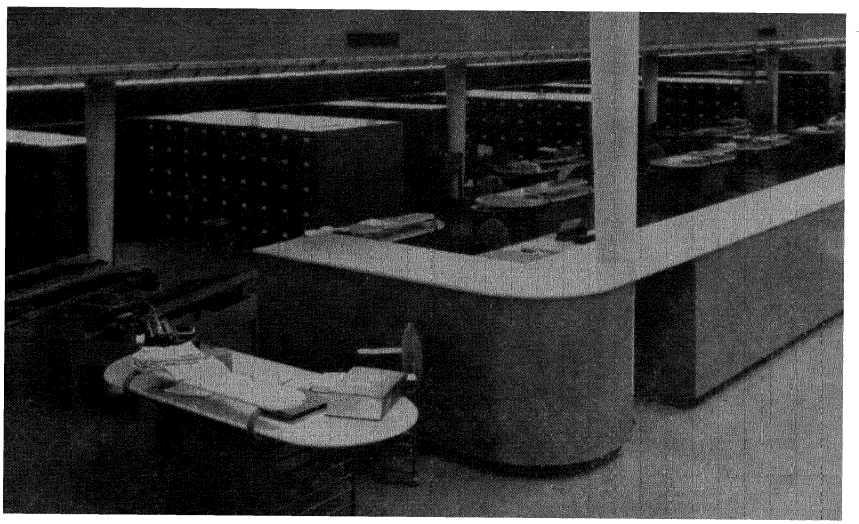
Mailing procedures have been developed to increase efficiency in mail handling. Among these are the use of zone numbers in the address, standardization of envelopes and letterheads, the use of window envelopes when practicable, and familiarity with transit schedules. Savings can be effected if regulations pertaining to second-, third-, and fourth-class mail are understood and applied. These are just a few of the phases of mail handling for which the office manager is responsible.

*Correspondence.* Letters are, by their very nature and purpose, important to every business organization. They pertain chiefly to orders, instructions, and explanations; they are used to convey information and to establish goodwill. Letters are considered by many people as indicative of the general quality and efficiency of the operation of any business. They are used in so many ways that they constitute an important part of office work. It is estimated that approximately one-third of the office activity in most businesses is concerned with written communications: incoming, outgoing, and interdepartmental correspondence and memorandums. It is also estimated that the labor cost of an average business letter is approximately 50 cents; materials and postage are additional costs. These facts suggest the importance to office management of proper control over correspondence.

Some of the phases of correspondence of direct concern to the office manager are:

1. Seeing that individuals who write and dictate letters are familiar with the fundamentals of good letter writing.
2. Seeing that the stenographers and typists are familiar with letter forms and styles.
3. Deciding to what extent voice-recording equipment can be used economically and effectively.
4. Training dictators in the use of effective dictating techniques and procedures.
5. Organizing procedures within the organization for effective correspondence.

*Filing.* Filing involves two operations, placing and finding. It may be defined as the systematic and convenient storage of records and



*Courtesy Remington Rand Inc.*

*Figure 9-5. Centralized Filing Department.* The records of the Armstrong Cork Company are centralized in an area designed and built for the purpose. Note the functional equipment and furniture, and the grouping of units for work efficiency, lighting, and ventilation.

correspondence so that they may be located immediately when needed in the future. Almost every employer has at one time or another been inconvenienced because he could not locate a letter or memorandum that had been improperly filed, either by himself or by his secretary. Being able to find material is as important as knowing that it is filed somewhere. Where a centralized filing department exists, it is essential that all those who have access to the files be trained in the proper ap-

plication of the filing system in use and that uniform procedures be practiced.

Filing aids management by keeping important business records in a safe and systematic manner, by receiving records from all divisions of the firm, by distributing those records to the proper persons when needed, and by classifying them so that they can be used in performing and improving current practices.

*Courtesy Remington Rand Inc*

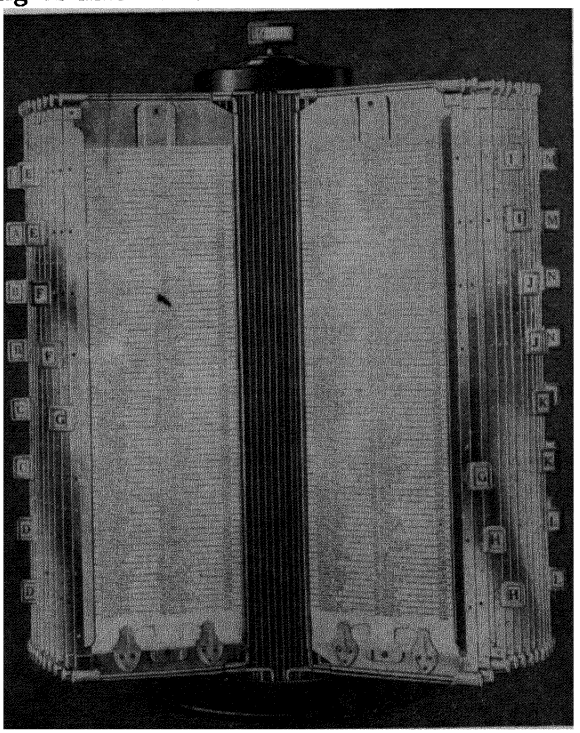
*Figure 9-6. Desk-high Files.* Much time and effort are saved by having desk-high filing units that move easily on roller-bearing suspensions. The operator has access to records in a sitting position and need not disturb other work in progress.

Four basic plans are used in filing materials: alphabetical (probably the most widely used), numerical, chronological, and geographical. There are several combinations and variations of each of these plans.

Some of the filing problems with which the office manager is concerned are:

1. Determining the filing systems or plans best suited to different phases of the business.
2. Selecting and placing filing equipment.
3. Deciding whether departmentalized or centralized filing is preferable.
4. Standardizing filing procedure and training employees to apply practices and principles uniformly.

5. Establishing effective filing control.
6. Disposing of inactive and out-of-date material.



*Courtesy Remington Rand Inc*

*Figure 9-7. Numeric Filing.* This system is operated chiefly by means of alphabetically arranged cards. The installation shown here has cards mounted on easily accessible revolving panels. In the third column of each panel are source numbers by means of which the files can be secured in the central records department.

## Building and layout

*Building.* The office manager is responsible for the housing and working environment of those under his supervision. One of the first considerations concerning housing has to do with office location: is the office to be in the building that houses the rest of the business, in a separate building adjacent to it, or at a location removed from other business property? Several factors enter into a choice of the most desirable location. The office manager must allow adequate space for future growth, and he must choose space that will make possible effective service at minimum cost. Proper office planning makes possible maximum utilization of available space; this means that the layout must be planned before construction or remodeling begins. Another considera-

tion relative to the office building is whether to own or to rent. Each plan has its advantages and disadvantages. The office manager will work with other executives in deciding this question.

Some of the building characteristics to be considered are the type of construction, floor loads, floor coverings, elevators, partitions and railings, and windows. Important service features are coatrooms and lockers, restrooms, attractive lobby and reception rooms, conference rooms, vaults and storage facilities, communication systems, quietness, heat, ventilation, and air conditioning.[2]

Proper lighting and color are very important, because they greatly affect the productive output of workers. Considerable experimentation and research have been done in both fields. The office manager must be well informed on this important phase of office environment. The importance of color dynamics will be discussed in Chapter X.[3]

*Layout.* This term refers to the utilization of space in providing an arrangement of physical facilities that will make for efficient execution and a free flow of work in the office. Wasted space increases costs, yet there must be adequate room for employees to perform their work. Neither the flow of work nor the personnel must be crowded. The office manager must know the causes of uneven flow of work and how to avoid them.

Studies have been made of space needed per person for doing different types of work and of the proper size of private offices and conference rooms. Proper use of space is an important phase of planning in office management, and one in which the office manager has an opportunity to render real service to both management and the workers.[4]

### Office equipment, appliances, and supplies

*Equipment and Appliances.* In addition to the selection of proper equipment, office management includes its use, care, and maintenance.

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[2] For a discussion of each of these factors see Chapter 11 of Maze, Coleman (editor), *Office Management; A Handbook,* pp. 299-318. New York: Ronald Press Company, 1947.

[3] See Wells, H. R., "Color and Lighting." *NOMA Forum* (monthly publication of the National Office Management Association), July, 1948, Vol. 23, No. 7, pp. 9-14; MacDonald, John, *Office Management,* 3rd ed., pp. 50-57. New York: Prentice-Hall, Inc., 1947; and Maze, Coleman (editor), *Office Management; A Handbook,* pp. 317-322. New York: Ronald Press Company, 1947.

[4] A detailed discussion of office layout is given in Maze, Coleman (editor), *Office Management; A Handbook,* Chapter 13, pp. 379-426. New York: Ronald Press Company, 1947. See also Martling, Harvey B., "Office Layout and the Selection of Office Furniture." *The Office Economist,* July-August, 1949, Vol. 31, No. 4, p. 4.

Of the few basic principles that must be observed, the first is that the responsibility and authority for the entire equipment program must be placed in the hands of one individual. Since there are more than 60 different models of typewriters and more than 300 different models of adding machines available, the necessity of centralized control of equipment and machinery is obvious. The wide range of models and their flexibility make possible considerable savings when each machine is properly used. Office equipment can be used efficiently only when the advantages of various makes and models are understood, so that the proper appliance can be utilized for each particular type of job. Another reason for centralizing authority in one person is in order to have some degree of standardization. It is impossible to have attractive offices when file cabinets of different colors are placed side by side and when wooden and metal desks and chairs are intermingled promiscuously. The only way to prevent the occurrence of such unpleasant arrangements is to let one person control purchase requisitions for all new equipment.

Desks, tables, chairs, and files are the most important items of furniture used in offices. There must be proper inventory control so that depreciation can be correctly calculated and proper maintenance secured. Date of purchase, original cost, serial number, property tag number, and estimated useful life must be recorded. Unit costs and standardization of color, style, and size are important considerations.[5]

The degree to which an office should be mechanized is always a difficult problem. Consideration must be given to operation qualities, maintenance costs, cost per unit of output, reputation of the manufacturer, and service rendered by the seller.

In addition to certain personal factors, the value of time to be saved if machinery is used, the effect upon number of personnel needed, and the accuracy and quality of work done determine to a large extent the advisability of mechanizing operations formerly performed by hand. Typewriters, voice recorders and transcribers, duplicating machines, computing machines, and billing, posting, tabulating, and accounting machines are the principal types used in offices. There are several competing makes of each type of machine; the office manager must be

[5] A report of a National Office Management Association survey of 200 companies on "Trends in the Use of Wood and Steel Office Furniture" is given in the August, 1949, issue of the *NOMA Forum* (Vol. 24, No. 8, p. 24). See also Hunt, Raymond, "Administration of Office Equipment." *NOMA Forum,* February, 1949, Vol. 24, No. 2, pp. 19-27.

familiar with all of them in order to select those best suited to his office.[6]

*Supplies.* Office supplies are used in large quantities and constitute a sizable item in the office manager's budget. The amount needed and time for delivery must be anticipated in order to strike a proper balance between taking advantage of quantity discounts and keeping investment in supplies inventories at a minimum. Supplies are easily wasted and often they are taken for personal use; therefore, a scheme of control must be used to keep down excessive costs. In order to secure proper supplies, to keep an adequate quantity on hand, and to avoid waste, proper systemization and control must be exercised over purchasing, storage, and distribution. Centralized responsibility and authority are needed just as much for supplies as for furniture and machinery.

## Management of personnel

Another area in which there are office-management problems is personnel management. The office manager is faced with almost all the problems common to other phases of management where personnel are involved. Some of these problems are as follows:

1. Job analysis and job description
2. Procurement, selection, training, and placement of workers
3. Health and welfare of workers
4. Transfer and promotion
5. Wage and salary administration
6. Employee morale and office atmosphere

These are discussed in the next chapter and do not need special attention here, for the personnel problems of the office are not unlike those of other departments. The office manager must be skilled in all these phases of handling men. He must know what constitutes a day's work for a day's pay, and he must know how to organize and administer his office from the personnel point of view.[7]

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[6] For detailed discussion of administration of office equipment see Chapters 11 and 12 of Terry, George R., *Office Management and Control.* Chicago: Richard D. Irwin, Inc., 1949.

[7] The NOMA Bulletin No. 8 (June, 1948), *Collective Bargaining Manual,* is a 31-page pamphlet written especially for the office manager. See also Parker, Willard E., "Current Office Personnel Problems." *National Office Management Association Proceedings, 1948,* p. 73; and Thum, C. T., "A Practical Personnel Program for the Office." *NOMA Forum,* January, 1948, Vol. 23, No. 1, pp. 10-20.

## Managerial control of the office

By control is meant the direction and co-ordination of office personnel, and the use of equipment, appliances, and supplies in such a manner as to give the greatest possible amount of service, in the shortest possible time, at the smallest possible cost.

Control depends upon knowing the goals desired, understanding current practices, and having a definite plan for control with authority to see that it is carried through to completion. In the field of office management, control is accomplished through training, orders, office procedures, and supervision. Standards, manuals, and budgets are other ways through which control is exercised.

*Office Procedures.* The term *procedure* refers to a detailed explanation of how to do a specific job, such as mimeograph duplicating or verifying invoice amounts and extensions. It consists of a series of related steps constituting an established scheme for the performance of a specific task. Use should be made of pictures, charts, diagrams, and solutions to a few sample problems. The steps to be followed should be clearly stated and, if practicable, illustrations should be given. When procedures are outlined for various jobs, the performance of each task is simplified; there is little or no need for planning each stage of the work individually.

Some of the advantages gained from the use of office procedures are:

1. Loss of time due to delay and indecision is decreased.
2. Uniformity in handling routine tasks makes it possible to locate work "in process" and check on work progress.
3. Responsibility can be fixed.
4. Training is simplified, for duties and operations of each job are clearly defined.
5. Since successive steps in an operation are clearly indicated, opportunities for omissions and inaccuracies are minimized.
6. The quality of service is improved and financial savings accrue.[8]

In establishing a procedure, several factors should be observed: an analysis should be made of the entire office process in terms of the physical layout, a logical sequence for the various steps should be

[8] See Terry, George R., *Office Management and Control,* p. 605. Chicago: Richard D. Irwin, Inc., 1949.

established, the amount of writing to be done should be kept at a minimum, the procedure should be flexible enough to be adaptable to individual needs and managerial preferences, and a different procedure should be established for each type of work to be done.

## BILLING DEPARTMENT TYPING

*Local Invoices*

STANDARD TIME (PER EACH)

| | STD. | RATIO OF OCCURRENCE | ACTUAL OCCURRENCE COUNTED | RESULTING AVERAGE TIME | TOTAL STANDARD |
|---|---|---|---|---|---|
| SOLD TO | .40 | | | | |
| SHIP TO | .20 | | | | |
| SHIPPED FROM & DATE | .10 | | | | |
| HEADING | .30 | | | | |
| COMMODITY | .13 | | | | |
| 1st LONG LINE | .30 | | | | |
| OLD COMMODITY | .15 | | | | |
| DISCOUNT | .08 | | | | |
| TEAR-OFF | .10 | | | | |
| CLIP & DISPOSE | .20 | | | | |
| EXAMINE ORDER | .25 | | | | |
| RECORD WORK | .08 | | | | |
| TIME COMMON TO EACH INVOICE | | | | | 2.29 |
| PLUS ALLOWANCE: | | | | | |
| SOLD TO LONG LINES | .40 | 1/4 | x77 | 30.8 | |
| SHIP TO LONG LINES | .20 | 1/2 | x143 | 28.6 | |
| SHORT LINES | .23 | 1/16 | x19 | 4.4 | |
| LONG LINES | .30 | 1/1.5 | x183 | 55.0 | |
| COMMODITIES | .25 | 1/10 | x31 | 7.8 | |
| OLD COMMODITIES | .13 | 1/10 | x30 | 3.9 | |
| DISCOUNTS | .08 | 1/10 | x31 | 2.5 | |
| FIGURES & PART NOS. | .15 | 1/10 | x31 | 4.7 | |
| NOTES PER LINE | .15 | 3/1 | x900 | 135.0 | |
| EXTRA COPY (INSERT) | .50 | 1/25 | x12 | 6.0 | |
| ERASE & CORRECT | .50 | 1/1 | x300 | 150.0 | |
| "NO PRICE" COPY | .25 | 1/25 | x12 | 3.0 | |
| PP & INS. | .15 | 1/6 | x53 | 8.1 | |
| TYPE "TOTALS" | .08 | 1/1.9 | x160 | 12.8 | |
| INFORMATION | 2.00 | 1/50 | x6 | 12.0 | |
| TOTAL | | | | 464.6 | — 1.54 |
| WEIGHTED STANDARD PER AVERAGE INVOICE | | | | — 300 | — 3.83 |

*Courtesy Remington Rand Inc.*

*Figure 9-8.* This chart shows a calculation of standard time for typing invoices.

*Office Standards.* If fair comparisons of office work are to be made, there must be standards and records of performance. Mr. I. J. Berni states that "it is generally accepted in office management circles that the average clerical worker is busy on production work only about 65

percent of the working day." [9] He goes on to suggest that, with proper incentives, even the best and most experienced clerks can and will increase the amount of satisfactory work completed by approximately 35 percent without any danger of nervous fatigue.

This indicates that without standards control is difficult, if not impossible. The idea of determining standards is based upon measurements of output per specified unit of time. An analysis of the method used by the worker and the motions he goes through in its performance will probably result in increased productivity. Standards can best be determined by timing actual performances of the tasks involved.

**BILLING DEPARTMENT**

**COMPARISON CHART**

| OPERATION | AVERAGE DAY'S WORK PRIOR TO TIME STUDY STANDARD | TIME STUDY STANDARD | AVERAGE DAY'S WORK SIX MONTHS AFTER TIME STUDY |
|---|---|---|---|
| 1. TYPE INVOICE | 90 INVOICES | 120 | 136 |
| 2 PRICE-DISCOUNT ORDER | 300 ORDERS | 384 | 480 |
| 3. COMPTOMETER ORDER EXTENSION | 400 ORDERS | 480 | 538 |
| 4. INVOICE PRICE-DISCOUNT CHECK | 375 INVOICES | 400 | 412 |
| 5. INVOICE COMP-TOMETER EXTEN-SION CHECK | 600 INVOICES | 960 | 1,075 |

*Courtesy Remington Rand Inc*

*Figure 9-9.* This comparison chart shows an average day's work before and after determining standard time by means of a time study.

It is not possible to give one set of standards that would apply for all types of industrial activity. Practices in different companies are reported in Appendix B of the *Office Management Handbook*.[10] An example of what can be done to reduce costs through the establishment of standards based on time and motion studies is reported by John A. Handy, Jr., in the magazine *Systems for Modern Management* for June, 1949. The major cost element, salaries, "was cut approximately 33 percent in three months at almost no additional expenditure of money

[9] Berni, I. J., "Good Personnel Management Can Raise Office Production." *The Office*, July, 1949, Vol. 30, No. 1, p. 17.

[10] Maze, Coleman (editor), *Office Management; A Handbook*, pp. 783-809. New York: Ronald Press Company, 1947. See also *Office Standards And Planning Book*. Jamestown, New York: Art Metal Construction Co., 1948.

merely through the establishment of time study standards and measurement of what was really required. The time study standards used in the illustrated example [Figures 9-8, 9-9, and 9-10] are typical of those which can be established in almost all office departments, at least on the elements of work which involve repetitive or production operations." [11]

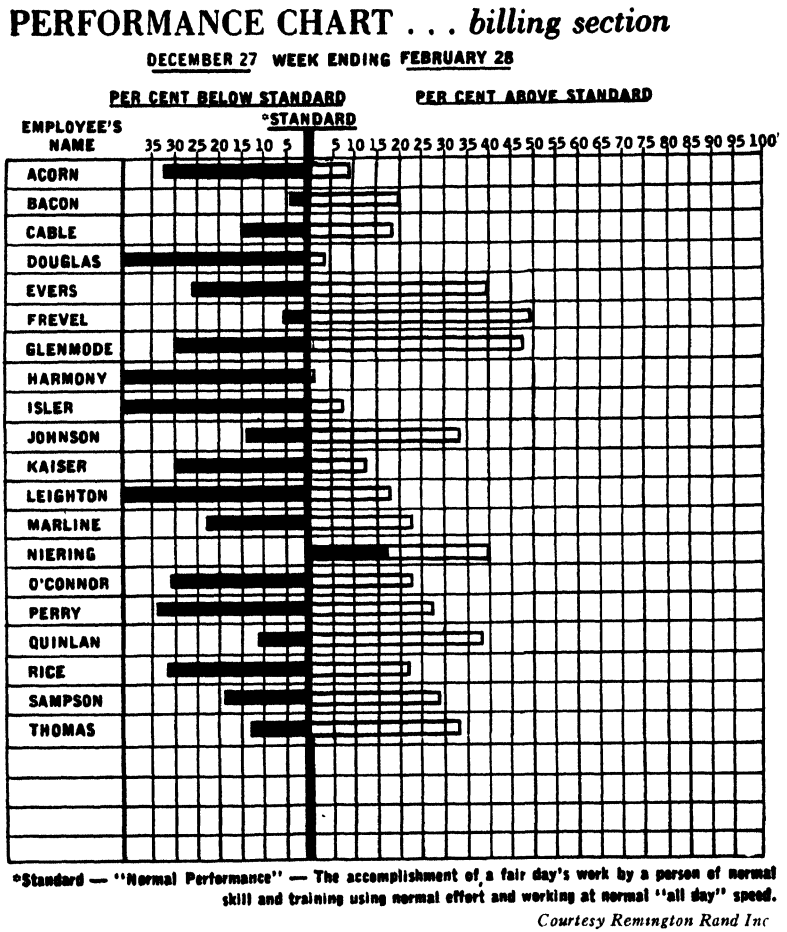


*Figure 9-10.* Performance before and after setting a standard by means of a time study is shown here.

In addition to standards for production, considerable reductions in costs can be gained through the adoption of uniform standards for

[11] Handy, John A., Jr., "Reducing Office Costs." *Systems for Modern Management,* June, 1949, Vol. 13, No. 6, p. 28.

equipment, supplies, and office forms. In 1946 the Board of Directors for the National Office Management Association requested the American Standards Association to establish a project on office standards. After much planning, the committee appointed to make suggestions about the scope of such a study recommended that the project should include: dimensions, quality, single performance characteristics, methods of testing, and nomenclature for:

1. Office equipment, such as desks, chairs, tables, safes, files, and cabinets;
2. Paper used in the office, including bristols, bonds, ledgers, and folder stocks;
3. Forms, records, and procedures;
4. Supplies such as pencils, binders, erasers, and staplers; and
5. Business machines, such as those for adding, calculating, dictating, duplicating, and typewriting.[12]

This recommendation was approved by the American Standards Association, and many Office Standards Committees were appointed to carry on the work of establishing desirable standards. The results of the work of these committees will be published by the National Office Management Association when it is completed.

The establishment of certain production standards makes possible the scheduling and equitable distribution of the work to be done. The effectiveness of individuals and groups can be determined, control over costs achieved, and the morale of the workers raised.

*Office Manuals.* Employees are entitled to know not only their duties and responsibilities in terms of their specific jobs but company policies and practices as well. To give the employees this information, office manuals are frequently used; they are regarded as "musts" by the management of many business firms.

## Control through budgets

The office manager exercises control over his department by means of a budget. In addition, he is responsible for keeping adequate records from which budgets for other departments are prepared. In fact, the office manager collaborates with the administrative executives of the other departments in the preparation of budgets for their departments. In all probability he will prepare the master budget for the entire organization. If there is to be a fully effective cost-reduction program in

[12] Hilton, C. E., "Standards Galore." *NOMA Forum,* January, 1948, Vol. 23, No. 1, p. 29.

the administration of an office, there must be "a continuing cost control and budgetary program which is applying pressure in the reduction of costs." [13]

The use of budgets does not within itself constitute management; rather, budgets are instruments or tools that management may use for control purposes. When well prepared and based on past performances, they serve to reveal weaknesses in office organization; they facilitate the fixing of responsibility, make possible comparisons that show trends in office performances, and help to give balance to the relationship of each division to the remaining divisions within the office organization.

## Qualifications of the Office Manager

The qualifications of the office manager fall naturally into these three divisions: personal qualities, educational training, and business experience.

### Personal qualities

The personal qualities needed by the office manager are the same as those for other business executives. He must be a leader of men; he must be capable of thinking and planning in a constructive manner and of seeing that his plans and decisions are carried through to completion. He must be capable of looking at the entire scope of an organization rather than at isolated phases. In addition to having administrative ability, he must possess the qualifications of a good salesman, because he must sell his ideas to top management and influence his coworkers to see the importance of the services rendered by the office. He should be able to express himself simply and clearly, and he should possess the following personal qualities: tactfulness, imagination, patience, co-operation, initiative, open-mindedness, loyalty, and sincerity.

### Training

Although courses in office practice and office management are offered in many colleges of business administration, there usually is no specialized curriculum designed specifically for those who wish to become office managers. In addition to courses in office practices and procedures and in office management, the prospective office manager should study business organization and management; personnel management, including courses in applied psychology; and economics, accounting, and secretarial science.

[13] Lochiel, R. G., "Teaching Top and Bottom Management For Cutting the Cost of Operations." *NOMA Forum*, August, 1949, Vol. 24, No. 8, p. 28.

### Experience

The office manager, like any other executive, must have a wide acquaintanceship with business in general, as well as detailed knowledge of the firm for which he works and a mastery of good business principles as applied to his own specialty. His work brings him into contact with many different phases of business and with many different kinds of people; this means that the broader his practical business experience is, the better prepared he will be. His experience, like his educational training, should include work in administration, in accounting, and in secretarial work.

Most office managers begin their business careers as accountants or as secretaries. The work of the accountant was discussed in Chapter VII. Secretaryship as a career will be presented as a part of this chapter.

Something of the business ethics required of an office manager are reflected in the code of the National Office Management Association shown in Figure 9-11.

## Secretaryship in Business

Because there are different types of office workers, it is necessary to clarify at the outset what is meant by one specific type of office work —secretaryship.

People are employed in offices to perform routine, mechanical, and clerical jobs. One such group is composed of operators of various types of office equipment, such as duplicating machines, posting and billing machines, calculators, and keypunch machines. Another group consists of those who perform various types of clerical duties, such as mail clerks, file clerks, accounting clerks, clerk-typists, and general office clerks. A third group includes those whose work is largely that of typewriting; this group includes typists and voice-transcriber operators. These office workers are not secretaries. The skill required to render an acceptable performance for many of these operations can be acquired within a relatively short period (a few months) of intensive training. A secretary is called upon occasionally to perform these tasks, but they are not part of his regular routine and he does not devote much of his time to them.

There is also the stenographer, who spends most of his time taking dictation, transcribing dictation, and using the typewriter. Again, the secretary might take dictation, but he does not spend much of his time doing stenographic work.

The secretary is in reality a professional individual; he has a close

personal contact with his employer, supervises the work of other office personnel, and has the responsibility for relieving his employer of many important administrative duties. The secretary may be said to be his employer's clerical-stenographic-administrative assistant. Adequate preparation for secretaryship requires much more than the mastery of a few specific skills.

National Office Management Association

This certifies that

has become a member of this Association and is entitled to all its benefits and privileges for the duration of membership

Given this month of ..... 19.....

H. K. Evans
Secretary

## CODE OF ETHICS

AS A MEMBER OF THE NATIONAL OFFICE MANAGEMENT ASSOCIATION

### I Acknowledge:

**That** *I have an obligation to the science and art of management. I will uphold the standards of my profession, continually search for new truths and disseminate my findings. I will keep myself fully informed of developments in the field of management and cooperate with others in the use of our common knowledge.*

**That** *I have an obligation to my employer, whose trust I hold I will endeavor, to the best of my ability, to guard his interests, and to advise him wisely and honestly*

**That** *I have an obligation to do all in my power to assure the progress and contentment of my fellow workers I will at all times deal with them fairly and openly, sharing of my acquired knowledge and experience freely*

**That** *I have a dual obligation to society, arising through my personal and company relations in the social and economic life of our nation; further,*

**That** *I have a continuing obligation to my country and to the chosen way of life of my fellow citizens.*

I ACCEPT MEMBERSHIP IN THIS ASSOCIATION AS A PERSONAL RESPONSIBILITY TO ACTIVELY DISCHARGE THESE OBLIGATIONS AND I DEDICATE MYSELF TO THAT END

*Courtesy NOMA*

*Figure 9-11. Code of Ethics.*

There are several types of secretaries: the *personal secretary,* the *private secretary,* the *business secretary,* and the *executive secretary.* The personal secretary is usually employed by people who conduct their affairs at home, such as retired people, philanthropists, actors, and writers. The private secretary is employed as an assistant to the owner of a business or a professional man. The business secretary is usually an assistant to an executive in a large firm; in addition to taking care of some correspondence, he relieves his employer of many administrative details and responsibilities. The executive secretary is usually an assistant to the director of an institutional organization (for example, a university president), or is in charge of the office for a national or state professional organization, such as the National Educational Association, the United Business Education Association, the American Medical Association, or the National Office Management Association.

### The significance of secretarial work in business

Every large business organization employs many secretaries. Business executives would be seriously handicapped if they had to devote hours each day to details normally handled by their secretaries. By shifting these details, including the delegation of work to other office personnel and the supervision of their work, to his secretary, the business executive frees his time for important committee work, board meetings, administrative planning, and public relations work. Business executives would not be one-half so effective or so valuable to their organizations if they did not have secretaries to help them. Any person who is accustomed to having a secretary and who has to do his work for several days without one can testify to the secretary's importance to his organization.

### The nature of secretarial work

The work of the secretary is varied; in the course of a day he performs dozens of different duties. These include serving in a stenographic, clerical, editorial, and supervisory capacity; handling correspondence and filing; performing personal-social duties; answering the telephone and acting as receptionist; and attending to administrative detail.

### Desirable personal qualifications

A secretary's success depends upon both technical skill and desirable personal qualities. He must possess above-average intelligence, good judgment, a keen memory, orderliness, and versatility.

An office caller's first impression of the firm is often determined by the secretary's personal appearance and manner. A secretary who is well groomed and well mannered, polite, and courteous makes a favorable impression upon those who call to see the employer.

The secretary's voice is important both in the reception room and on the telephone. It is frequently necessary for the secretary to entertain callers for several minutes until his employer is free to receive them. Here a broad knowledge and wide experience will prove of inestimable value.

Good health makes it possible for the secretary to be on the job regularly and to have good posture, a good appearance, and a good disposition. A person who is not in good health cannot be so mentally alert as a secretary is expected to be.

There have been many studies of duties and traits that employers value in their secretaries. Those considered of greatest importance by the largest number of men are: accuracy, ability to assume responsibility, dependability, intelligence, courtesy, initiative, sound judgment, tact, personal pleasantness, and personal appearance. Other important qualities are:

| | | |
|---|---|---|
| Loyalty | Stability | Sense of humor |
| Adaptability | Enthusiasm | Co-operation |
| Punctuality | Reliability | Industry |
| Sincerity | Resourcefulness | Discretion |

## Employment and promotion opportunities

According to the United States Bureau of the Census, there were slightly over one million persons employed in stenographic and secretarial positions in 1940. This number increased at an average rate of 100,000 each year from 1940 to 1948. It is estimated that there will be approximately two million stenographic and secretarial positions by 1952.

This annual increase makes secretaryship an attractive occupation. Combined with the vacancies that result from marriage, retirement, and promotion to executive positions, it affords more than one-fourth of a million job opportunities each year for those trained to do secretarial work.

Though most secretarial jobs are to be found in large urban communities, there are employment opportunities in every community, large or small, for both men and women. In spite of the large numbers who enter this field each year, the demand for well-trained, experienced secretaries exceeds the supply.

There are excellent opportunities for secretaries in the employ of the federal and state governments. During 1949, for example, there was such a shortage of secretarial workers that the stenographic-secretarial examination was given almost every month by the Federal Civil Service Commission. Secretaries working for the federal government under Civil Service are given ratings from GS 3 to GS 7.

State Merit System or Civil Service examinations are given in the various states whenever workers are needed. The examination for secretarial positions is given at least once a year.

Secretaryship is excellent experience, particularly for young men, and prepares one for executive positions. The personal secretary of an executive of a business organization may easily qualify himself for a more important position in that company. His work enables him to learn the principles and innermost functions of the organization. Because he works so closely with business executives, he has every opportunity to develop the knowledge, traits, and characteristics of those who hold executive positions. Woodrow Wilson, Chief Justice Hughes, Irvin S. Cobb, Billy Rose, H. V. Kaltenborn, and Dorothy Thompson are among the hundreds who have stated that their progress to important positions came considerably through the richness and value of their secretarial experience.

### Advantages of secretarial work as a career

Some of the advantages of secretaryship are:

1. Modern offices are well-lighted, ventilated, and clean.
2. There is a wide choice of employment opportunities, for there are secretarial positions in almost every type of business endeavor.
3. Because there are secretarial positions in every geographical area, the secretary may choose his place of residence freely.
4. Secretaries have close personal contact with executives who control promotions.
5. For the most part, the workday is over at five, and the secretary's duties and responsibilities are left at the office.
6. Secretarial work is valuable as an entering wedge in almost any field.
7. Work is interesting because of the great variety of tasks performed.

## Terms for Study

| | | |
|---|---|---|
| Alphabetical | Forms | Records |
| Appliances | Geographical | Reports |
| Budget | Manual | Simplification |
| Centralization | Memorandum | Systemization |
| Correspondence | Numerical | Vertical |
| Filing | Procedure | |

## Questions

1. Management is dependent upon the office for what types of services?
2. What are the purposes of office records? Why are printed forms used in offices?
3. Why is centralized authority and responsibility essential for efficient office management?
4. Into what areas are office problems classified?
5. What does it cost to prepare an average letter for mailing?
6. Why is proper filing important to management?
7. What are the main types of filing plans?
8. What information about office equipment and appliances is recorded in the equipment register?
9. What are some of the problems concerning office personnel with which the office manager must deal?
10. What are some of the ways through which office control may be exercised?
11. What is meant by the term *office procedures*?
12. In what ways do office manuals serve office management?
13. What are some of the accepted standards for various types of office work?
14. How can a budget be used as a control device?
15. In what areas should one who aspires to the position of office manager get practical experience?
16. What are the chief differences between the work of a stenographer and that of a secretary?
17. What personal qualities do employers expect their secretaries to possess?
18. Why does secretaryship provide excellent preparation for executive positions?

## Problems and Projects

1. Consult typewriting manuals, texts on business correspondence, or secretarial handbooks and become familiar with four different letter styles. (Include the "Simplified Letters" sponsored by the National Office Management Association.) What are the advantages of each style?

2. Visit the nearest United States Employment Service office and learn how many calls for secretaries, stenographers, and other types of office workers that office has received during the past six months.

3. Secure a copy of the most recently published edition of the National Office Management Association's *Salary Survey of Office Occupations* and determine the current prevailing wages for secretaries in your area. (These are available only to NOMA members and participating firms. You can probably arrange to borrow a copy from a NOMA member in your community.)

4. Have the personnel or office manager of a local business enterprise explain the criteria he uses in selecting secretaries for employment. Also, find out if it is the policy of the company to select their personal or private secretaries from the personnel within their organization.

5. Prepare a set of criteria for use in evaluating the quality of a particular firm's correspondence.

6. Choose a particular type of office equipment and list the leading manufacturers of that type of equipment who serve your area.

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CHAPTER X

# PERSONNEL MANAGEMENT

IN CHAPTER V, "Business Management and Internal Organization," it was shown that personnel management is one of the important phases of business management. In this chapter the importance of the personnel department's services to business management, the nature of personnel work, and career opportunities are considered.

## The Significance of Personnel Management

It is desirable at the outset to distinguish between the terms *personnel management* and *industrial relations.*

*Personnel management* has to do with planning, directing, and co-ordinating activities that are concerned with securing, training, organizing, and utilizing employees in such a manner as to attain company objectives efficiently and economically, to the best advantage of the employees in terms of their capacities, interests, and opportunities.

> Personnel work is the planning, supervision, direction, and co-ordination of those activities of an organization which contribute to realizing the defined purposes of that organization with a minimum of effort and friction, with an animated spirit of co-operation, and with proper regard for the genuine well-being of all members of the organization.[1]

Some of the problems, such as employment, training, transfer, and promotion, call for dealing with the labor force as individuals. Others, such as the determination and administration of a sound wage policy and the maintenance of worker morale, involve dealing with the labor force collectively rather than as individuals.

*Industrial relations* is a broader term; it includes all that personnel management is generally thought to include and, in addition, embraces problems of labor relations dealing with labor unions, collective bargaining, and labor disputes. These subjects will be discussed in the following chapter.

Personnel work is one of the newer professions. Following World War I, industrial leaders began to sense the economic waste of hiring

[1] Tead, Ordway, and Metcalf, Henry, *Personnel Administration,* p. 39. New York: McGraw-Hill Book Company, 1933.

employees for jobs to which they were unsuited. World War II gave a forceful impetus to personnel work, for the armed forces used technically trained men and women to classify and assign the millions of individuals who entered the service. Business and industry, faced with a critical labor shortage during that period, looked to personnel departments to find new sources of labor supply and to keep employees on the job, contented and productive.

Manpower is now considered to be the most important asset in business and industry, and the full and effective utilization of this manpower is a major responsibility of business management. Better working conditions, better wages, and increased benefits make employees happier, more loyal, and more productive. Management benefits through increased production, less labor turnover, and freedom from labor conflicts.

In small businesses a separate personnel department is not required. However, someone must do the interviewing, testing, and employing; someone must be responsible for training, disciplining, and discharging employees. It is possible to have these specialized services done by someone outside the business organization, but if a business is to have a tailor-made personnel policy and program, it is necessary for someone in the organization to know personnel problems, techniques, and procedures.

The personnel department of a large business is very closely related to all the functions of the enterprise. In addition to hiring all workers, it affects other departments by its training and service programs. Since the personnel are distributed throughout the business, the personnel department is definitely interested in all the divisions of the company.

One illustration is given here to present an idea of the personnel department's tremendously important role.

A study of 1,167 trainees employed by 247 companies was conducted by the management-consultant firm of Robert N. McMurry and Company of Chicago. It revealed that 42 percent of these trainees either gave unsatisfactory performances or had left the employ of the company by the end of the year in which they were employed. The median outlay per trainee was $2,750 per year. The cost to one company, where only 16 of 31 trainees were still on the job at the end of the year, was $41,250, and there were still gaps to fill in the organization. Mr. McMurry concluded that the fault may lie not so much with the trainee as with the employment techniques used in their selection. He recommends that in addition to the usual appraisal of technical qualifications and academic records and the use of employment tests, there should be

an evaluation of "the degree of emotional maturity an applicant has in relation to the job he wants." There should be "a clear definition of personality qualifications for a job, and a patterned interview that discounts the interviewer's personal biases." [2]

## The Nature of Personnel Work in Business

The organization of a personnel department is shown in Figure 10-1.

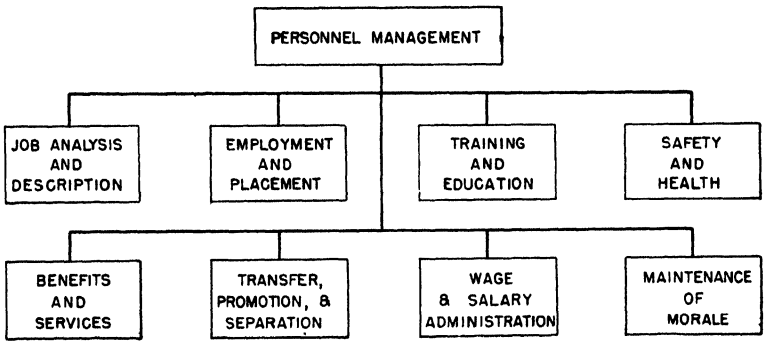


*Figure 10-1. Problem Areas in Personnel Management.*

### Job analysis and description

Job analysis is the study of a particular job to determine various facts about it. Job analysis determines what, why, and how work is to be done, and it designates how much skill and what personal qualifications are required for the efficient performance of each job.

The job description is a written report based upon the analysis. The job description includes a statement of machines and equipment used, operations performed, physical or mental skill required, working conditions recommended, and degree of responsibility assigned. After job descriptions have been prepared, different jobs can be classified and the relationships among them determined.

Both analysis and description are important to management, because they form the basis for selecting and training workers, provide data for handling promotions and transfers, are essential sources of information for settling grievances, and help in forming wage payment plans.

All these data are advantageous to both management and the worker; they represent the application of scientific principles in per-

[2] *Business Week*, November 27, 1948, No. 1004, p. 30.

sonnel administration. They will not prevent all misunderstandings from arising, but they will serve to give information to both management and the worker and make for better understanding of the worker's responsibilities.[3]

## Employment and placement

The important functions of the employment division of the personnel department are the selection and placement of new workers. These functions are difficult to perform adequately. Proper selection of employees can take place only after job analyses and descriptions have been completed.

Employment procedures were considered in Chapter I. Either before or after an applicant's past record and references are investigated, he is given an interview by some member of the company's regular employment staff.

*The Employment Interview.* One purpose of the interview is to gather information about the applicant. It is desirable to learn about his attitude toward his work in other places, to observe whether he is able to express himself clearly, and to evaluate his personal traits and characteristics. It is important to determine how he will fit into the organization, what his attitude toward his coworkers will be, and what their reactions toward him are likely to be.

In the past, interviews have not been a completely reliable means of selecting employees. This has been at least partly the result of personal prejudices and failure to administer the interview objectively and scientifically.[4]

On the other hand, many business firms have successfully placed considerable emphasis on interviews.[5] In these cases the interviewer was trained and unbiased, and conducted a carefully planned interview in which he sought specific information on subjects that had been determined in advance of the interview.[6]

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[3] For a detailed discussion of job analysis and description, see Yoder, Dale, *Personnel Management and Industrial Relations,* 3rd ed. Chapter V. New York: Prentice-Hall, Inc., 1948.

[4] Hepner, Harry W., *Psychology Applied to Life and Work,* 2nd ed., pp. 299 ff. New York: Prentice-Hall, Inc., 1950.

[5] *Business Week,* November 27, 1948, No. 1004, p. 30.

[6] See McMurty, Robert N., "Validating the Patterned Interview." *Personnel,* January, 1947, Vol. 23, No. 4, pp. 263-272. See also Bingham, Walter V., and Moore, Bruce V., *How to Interview.* New York: Harper & Brothers, 1941; and Hennigsen, Carl, "DuPont Finds Dividends in the Proper Selection and Placement of People." *NOMA Forum,* May, 1949, Vol. 24, No. 5, pp. 14-17.

It has been frequently pointed out that approximately three-fourths of those who lose their jobs do so because of personal reasons. All too frequently this is misinterpreted to mean that these people are misfits because they have undesirable or unacceptable personalities. This is not necessarily the case; rather, it may be that these people have not been properly placed in jobs. One of the purposes of job analysis is to determine the type of personality needed for the efficient performance of each job. The interviewer attempts to determine what job would suit the personality of the applicant. It is the task of the interviewer to take everything into consideration. When the new employee is properly placed in a job, when he is given the necessary training, and when he is associated with individuals with whom he enjoys working, he is quite likely to get along well.

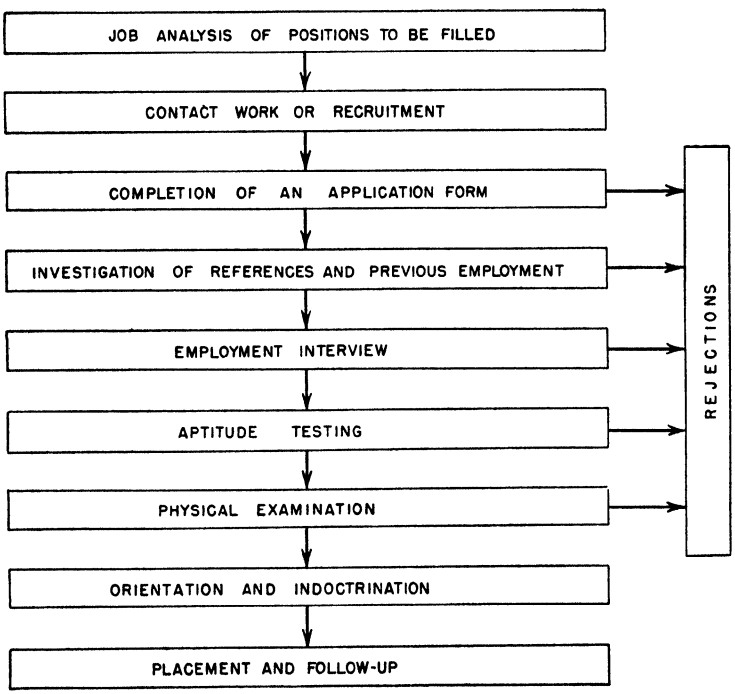



*Figure 10-2. Employment Procedure.*

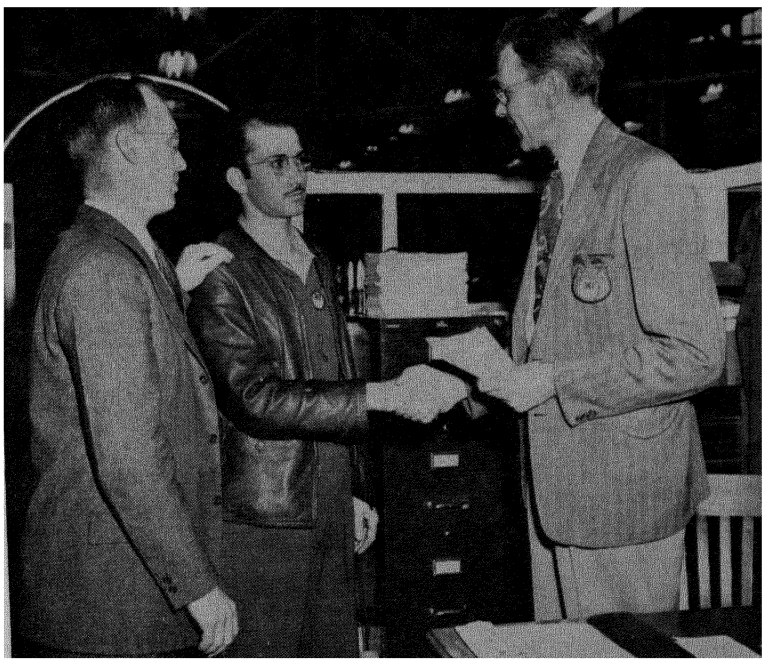
A second purpose of the interview is to give the applicant information about the firm and the job: salary, promotion policy, working hours and conditions, and skills required.

*Other Techniques Used in Employee Selection.* In addition to a careful investigation of the applicant's record and the employment in-

terview, various types of tests are frequently given. Some of these are intelligence tests, interest tests, knowledge tests, tests for special aptitudes and abilities, and skill or performance tests. These were all discussed in Chapter I.[7] In addition, the applicant is usually given a physical examination or asked to submit a physician's health certificate.

*Orientation and Indoctrination.* It is also necessary for the worker to be familiarized with certain basic company policies and particularly with those of the department in which he is to work. This orientation and indoctrination can be accomplished by a tour of the company, by using films prepared for this purpose, by talks explaining certain company policies, or by a combination of these procedures.

The employment procedure described in the foregoing discussion is illustrated in Figure 10-2.



*Courtesy Boeing Airplane Company*

*Figure 10-3. Introducing a New Man to His Job.* Since it is necessary for a new man to be shown his assignment, a staff member of this company's shop school takes personal responsibility for introducing the employee to the general foreman of his division.

[7] See also Yoder, Dale, *Personnel Management and Industrial Relations,* 3rd ed., Chapter VIII. New York: Prentice-Hall, Inc., 1948.

## Training and education

After employees are selected, they must be trained. The purpose of training is to equip workers for the successful performance of their jobs. The training program embraces those who have been with the firm for many years as well as new personnel. The transfer and promotion of workers to new jobs necessitates job training. There is also special training for instructors, supervisors, foremen, and executives.

A firm pays for training whether it has formal training programs or not. If the inefficient worker is not given help in learning his work, he learns strictly by experience. Such training is more prolonged and more expensive to his employer than training in an organized program.

Five kinds of training are as follows:

1. *Job training.* Here specific training is given the worker under supervision on the job.
2. *Vestibule training.* Here training is given away from the job under conditions that duplicate as nearly as possible the job situation. Skilled instructors strive to develop techniques and working processes.
3. *Apprenticeship training.* This type of training is similar to job training with the exception that here the worker is engaged in learning a craft that involves many related tasks, whereas job training is usually confined to one specific job.
4. *Supervisory training.* This type of training is basically leadership training in orientation, administration, human relations, technical knowledge, and instruction.[8]
5. *Executive training.* This is the highest level of training. It is obviously designed to build the highest quality of leadership in the administration of the business.

*Training Methods.* Training is usually provided in three ways: Courses are organized by the training department of the business and taught by an employee of the firm, persons are employed for the specific purpose of teaching the courses, or educational institutions organize and teach certain courses at the request of a business. Under the first two plans, the courses are usually held on the premises of the business firm. In the third case, courses are usually offered at night on the campus of the educational institution and business firms encourage their employees to take them. For example, the American Bankers Association has prepared a regular course of study for banking em-

[8] Planty, Earl, and McCord, William, "The Scope and Organization of Supervisor Training." *Personnel,* January, 1946, Vol. 22, No. 4, p. 224.

ployees; member banks, either co-operatively or individually, have a continuous instructional program.

In addition to leadership courses, instruction in production techniques, skill-development courses such as typewriting and shorthand, and classes in English are taught. All the modern methods of teaching, including lectures, demonstrations, instructional films, and conferences, are employed. Regular classrooms are provided and equipped with such teaching aids as blackboards, handbooks, cash registers, and projectors. Libraries are maintained and technical magazines are circulated among the employees.

During World War II, the War Production Board organized a program called "training within industry." Job analyses and instructional programs were planned for, or in co-operation with, different types of business and industry. The work of this group continued after the war under the name of the Training Within Industry Foundation. Its services are employed by many firms to supplement their own in-service training programs.

### Safety and health

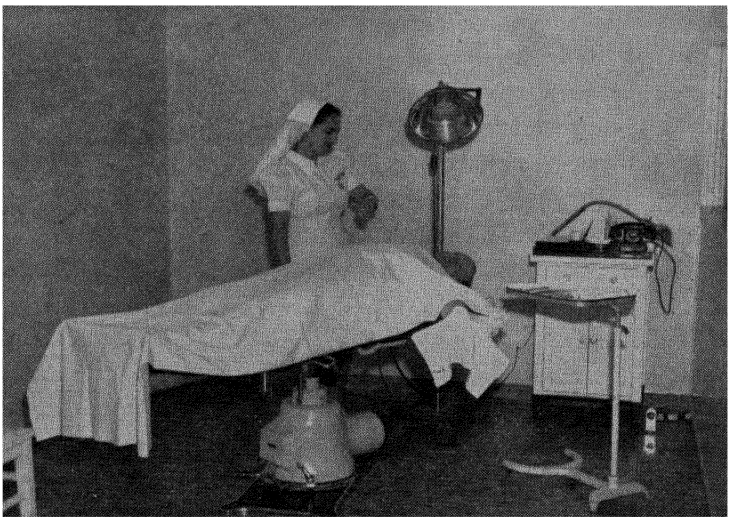
*Health Programs.* The basic principle underlying the organization of a health service for company employees is the fact that employees must be well or they will be unable to work. Maintaining a healthy working force requires, first, a physical examination at the time of employment and, second, a health program to keep employees in good physical condition.

It is estimated that approximately 2 percent of workers' productive time is lost because of illness and that illness is responsible for approximately 8 percent of all permanent separations from the labor force.

In addition to providing medical and dental services, a complete health program would include organized first aid, an optical clinic, proper sanitation, proper lighting, adequate heat and ventilation, and adequate safety provisions.

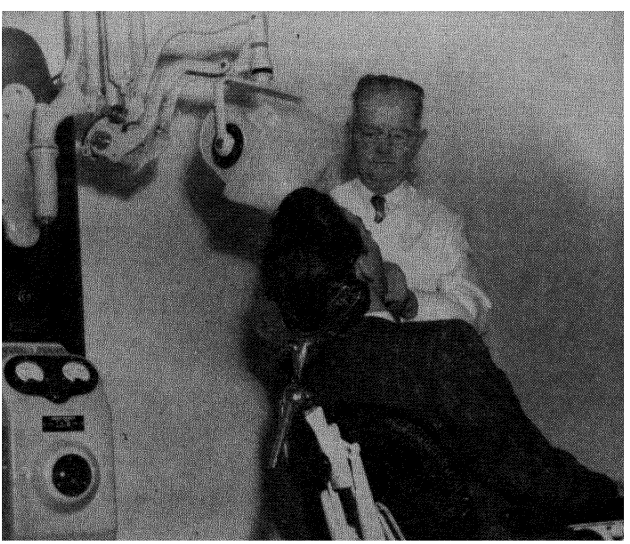
The amount of health service varies from first aid and emergency treatment in small businesses to complete medical, surgical, and hospitalization service in large businesses. In recent years many firms have adopted the plan of giving mass X-rays and inoculations. They believe in preventive medicine, not only because it increases production for the firm but also because it eliminates much human waste and suffering.

The pictures shown in Figures 10-4, 10-5, and 10-6 were not taken in a professional medical clinic but in the health clinic of a manufacturing firm that believes in preventive medicine.



*Courtesy The Gates Rubber Company*

*Figure 10-4.* A modern emergency operating table is part of this company's up-to-date equipment.



*Courtesy The Gates Rubber Company*

*Figure 10-5.* Emergencies get quick attention in this emergency room. Here an X-ray photograph is being taken.

*Courtesy The Gates Rubber Company*

*Figure 10-6.* When the doctor prescribes medicine, the prescription is filled by this company's own staff.

*Safety.* It is difficult to determine accurate figures for the frequency and cost of industrial accidents because of the lack of uniformity in reporting accidents to state authorities. Usually, only accidents that result in a loss of time greater than the shift during which they occur are reported, and in 14 states only those for which compensation is paid are reported. Also, the number of accidents varies proportionally as the rate of production is speeded up or slackened. However, there are approximately two million work injuries annually, of which one in 20 results in permanent total disability and an additional one in 23 results in permanent partial disability. This represents a tremendous loss of time and money, the expense of which must be absorbed by the company as a cost of production or be passed on to the consumer as a part of the cost of the article manufactured. In either event it is to the advantage of business and the public to prevent all possible industrial accidents.

Research studies have been undertaken to determine the causes of industrial accidents as a basis for preventive techniques and procedures. The many factors that contribute to industrial accidents have been classified into two distinct types: first, those due to personal characteristics and attitudes of workers, and second, those due to impersonal factors or working conditions. Studies made by the National Safety

Council have revealed that both factors are present in approximately 66 percent of all accidents. Accidents are often caused by lack of knowledge on the part of the worker, improper attitude, and physical defects, on the one hand, and by inadequate lighting and ventilation, improper guards on machinery, and defective machinery, on the other.

*Courtesy Norton Company*

*Figure 10-7. Safety Devices.* The equipment displayed here is that used by a large manufacturing company.

The safety division of personnel management is responsible for the establishment of safety standards and policies, for safety inspections, and for a safety education program. Some of the techniques used are: safety manuals, safety records, training in the use of fire equipment, posters, the plant magazine, individual and group conferences, and films.

## Benefits and services

We have just noted that employees' attitudes play an important role in accident cause and prevention. Studies have shown that there are many things in addition to providing adequate wages and liberal retirement plans that companies can do to create desirable attitudes on the part of their employees. Contented employees not only produce more but are more likely to remain with their company for a lifetime.

Years of continuous service are desirable to both the company and the individual worker.

*Courtesy General Foods Corporation*

*Figure 10-8. Medical and Compensation Charges Economical.* Often visual aids are used by management to emphasize their attitude toward the economic importance of medical and compensation charges in their organization.

Financial aids to employees, group insurance, group hospitalization, retirement income payments, mutual savings programs, employee discounts on purchases, and loans during lay-off periods constitute some of the principal types of benefits. Other benefits and services commonly made available to employees are legal aid, income-tax service, counsel in personal matters, cafeterias, social get-togethers and company picnics, company periodicals, libraries, educational classes, service pins, and suggestion awards.

### Transfer, promotion, and separation

Transfer and promotion are important phases of personnel management; it is essential that a definite policy regarding them be established and that it be clearly understood by both management and labor.

*Transfer.* The term *transfer* is used to refer to the shifting of an

employee from one position to another without increasing his duties, responsibilities, requirements, or pay.

When transfers are made, care must be exercised to assure that there are valid reasons for making them and that hardships are not imposed on workers. It is important that the employees being moved understand the reasons for such transfers so that they will know they are being treated fairly and are not being shifted merely for the convenience of someone else. They should be informed, too, whether the transfer is permanent or temporary and, if the latter, for approximately how long it is to be effective.

*Promotion.* The term *promotion* refers to the shifting of an employee to a new position in which his prestige and responsibilities will be greater than they were in his former position. An increase in compensation is not essential, but increases usually accompany or soon follow promotions.

It is essential that a systematic plan of promotions be developed in order to avoid labor unrest and labor turnover. The best-qualified employees of a company become dissatisfied and leave if few opportunities for advancement exist or if promotions are made only infrequently. It is important, however, that promotions be deserved.

Promotions are advantageous to the firm as well as to the employee. Management thus knows that deserving employees have been taken care of, workers are situated where they can produce more, and the cost of orienting and training new people is greatly reduced.

An advancement in rate or rank that does not involve a move into a new job classification is called a horizontal promotion. One that moves an employee into a job that is of a higher classification is referred to as a vertical promotion.

*Separation.* Separations from the employ of a company may be either temporary or permanent, voluntary or involuntary. When a person is laid off, it is usually because of a temporary lull in business. It is customarily assumed that those laid off will be re-employed as soon as business returns to normal.

When employees leave the company of their own free will, it is highly desirable to determine the reasons for such separations as a basis for improving conditions and thus decreasing labor turnover.

### Wage and salary administration

Wages constitute one of the most important factors in employer-employee relations because they determine the income by means of which employees purchase the things they want and need. There have

been many different schemes advanced for determining wages; in addition to the law of supply and demand, some of the factors that affect wage levels are education, skill, personal traits, and experience.

*Standards for Wage Determination.* Wages are not determined by applying a single formula. Among the standards often bargained for by labor in wage negotiations are: (1) wages in proportion to productivity, (2) wages in proportion to living costs, and (3) wages in proportion to profits.

Several other considerations operate independently and in combination to influence wage rates. These are:

1. Relation between the labor supply and the demand for labor.
2. Degree of organization among the workers.
3. Wage levels in nearby communities.
4. Competition from other industries for similar workers.
5. Stage of the business cycle.
6. Desirability of working conditions.
7. Degree of skill required.

*Methods of Wage Payments.* In general there are two prevailing systems of paying workers. Under one system, wages are based on the amount of time spent on the job and are called *time wages.* Under the other, wages are based on the number of units produced and are known as *piece wages.*

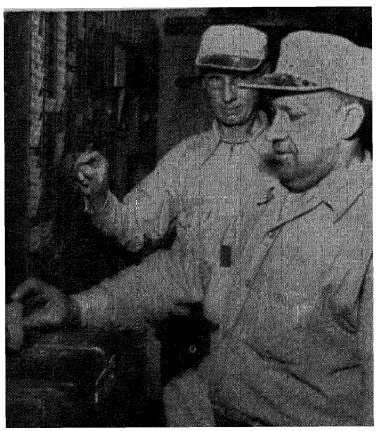
*Time Wages.* In many types of work it is more practicable to pay in proportion to the employee's responsibilities rather than in terms of his productivity; in fact in many instances it is impossible to measure output. The use of time wages is particularly valuable when quality rather than quantity is to be emphasized. It is also practicable where there are continual interruptions.

Secretarial work, training, supervisory work, and machine tooling are examples of occupations for which time wages are desirable. In such cases the worker is paid a certain amount per hour, week, or month. It is possible to maintain accurate records of time put in through the use of time cards and time clocks, which record when each worker arrives and departs.

The disadvantage of time wages is that they fail to encourage employees' maximum efforts. Because there is no immediate recognition of a person's superior performance, he frequently becomes discouraged and no longer puts his all into his work.

*Piece Wages.* The piece-rate payment plan is based upon paying a certain sum for each unit produced. It can be used only when it is

possible to count or in some other way to measure the output of an individual or a group. The unit payment may be on an individual basis or it may apply to a group or an entire department. It is particularly valuable in types of work where loitering is difficult to detect. It encourages the workers to supervise themselves and thereby decreases supervisory costs.



*Courtesy The Quaker Oats Company*

*Figure 10-9. Ringing In.* Wage payments are dependent upon such accurate records of working time as are made possible by the time-stamp machine used by this large company.

Care must be exercised to prevent a lowering of quality. It is also good practice to reward individual workers for maintaining a low level of material waste and spoilage. Workers sometimes hesitate to increase their production too greatly for fear that the employer might decrease the price paid per unit produced. To do this would destroy the increased incentive gained through using such a system.

*Wage-Incentive Plans.* There are wage-payment plans in operation that are designed to give added compensation for exceptional performance. They are known as wage-incentive plans and are based upon the piece-rate method of making wage payments.

Frederick W. Taylor was the first to develop a wage-incentive plan; it is known as the *Taylor Differential Piece-Rate plan.* After a careful and scientific study has been made of each worker's operations, a standard rate of output is established; this standard is such that the average worker can meet it. Two rates of pay prevail, one rate for the worker who fails to reach the standard and a higher rate of pay per piece for the worker who exceeds that standard. For example, if 100 units per

day is the standard output, a worker might receive 8 cents per piece if he produced fewer than 100 pieces. On the other hand, a worker who exceeded 100 units might receive 9 cents per piece. The worker who produced 95 units would receive $7.60 for his day's work, whereas the worker who produced 105 units would earn $9.45.

A second wage-incentive plan is the *Gantt Task and Bonus system.* Under this plan, if an employee exceeds the set standards by completing the work in less time, he receives as a bonus a percentage of the task rate. It is usually on a sliding scale and varies from 15 to 35 percent of the task rate. A worker who fails to complete the task in the time allotted for it receives the regular hourly rate but no bonus. There are two special features of this plan: (1) The bonus rate usually begins when the worker does three-fourths as much as the standard. This serves to encourage those who are striving to reach the standard as well as those who have already bettered it. (2) The foreman is usually given a bonus also, depending upon the amount or number of bonuses paid to the workmen under his supervision. An example of the manner in which this plan works is as follows:

Guaranteed weekly wage, $24; standard production, 8 units per week (5 man-hours per unit); standard time rate, 80 cents an hour; earnings for production that exceeds ¾ standard, 80 cents an hour plus premium of 20 percent of the wage for time allowed; earnings for production equal to ¾ standard or below, guaranteed weekly wage.

| *Employee* | *Units This Week* | *Standard Hours Allowed* | *Wage for Time Allowed* | *Premium Paid* | *Weekly Earnings* |
|---|---|---|---|---|---|
| A | 9 | 45 | $36.00 | $7.20 | $43.20 |
| B | 7 | 35 | 28.00 | 5.60 | 33.60 |
| C | 6 | 30 | —— | —— | 24.00 |
| D | 5 | 25 | —— | —— | 24.00 |

The *Halsey Premium plan* is similar to the Gantt system in that it is based on a standard time for completing a task. The premium, however, is a percentage of the prevailing hourly rate for the period of time saved. Suppose, for example, the standard time for a specific operation is 3 hours, the base pay is $1.00 an hour, and the premium is 50 percent of this rate for time saved. A worker who could complete this job in 2 hours would receive $2.50 for the completed task.

| | |
|---|---|
| 2 hours at $1.00 an hour (the base rate) | $2.00 |
| 50% of $1.00 for the 1 hour saved | .50 |
| | $2.50 |

Since the standard time is 3 hours and the base pay is $1.00 an hour, he would save the company 50 cents on the completed job. Should he maintain that schedule for an 8-hour day, he would earn $8.00 for the 8 hours of work plus $2.00 in premium pay (50 cents per hour for 4 hours saved).

Some business firms have plant-wide incentive plans that operate by giving a bonus for production above a certain standard. Should the plant produce an average of 110 percent of the standard expected, each employee would receive a bonus of one-tenth of his wages. There are many variations of this bonus idea; for example, the Kaiser-Frazer Corporation sets aside as a bonus to be paid to employees $5.00 for each car that leaves the assembly line. The General Motors Corporation makes available as a bonus 12 percent of all net earnings above 5 percent of the net capital. All employees do not participate in this bonus, however. The Eastman-Kodak Company has a bonus plan that is based upon the earnings of the company over a 5-year period and upon the common-stock dividend paid during the previous year. Still other firms use plans known as profit-sharing plans as bonus incentives.

Organized labor looks with disfavor upon wage-incentive plans that sponsor competition among the workers as individuals and set one against another. It prefers plans that tend to strengthen the feeling of group security among the workers—plans that are universal throughout the plant and apply to all the workers. They also disfavor plans that recognize only increased productivity resulting directly from increased personal effort. They feel that wage-incentive plans should give the workers the advantage of increased output resulting from factors other than the workers' personal skill and effort.[9]

### Maintenance of morale

Morale is affected by all the things that combine to make up the workers' environment. The treatment of the workers by management; the company's reputation for fairness; an adequate salary policy; the health, friendliness, and cheerfulness of all the members of the labor force; rest periods and working conditions—all seem to play a part in determining morale. How people feel has a direct effect upon how they work. It is a collective characteristic, referring to the state of mind of a group rather than of an individual.[10]

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[9] Barkin, Soloman, "Labor's Attitude Toward Wage Incentive Plans." *Industrial and Labor Relations Review,* July, 1948, Vol. I, No. 4, p. 553.

[10] Yoder, Dale, *Personnel Management and Industrial Relations,* 3rd ed., p. 439. New York: Prentice-Hall, Inc., 1948.

Morale is one of the most important factors in management-labor relations because it affects efficiency. There is a high degree of correlation between morale and unrest; when morale is high there is little unrest, and when there is much unrest morale is low. It appears to influence production output to a greater degree than does any other working condition.[11]

*Courtesy Waples-Platter Company*

*Figure 10-10. Coffee Time.* A mid-morning break is often an important factor in maintaining good employee morale.

Loitering, stalling, wasting time, absenteeism, labor turnover, and strikes are all evidences of unrest and low morale.

*Absenteeism.* The term *absenteeism* refers to workers' staying away from work, either voluntarily or involuntarily. There is a close relationship between absenteeism and unrest; excessive absenteeism is an in-

[11] Roethlisberger, F. J., and Dickson, William J., *Management and the Worker.* Cambridge: Harvard University Press, 1939.

dication of low morale, whereas high morale makes for a low rate of absenteeism.

We can measure absenteeism in the following manner: If an employee were eligible to work 25 days during a month and he failed to report on 2 of these days, his absenteeism percentage would be $2 \div 25$, or 8 percent. By using this same method it is possible to calculate a rate of absenteeism for a whole department or an entire firm.

The degree of absenteeism varies considerably for different types of industry. Rates have run as high as 10 percent in peacetime industry and as high as 15 percent in wartime. Lack of availability of adequate community facilities, such as busses, shopping centers, beauty parlors, and nurseries, and overindulgence in social activities are important factors contributing to absenteeism.[12]

Absences increase as the workday is lengthened. They are lowest on payday and highest on the day after. Illness and personal injury account for approximately 50 percent of all justifiable absenteeism; therefore, measures that improve the health and safety of the workers tend to cut down on absenteeism.

Proper selection and placement of employees are basic in attempting to decrease absenteeism because of the importance of having every worker in a job he can perform well and be happy at. Rewards, such as adding an extra day of vacation for every 60 days of perfect attendance, are far more effective in decreasing absenteeism than is the administration of penalties.[13]

*Labor Turnover.* The phrase *labor turnover* refers to the rate of change in the labor force resulting from workers' leaving the employ of a company. The most commonly used measure is known as *net labor turnover.* It represents the number of replacements per hundred workers—that is, the number of people employed to fill positions left vacant by separations. Thus, a firm that had an average working force of 100 and that had to replace 4 men who quit and 4 who were discharged would have a net labor turnover of 8 percent.

Management becomes concerned when labor turnover is excessive, and an analysis is made to determine causes as the first step toward remedying the situation. Inefficiency leading to discharge, marriage, mov-

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[12] Yoder, Dale, *Personnel Management and Industrial Relations,* 3rd ed., p. 493. New York: Prentice-Hall, Inc., 1948.

[13] Keane, R. H., "An Absentee Control That Really Works." *Industrial Relations,* July, 1947, Vol. 5, No. 3, pp. 15-17; and Dietz, Walter, "What Management Can do Within the Plant to Control Absenteeism." *Personnel,* November 1947, Vol. 24, No. 3, pp. 219-223.

ing of parents to another community, transfers of employees to other branches, being hired by a competitor, and retirement are all important causes of labor turnover, causing vacancies that necessitate the employment of new personnel. Turnover rates vary with the workers' degree of skill, unskilled workers showing higher turnover rates than semiskilled or skilled workers. Absenteeism varies with age and length of service. Failure to give adequate promotions is often a contributing factor.

*Handling Grievances.* Grievances are the result of feelings on the part of workers that they have been done an injustice. We have already seen that the workers' feelings are important, and regardless of whether the company is at fault, some attention should be given to their complaint. Although it is impossible to deal with all matters that trouble employees, management should look upon grievances as opportunities to improve the organization. If the complaint were not registered, the situation would probably never have been brought to the attention of management and there would not have been an opportunity to remedy it.

There are two types of grievances, those involving an individual or a small group of employees and those involving all employees. For example, one employee may feel that he is being asked to perform tasks not included in his job classification, or he may feel that he has been transferred to a new job without being given an adequate salary adjustment. He may feel that he is not getting his due according to the terms of the labor agreement. A grievance procedure must be developed whereby the employee may have a hearing regarding his complaint. If it is allowed to remain unattended, it may become serious and grow to a point beyond control.

Grievance procedures vary. The first step is usually for an employee to take the point of misunderstanding to his immediate superior. If the difference is not settled there, the complaint is usually put in writing and submitted to a grievance committee. It is important that both management and labor be represented in the group that considers the complaint. If the matter is not settled by this committee, it may be referred to the general grievance committee. If the grievance affects the whole working force, it may eventually be submitted for arbitration; this is particularly true in cases where management and labor cannot come to agreement.

Regardless of the exact procedure followed, it is important that a definite grievance procedure be established so that the individual can air his case or have the union steward speak for him. The grievance

procedure is organized for the purpose of studying the situation and making whatever adjustments are necessary in conformance with established policy. A prompt disposition of the grievance is almost as important as seeing that it is settled fairly. It is to the advantage of both labor and management to see that the firm's labor policy is publicized throughout the plant; this will greatly aid in preventing serious grievances from arising in the first place.

### Methods of boosting morale

Basic to the development of methods of lifting the morale of the workers is an analysis of the causes of unrest. This analysis should be a continuing process. Methods commonly used to improve morale center around better communications, employee suggestions, and better working environment.

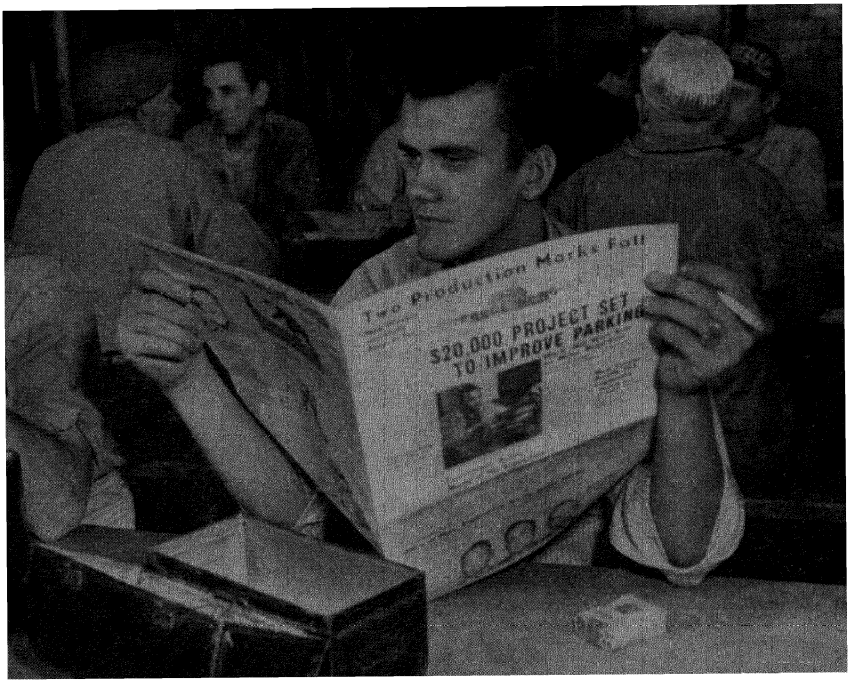
*Three-Way Communication.* One of the most important procedures is having clear-cut channels for communicating ideas throughout the organization. There is more interest and satisfaction when information is disseminated to the workers and understood by them. Frequently, discontent and unrest stem from misunderstandings that are the result of a lack of information about company activities and policies.

It is not enough to have an efficient scheme for disseminating information downward from top management. There must be ways for information to flow freely from the lower echelons to top management, and it is also desirable that information flow across the managerial structure as well. Bulletin boards, plant newspapers, conferences, manuals, and clubs are all useful as communication and co-ordination devices.

*Employee Suggestions.* The suggestion system has proved to be an effective means for developing and holding workers' interest in their jobs and in the business organization as a whole. This is a plan whereby awards are given for constructive suggestions to increase operation efficiency. The amount paid for the suggestion is proportional to the amount of time and money it saves. The use of awards for acceptable suggestions is widespread in business and industry.

Mr. Fred Denz, president of the National Association of Suggestion Systems, which has a membership of 350 firms and agencies, stated that employee suggestions during World War II saved 200 million man-hours. He reported that during a period of two and a half years Remington Rand Inc. received from employees more than 20,000 suggestions, by means of which the company saved one-half million dollars. For acceptable suggestions the company paid out $90,000 in

awards. Mr. Denz said, "But the real value of the system is that it builds a two-way channel of communication between the employee and the boss. It makes humanics out of mechanics." [14] It is not enough to install collection boxes for employees' convenience; they must be stimulated to use them. Above all, every suggestion submitted should be acknowledged, whether or not it is accepted.



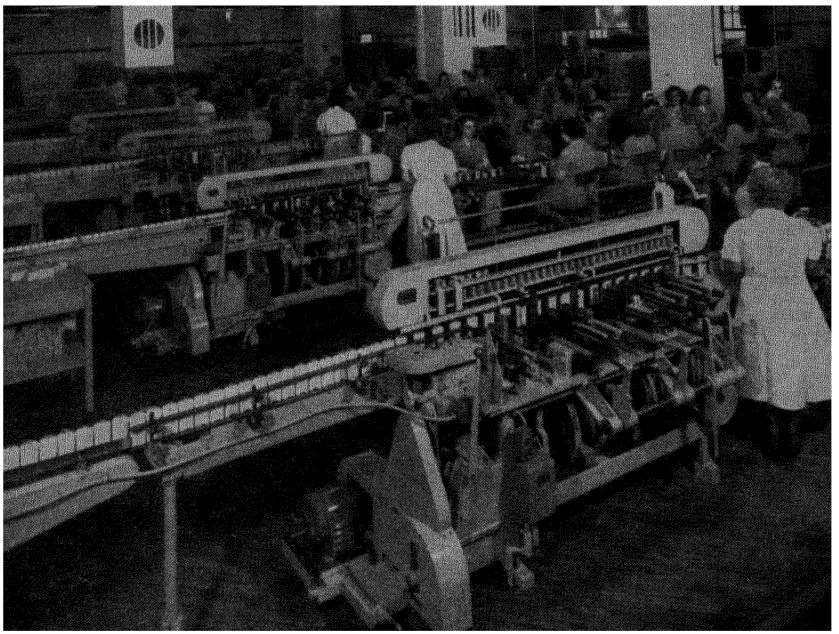

*Courtesy Ford Motor Company*

*Figure 10-11. Good Morale through Good Communications.* At lunch an employee relaxes and reads a copy of his company's employee paper, which carries information about employee and company policies. This employee-relations department publishes 22 such papers in various company plants.

*Rest Periods.* The purpose of rest periods is to overcome fatigue and monotony, thereby increasing worker efficiency. Employees rest regardless of whether a formal period is set aside for doing so. Experimentation must determine the most effective frequency, duration, and timing of rest periods, depending upon the kind of work being done. A 5- to 15-minute period in the middle of the morning and again in the afternoon is frequently desirable. Some businesses provide snack

[14] *The Denver Post,* May 12, 1948, Vol. 56, No. 284, p. 2.

bars. It is good to have everyone in a department take a rest period at the same time. This makes it possible to stop machinery, open the windows, and change the air in the room. It encourages those who are reluctant to stop work to do so, and it also helps to discourage abuse of the rest pause by others.



*Courtesy Pneumatic Scale Corporation Limited*

*Figure 10-12. Music on the Job.* Note the loud-speakers installed in this modern factory for reproducing music designed to increase efficiency and improve morale.

*Music.* Many manual operations are more effectively performed to the accompaniment of soft rhythmic music. Several studies of the use of music have been made, and they show its use to be beneficial. Production is stepped up, the quality of work is improved, and worker effectiveness is increased.[15] Complete sections of modern factories are wired for music that is played especially for this purpose.

*Color Dynamics.* Eye muscles get tired just the same as other muscles do; eye fatigue affects the other parts of the body, and continued eye-strain leads to nervous fatigue. The scientific utilization of the energy

[15] Smith, Henry Clay, "Music in Relation to Employee Attitudes, Piecework Production, and Industrial Accidents." Palo Alto, Calif.: Standard University Press, 1947.

in color, employing proper color blends and contrasts to walls, ceilings, and equipment, is restful to the eye and decreases eyestrain and mental fatigue.

The Wire Rope Division of the Jones & Laughlin Steel Corporation at Muncy, Pennsylvania, applied color dynamics throughout the plant, the project covering a 21-month period beginning in May, 1945. At the end of three years, the management of the plant reported a reduction of 38 percent in the number of lost-time accidents, a reduction in absenteeism from 5 percent to 2 percent, a reduction in labor turnover from 4.5 percent to .4 percent, and an increase of 10 percent in machine efficiency. An appreciable portion of that achievement was attributed directly to color dynamics.[16]

## Personnel Management as a Career

### Employment and promotion opportunities

Personnel administration is not a single type of job but a broad field of work with many branches. The four main fields in which there are employment opportunities are educational institutions, government service, business and industry, and labor organizations.

*Educational Institutions.* Personnel work has always been part of the teacher's job. However, in recent years greater attention and emphasis have been given to the guidance and counseling phases of teaching. One plan is to have the entire instructional staff participate in the counseling and guidance program. A second plan is to select a small number on the teaching faculty and give them special training for counseling work and to cut their teaching load by one-third or one-half because of their counseling responsibilities. A third plan is to employ expertly trained personnel workers who are assigned to full-time counseling activities.

The main purposes of educational guidance and counseling are to aid the student in understanding himself better, in adjusting to school and social experiences, in developing democratic citizenship responsibilities, and in acquiring economic and vocational efficiency.[17]

Williamson has classified personnel workers in educational institutions as group, instructional, clinical, administrative, and advisory.[18]

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[16] *Pittsburgh Color Dynamics,* p. 20. Pittsburgh: Pittsburgh Plate Glass Company, 1947.

[17] Educational Policies Commission, *The Purposes of Education in American Democracy,* p. 47. Washington: National Education Association, 1938.

[18] Williamson, E. G., "Training and Selection of School Counselors." *Occupations,* October, 1939, Vol. 18, p. 712.

Job opportunities in educational personnel work are:

Selection and admission of students (on the college level)
Orientation and placement
Counseling relative to personal, vocational, and financial problems
Health program
Testing and records
Research

*Government Service.* The government probably employs more workers than any one type of business or industry. Since 1883, when the first Civil Service Law was passed, personnel work in government has grown considerably. In addition to the federal government, some states have what is called a Civil Service Commission and others a Merit System. In addition to Civil Service personnel work, there is work with military personnel and with governmental workers who do not enjoy Civil Service status.

Some of the job opportunities in governmental personnel work are:

Job analyses and classifications
Recruitment and selection
Training
Working conditions
Counseling
Evaluation, promotion, and ratings
Resignations, layoffs, transfers, and separations

In governmental work salaries vary depending upon the nature of the work performed and the classification of the job. The lower levels of jobs include personnel records clerk, payroll clerk, coding clerk, reviewer of forms clerk, and interviewer. The higher levels, such as personnel supervisor, employment manager, training director, classification analyst, placement analyst, personnel officer, and personnel director, include job classifications of GS 10 to 12. Special classifications, such as personnel technician, personnel assistant, administrative officer, classification examiner, counselor, and training specialist, are rated from GS 7 to 10.

*Business and Industry.* Business is distinguished from industry in that it pertains to enterprises that do not perform manufacturing operations—for instance, banks, offices, hotels, and retail stores. Industry employs the greater number of workers and comprises industrial relations in its broadest aspects.

Business management realizes that when their workers are properly placed, when a spirit of co-operation prevails, and when employees are happy in their jobs and desire to remain with the firm, production and

profits increase. To achieve these conditions personnel departments are established in business organizations. As the company grows and expands, the work of this department requires the services of additional people. The beginner should not expect, however, to start work as an executive; he must be willing to earn his right to important and responsible positions. Most of the personnel staffs of large organizations have come up from the ranks; experience and education serve as the basis for advancement. Frequently personnel workers do not go immediately into the personnel department but work in other departments of the organization to learn the nature of the processes and methods used.

Some of the beginning positions in personnel work are: job analyst, employment interviewer, tester, and personnel technician. Persons holding any of these positions might advance to the position of employment manager.

Positions on the same level as the employment manager are: training director; director of safety and health activities; director of transfers, promotions, and discharges; and director of employee benefits and services. All these are accountable to the personnel director.

In addition to the personnel director frequently there are a public relations director, a labor relations director, and a director of research.

Personnel workers are among the first to learn of job vacancies in other departments of a business organization. If one meets the qualifications for the positions to be filled, he may become a candidate for it.

*Labor Organizations.* There are many positions for industrial relations workers with labor organizations. As unions grow in membership and expand to new areas that are at present relatively nonunionized, many additional workers will be needed. Some of the positions with labor organizations on the local level are: organizer, counselor, legal counsel, business agent, and publicity director. On a regional and national level there would be most of these plus the educational director, research director, and public relations director.

### Qualifications and preparation necessary for success

One engaged in personnel work should possess a personality that places people at ease at their first meeting. Inherent in a good personality is mental and physical health.

One must have a flexible mind and be a good judge of men; this is one of the most important qualifications. The person who deals with the problems of others must be a good listener. He must also be able to express his ideas unmistakably and in the language of the employee

with whom he is dealing. *The personnel worker must possess a sympathetic understanding and appreciation of the point of view of the workers.* Other qualifications are patience, a sense of humor, open-mindedness, dependability, and fairness. One must be able to recognize new ideas and be willing to consider them on the basis of merit.

The two chief qualifications one must possess to be of great value to his company are an expert knowledge of the work within his specialized field and a thorough knowledge and understanding of his company. Though this is true in most fields of endeavor, it is particularly true in personnel work; knowledge within a specialized field can be gained in school, but an understanding of the firm and its policies must be learned on the job. There is, therefore, a need for those in the personnel department who have been with the company for many years.

### Advantages and disadvantages of a career in personnel management

Some of the advantages are:

1. Salaries at the top levels are exceptionally high.
2. Working conditions and environment are above average, and the work is not physically exhausting.
3. The field is new and rapidly developing.
4. Experience and training in personnel management may lead to work in many other fields of employment.
5. The promotional opportunities for qualified workers are good.
6. The work is of the service type and gives one the feeling of satisfaction that comes from helping others.

Some disadvantages are:

1. It is sometimes necessary to serve a period of apprenticeship in the form of other types of employment before qualifying for a position in personnel work.
2. Since the personnel worker represents both management and labor, it is sometimes difficult to give an opinion without antagonizing one of the two groups.
3. Personnel workers at high levels are sometimes subject to orders from management that make it difficult or impossible to operate to the advantage of both labor and management.
4. The strain of dealing continually with differences of opinion may cause nervous frustration.

5. Personnel workers deal with intangible and abstract human relationships rather than with concrete objects.

## Terms for Study

Absenteeism
Apprenticeship
Bonus
Employee benefits
Grievance
Grievance procedure
Indoctrination
Industrial relations
Interview
Job analysis
Job description
Morale
Orientation
Piece wages
Productivity
Profit sharing
Separation
Time wages
Transfer
Wage incentives

## Questions

1. What is the meaning of the term *personnel management?*
2. In what ways is the personnel department interrelated with other departments in a business organization?
3. What are the important functions of the personnel department?
4. Why is it important to prepare job analyses and job descriptions?
5. For what purposes are prospective employees interviewed?
6. What is one of the first things that the personnel department does for a new employee when he reports for work?
7. What is meant by the term *vestibule school?*
8. Why are the safety and health of the workers of great concern to management?
9. What are some of the employee benefits and services that are commonly available to workers?
10. Under what circumstances are employees transferred from one department to another within a business enterprise?
11. Do you consider it a good policy to promote employees when vacancies occur, or is it better to go outside the business to fill them?
12. What are some of the standards for determining wages?
13. When are time wages more satisfactory than piece wages as the basis of payment for services rendered?
14. How do wage-incentive plans help labor? Management?
15. What is labor's attitude toward wage-incentive plans?
16. From management's point of view, what are some of the evidences of high morale among workers?
17. Of what significance and value to management is a grievance procedure?
18. Why are effective communication channels essential to the smooth functioning of a personnel program?
19. Why is the use of color so important in offices and factories?
20. What are some of the different types of jobs in personnel management?

## Problems and Projects

1. Prepare five questions you might ask an applicant who was being interviewed for a position as accountant.

2. Choose a specific type of worker and indicate what you consider to be three or four of the most important personal qualifications he should possess.

3. Prepare a list of items that *usually* appear in an application form. Under what general headings might these items be classified?

4. What information about an applicant for an office position would you request in a letter to one of his references?

5. What questions would you ask an employee who was voluntarily leaving the employ of your company?

6. What are the advantages to the employer and to the employees of group insurance?

7. Select a particular type of business with which you are familiar and suggest three different types of training programs that would be desirable for it.

8. What are some employee services that benefit the members of the employee's family as well as the worker himself?

9. What type of payment plan appears to be the most desirable for paying secretaries? Furniture salesmen? Machinists? Shop foremen? Employment interviewers?

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CHAPTER XI

# LABOR-MANAGEMENT RELATIONS

THE PREVIOUS CHAPTER was concerned with recruitment, training, and promotion of workers; worker welfare; wage and salary policies; and maintenance of worker morale. In this chapter the significance of labor unions, techniques used in collective bargaining, labor agreements, and the settlement of labor disputes are discussed.

## Importance of Labor-Management Relations

The rapid growth of labor unions and the high percentage of productive workers who are covered by labor agreements have brought to the forefront labor-management relations. Approximately one-half of all eligible workers are covered by collective agreements. As a result, both management and labor are interested in securing the services of the most able negotiators available.

Since union negotiators are empowered to represent and bargain for all the workers as a group, the results of labor-management negotiations are of vital interest and concern to hundreds or even thousands of individuals. Their importance to labor is partially brought out by the figures shown in Table XI-1.

The importance of such negotiations to both labor and management is shown by the data in Table XI-2.

Since concessions won by labor usually cost the business relatively large sums of money, management is just as vitally interested and concerned as is labor. The government as the representative of the best interests of the American public is also interested in a peaceful, equitable settlement of labor-management differences.

Idleness in industry and business is costly to labor, management, and the public. Therefore, it is to the advantage of everyone concerned to settle labor-management controversies before work is halted. Where work stoppages do occur, it is important that differences be settled as soon as possible in order to keep to a minimum the loss in earnings suffered by the workers and the loss to business that brings about increased costs.

TABLE XI-1. STRIKE RESULTS—BENEFITS GAINED BY THE WORKERS—1935 THROUGH 1945.*

| | *Percentage of Gains to Workers* | | | |
|---|---|---|---|---|
| *Year* | *Substantial* | *Partial or Compromises* | *Little or No Gains* | *Other Results* † |
| 1935 | 44.3 | 18.7 | 33.4 | 3.6 |
| 1936 | 45.9 | 23.6 | 27.5 | 3.0 |
| 1937 | 46.4 | 31.8 | 17.3 | 4.5 |
| 1938 | 40.0 | 29.9 | 20.9 | 9.2 |
| 1939 | 39.7 | 32.3 | 18.7 | 9.3 |
| 1940 | 42.0 | 31.8 | 17.4 | 8.8 |
| 1941 | 41.9 | 35.8 | 14.5 | 7.8 |
| 1942 | 34.6 | 34.8 | 17.0 | 13.6 |
| 1943 | 30.7 | 25.6 | 25.7 | 18.0 |
| 1944 | 20.7 | 9.8 | 18.3 | 51.2 |
| 1945 | 24.0 | 11.6 | 16.1 | 48.3 |

* Source of data: *The Economic Almanac,* p. 44. New York: National Industrial Conference Board, 1949.

† Other results include strikes awaiting decisions of National War Labor Board, strikes caused by rival unions, and jurisdictional strikes.

TABLE XI-2. NUMBER OF WORKERS INVOLVED IN STRIKES, AND NUMBER OF MAN-DAYS OF IDLENESS RESULTING—1935 THROUGH 1948.*

| *Year* | *No. of Workers Involved* | *Man-Days of Idleness* |
|---|---|---|
| 1935 | 1,100,000 | 14,900,000 |
| 1936 | 710,000 | 11,400,000 |
| 1937 | 1,950,000 | 30,800,000 |
| 1938 | 688,000 | 8,930,000 |
| 1939 | 1,180,000 | 18,500,000 |
| 1940 | 573,000 | 6,680,000 |
| 1941 | 2,360,000 | 23,000,000 |
| 1942 | 852,000 | 4,740,000 |
| 1943 | 1,970,000 | 13,300,000 |
| 1944 | 2,130,000 | 8,880,000 |
| 1945 | 3,070,000 | 24,400,000 |
| 1946 | 4,940,000 | 124,000,000 |
| 1947 | 2,170,000 | 34,600,000 |
| 1948 † | 1,960,000 | 34,100,000 |

* Source: *Handbook of Labor Statistics, 1947,* p. 138. Washington: United States Department of Labor, Bureau of Labor Statistics, 1949.

† Figures for 1948, *Monthly Labor Review,* May, 1949, Vol. 68, No. 5, p. 512.

## Labor Organizations

### Factors that encourage labor to organize

Two of the several factors that cause members of the labor force to band together are the strength of numbers and representation by qualified negotiators.

*Strength of Numbers.* The individual worker is at a decided disadvantage when dealing with the management of a large corporation. If his requests for better working conditions, better working hours, or better pay are refused or only partially granted, there is little that he can do. The grouping together of individual workers into an organization strengthens their bargaining position.

*Representation by Qualified Negotiators.* The workers, through their use of organization procedures, are able to select their own representatives. This gives the individual member who is unprepared to argue his own case the advantage of being represented by the most able persons in the group. In fact, the services of experienced negotiators who are members or employees of the union but not members of the local labor group are frequently made available.

### Aims of labor organizations

The over-all purpose of labor organizations is to gain greater benefits and advantages for the workers. These include higher wages, shorter hours, better working conditions, and greater security.

One of the first demands upon management made by organized labor was for higher wages; closely associated with this was the demand for a shorter working day. As a result of continual union demands the daily wage was increased at the same time that the workday was shortened. The 40-hour week in time became the standard and hourly wage rates were greatly increased.

Other objectives of organized labor have been vacations with pay, paid holidays, seniority provisions, sickness and health benefits, and retirement pensions. Through unified efforts labor organizations have succeeded in improving labor's lot.

### Types of labor unions

There are two basic types of unions in the United States, *craft unions* and *industrial unions*. Craft unions are organizations of skilled workers engaged in the different crafts or trades. The function performed by the worker forms the basis of membership. Craft unions include such workers as machinists, carpenters, painters, and plumbers. In-

dustrial unions, which are not restricted to skilled workers, include skilled, semiskilled, and unskilled workers. The nature of the industry, rather than the function of the individual worker, forms the basis of membership. For example, workers in the automobile industry are represented by the United Automobile Workers, in the clothing industry by the Amalgamated Clothing Workers Union, and in the mining industry by the United Mine Workers of America.

*American Federation of Labor.* The American Federation of Labor, commonly referred to as the A.F. of L., was originally organized in 1881 and is now made up of thousands of international, national, state, and local unions, comprising over seven million members. As the name implies, it is a federation of affiliated but autonomous groups. As an organization it has little power over its sovereign units; it does have the power of expelling a group from its membership. By combining into this federation, the respective units have more influence to use in securing legislation favorable to labor. Historically it has been predominantly a craft union; some industrial unions, such as the International Ladies Garment Workers Union, are affiliated with it.

Most of the work of the A.F. of L. is performed by its five departments: the Metal Trades, the Building and Construction Trades, the Union Label Trades, the Maritime Trades, and the Railway Employees. Its business is transacted during the annual convention.

*Congress of Industrial Organizations.* This organization was born in 1935 when eight unions, then members of the A.F. of L., formed the Committee for Industrial Organization. This group was opposed to the emphasis that the A.F. of L. placed upon craft unionism and favored the organization of large industries along the lines of industrial unionism. The unions that were associated with the Committee for Industrial Organization were suspended from membership in the A.F. of L. in 1936. This resulted in the group's formation as a rival labor organization. The name Congress of Industrial Organizations was adopted in 1938. During the following decade the C.I.O. pushed the organization of workers in many fields not previously organized and grew in power to rival the A.F. of L., with approximately six million members in 1947.

*Independent Unions.* Unions affiliated with neither the A.F. of L. nor the C.I.O. are known as independent unions. Perhaps the most notable independent unions are the railroad brotherhoods. There are four railroad craft unions: the Brotherhood of Locomotive Firemen and Enginemen, the Brotherhood of Railway Trainmen, the Brotherhood of Locomotive Engineers, and the Order of Railway Conductors.

Although these four brotherhoods are separate and distinct organizations, they frequently act co-operatively.

Another outstanding and well-known independent union is the United Mine Workers of America. An industrial union, it is affiliated with neither the A.F. of L. nor the C.I.O. but in the past has been associated with both.

Other important independent unions are the National Federation of Telephone Workers and the International Association of Machinists. The latter group withdrew from the A.F. of L. in 1947.

## Collective Bargaining

One of the most important functions of labor organizations is collective bargaining. By this process labor, through its representatives, bargains with management over terms and conditions of the labor contract or labor agreement. It is called collective bargaining because labor acts collectively—that is, as a group; employers also may act collectively. The individual workers authorize the union to act as their agent, and they agree to accept the terms agreed upon by the union representatives. The employer bargains with these union representatives, recognizing the union as the authorized agent of the workers.

In 1941, according to estimates of the Bureau of Labor Statistics of the United States Department of Labor, there were 31 million workers employed in occupations in which unions were actively engaged in organizing and seeking to obtain written collective agreements. Of this number 9⅓ million, or 30 percent, were employed under collective-bargaining contracts. In 1942, 40 percent of 31 million were employed under collective-bargaining contracts; in 1943, 45 percent of 32 million; in 1944, 47 percent of 30¼ million; in 1945, 48 percent of 29 million; and in 1946, 48 percent of 31⅕ million.[1]

Among the manufacturing industries, over 90 percent of the production wage earners in the aluminum, automobile, basic steel, brewery, fur, glass, men's clothing, rubber, and shipbuilding industries are working under union agreements. The proportion of wage earners in various manufacturing industries who are under union agreements is shown in Table XI-3.

[1] *Monthly Labor Review,* April, 1945, Vol. 60, No. 4, p. 816. Also *Monthly Labor Review,* May, 1947, Vol. 64, No. 5, p. 765. (In most industries this includes all wage and salary workers except those in executive, managerial, and certain types of professional positions. It excludes all self-employed, domestic workers, agricultural workers on farms employing fewer than 6 persons, all federal and state government employees, teachers, and elected and appointed officials in local governments.)

Approximately 33 percent of all nonmanufacturing workers were employed under terms of union agreements at the beginning of 1945. Over 95 percent of the coal miners, maritime workers, longshoremen, and railroad employees, including clerical and supervisory personnel, and over 90 percent of the iron-mining and telegraph personnel are under union agreements. The proportion of wage earners in various nonmanufacturing industries who are under union agreements is shown in Table XI-4.

TABLE XI-3. PROPORTION OF WAGE EARNERS IN MANUFACTURING INDUSTRIES UNDER UNION AGREEMENTS IN JANUARY, 1945.*

| *80-100 Percent* | *60-79 Percent* | *40-59 Percent* | *20-39 Percent* |
|---|---|---|---|
| Agricultural equipment | Books and job printing and publications | Baking | Beverages, non-alcoholic |
| Aircraft and parts | Canning and preserved foods | Chemicals, excluding rayon yarn | Confectionery products |
| Aluminum | Coal products | Flour and other grain products | Cotton textiles |
| Automobiles and parts | Gloves, leather and cloth | Furniture | Dairy products |
| Breweries | Machinery and machinery tools | Hosiery | Silk and rayon textiles |
| Carpets, rugs, wool | Millinery and hats | Jewelry and silverware | |
| Cement | Paper and pulp | Knit goods | |
| Clocks and watches | Petroleum refining | Leather luggage, handbags, novelties | |
| Clothing, men's | Railroad equipment | Lumber | |
| Clothing, women's | Steel products | Paper products | |
| Electrical machinery, equipment, and appliances | Tobacco products | Pottery, including chinaware | |
| Furs and fur garments | Woolen and worsted textiles | Shoes, cut stock and findings | |
| Glass and glassware | | Stone and clay products | |
| Leather tanning | | | |
| Meat packing | | | |
| Newspaper printing and publication | | | |
| Nonferrous metals and products | | | |
| Rayon yarn | | | |
| Rubber products | | | |
| Shipbuilding | | | |
| Steel, basic | | | |
| Sugar, beet and cane | | | |

* Source: *Monthly Labor Review*, May, 1947, Vol. 64, No. 5, p. 766.

TABLE XI-4. PROPORTION OF WAGE EARNERS IN NONMANUFACTURING INDUSTRIES UNDER UNION AGREEMENTS IN JANUARY, 1945.*

| *80-100 Percent* | *60-79 Percent* | *40-59 Percent* | *20-39 Percent* |
|---|---|---|---|
| Actors and musicians | Radio technicians | Bus lines, intercity | Barber shops |
| Airline pilots and mechanics | Theater—stage hands, motion picture operators | Light and power | Building servicing and maintenance |
| Bus and streetcar, local | | Newspaper offices | Cleaning and dyeing |
| Coal mining | | Telephone service and maintenance | Crude petroleum and natural gas |
| Construction | | | Fishing |
| Longshoring | | | Hotels and restaurants |
| Maritime | | | Laundries |
| Metal mining | | | Nonmetallic mining and quarrying |
| Motion picture production | | | Taxicabs |
| Railroads—freight and passenger, shops and clerical | | | |
| Telegraph service and maintenance | | | |
| Trucking, local and intercity | | | |

* Source: *Monthly Labor Review*, May, 1947, Vol. 64, No. 5, p. 766.

## Techniques used by labor

In collective bargaining union negotiators attempt to get the highest possible price (in terms of wages, hours, or working conditions) for the services of the union members. The unions have developed several devices to aid them in gaining their objectives. It is understood, of course, that the following tactics are not employed by all unions and that all of them are not necessarily employed simultaneously.

*Standardization.* The idea here is to establish a minimum price for each type of work. This minimum serves as a standard, but workmen who are more efficient than the average are paid higher rates. When a wage scale has been established, there is a tendency for the standard to become the average rate rather than a minimum rate.

*Jurisdictional Limitations.* Two types of limitations are frequently used, those pertaining to the type of work to be performed and area limitations. For example, the labor contract between the employer and

the unions may specify that certain operations are to be performed by the iron workers and other operations by sheet-metal workers. In some cases it is difficult to determine just which group is responsible for certain work, and a jurisdictional dispute between the two groups of workers may arise. Such disputes are frequently intensified to the point where strikes are called and work is stopped. The area restriction works in such a way that a certain geographical area is declared to be the exclusive territory of a specific local union. Workers in similar trades who are not members of the local union are not permitted to work at that trade in the specified area.

*Limitation of Output.* Frequently the output of the worker is limited through the use of restrictions; these restrictions may refer to units of production, tools permitted, or methods used. A limitation upon the size of brush used or restrictions on the use of spray guns in painting are excellent examples; limiting the number of bricks that may be laid during a regular working day is another. (This technique of limitation of output is used principally by craft unions in the skilled trades.) The unions can enforce these restrictions upon their members by levying fines against those who do not observe them.

*The Closed Shop and Union Shops.* Where an open shop is maintained—that is, when both union and nonunion workers are employed —collective bargaining is difficult. On the other hand, if all the workers are represented by the union, it is in a strong bargaining position. The closed shop is one in which all employees must belong to the union and must continue to be members in good standing throughout their period of employment. This forces the employer to hire only those workers who are already members of the union and puts the union in a strong bargaining position. The *preferential union shop* is one where the employer agrees to go first to the union when employing new personnel. If no union men are available, nonunion men of "equal competence" may be employed, but such employees must join the union. Where a *union shop* is maintained, the employer may hire either union or nonunion men but after a brief trial period (usually 30 to 60 days) the nonunion men must join the union.

*Picketing.* Picketing is an effective technique used by labor unions. Men placed at each entrance to an establishment are provided with banners that set forth their complaints against the management. This serves to inform the public of their case and to enlist sympathy and support. Its greatest effectiveness is in controlling the available labor supply by preventing union men from reporting for work. In addition to members of the union directly concerned, members of closely allied

unions may respect the picket line and also refuse to report for work. In some cases even though associated unions do not respect the picket line they will refuse to work if the employer hires nonunion workers to do the work of the union men who are on strike.

*Boycott.* The boycott is an attempt on the part of unions to restrict the patronage of a firm by influencing people to refuse to do business with that firm. In the *primary boycott,* employees of the firm being boycotted refuse to buy from their employer. This is effective only if the amount of their patronage is consequential. The *secondary boycott* is for the purpose of influencing others to refrain from patronizing the firm. It may be directed toward a business that buys from the firm being boycotted or to the public at large. In some cases a prolonged boycott influences customers of long standing to transfer their patronage permanently to other business institutions. This hurts the employees themselves, for when they return to work this loss in business will mean decreased sales and possibly decreased commissions.

*Strikes.* When all other devices fail, the strike may be employed. There are many different kinds of strikes but the effect is the same in each case: workers refuse to work until their demands are met or a compromise is reached. The result is a partial or complete work stoppage.

The benefits gained by workers through the use of the strike were summarized in Table XI-1. It was shown by the data presented there that the strike is an effective weapon. The losses due to idleness were summarized in Table XI-2 in terms of man-days lost as a result of strikes. Not only do the workers on strike lose, but business costs are increased as a result of the strike and this hurts both business and the public. Most of these strikes were called in order to gain increases in wages, shorter hours, recognition of the union as the bargaining agent, improved working conditions, and job security. The major issues involved in strikes from 1935 to 1948 are summarized in Table XI-5.

### Techniques used by management

*Employers' Associations.* As a counter weapon to combat the power of the labor organizations, employers have united in order to strengthen their bargaining position. Instead of bargaining with one employer, the union representatives negotiate with several employers who act collectively. Some of the best known employers' associations are the National Association of Manufacturers, the Chamber of Commerce of the United States, and the Smokeless and Appalachian Coal Association.

TABLE XI-5. WORK STOPPAGES BY MAJOR ISSUES.*

| Year | Number of Work Stoppages | Percentage Attributed to Each Issue: Wages and Hours | Union Organization, Wages and Hours | Union Organization ‡ | Other Working Conditions § | Inter-Union |
|---|---|---|---|---|---|---|
| 1935 | 2003 | 37.9 | | 47.2 | 14.9 | |
| 1936 | 2156 | 35.1 | | 50.2 | 14.7 | |
| 1937 | 4720 | 29.9 | | 57.8 | 12.3 | |
| 1938 | 2772 | 28.0 | | 50.0 | 22.0 | |
| 1939 | 2639 | 26.5 | | 53.5 | 20.0 | |
| 1940 | 2493 | 30.2 | | 49.9 | 19.9 | |
| 1941 | 4314 | 35.6 | | 49.5 | 14.9 | |
| 1942 | 3026 | 46.8 | 17.5 | 13.7 | 16.4 | 5.6 |
| 1943 | 3734 | 51.0 | 6.2 | 9.5 | 29.3 | 4.0 |
| 1944 | 4958 | 43.3 | 5.0 | 11.3 | 36.3 | 4.1 |
| 1945 | 4616 | 42.4 | 7.9 | 12.6 | 32.7 | 4.2 |
| 1946 | 4990 | 44.9 | 18.3 | 14.1 | 17.6 | 4.9 |
| 1947 | 3693 | 46.3 | 15.1 | 14.7 | 18.8 | 4.3 |
| 1948 † | 3419 | 50.8 | 9.4 | 13.4 | 21.5 | 3.8 |

* Source: *Handbook of Labor Statistics, 1947*, p. 138. Washington: United States Department of Labor, Bureau of Labor Statistics, 1949.

† 1948 figures, *Monthly Labor Review*, May, 1949, Vol. 68, No. 5, p. 512.

‡ For the years 1935 to 1941 stoppages primarily over organization matters but also involving wage and hour issues were classified under "union organization."

§ For the years 1935 to 1941 stoppages primarily over inter- or intra-union matters (jurisdictional and rival union disputes) were classified under "other working conditions."

Some employers' associations wage an active campaign against the unions in their industries. They try to curtail and weaken unions already organized to prevent the formation of new ones. One of the subcommittees of the United States Senate Committee on Education and Labor held public hearings throughout the country in 1938 and 1939. The evidence collected by this committee was released to the press and published by the government.[2] This committee reported that some belligerent employers' associations employed a system of espionage to discover employees who were furthering attempts to unionize plants; they encouraged attacks upon employers who dealt with unions; they developed an extensive blacklist of workers suspected of union leanings

[2] *Hearings Before a Subcommittee of the Committee of Education and Labor, United States Senate, Pursuant to Senate Resolution 266, 74th Congress.* Washington: Government Printing Office, 1939.

in an effort to keep them from securing employment; and they sought to discredit union leaders among the union members.

*The Court Injunction.* By obtaining an injunction from the court, employers may prevent certain specified acts on the part of labor groups. Injunctions are used principally to prevent coercive practices of unions and to protect a firm's property. Violating an injunction places the union in contempt of court and subject to punishment by fine or imprisonment, or both. Notable examples of the use of this weapon, although it was not employed in this case by an employer but by the federal government, were the rulings of Judge Goldsborough against John L. Lewis and the United Mine Workers of America in 1946 and 1948.

*The Lockout.* An employer may refuse to allow the employees to work until they agree to his stipulations. This is termed a lockout and serves the employer in much the same way that the strike serves workers. The lockout is used only as a last resort.

It should be made clear that not all business organizations are opposed to collective bargaining with labor organizations; many of them feel that it is advantageous to management as well as to labor. When the collective labor agreement exists, management does not have to deal with individuals in regard to wages, overtime, and working conditions. Collective bargaining tends to make for uniform labor policies and practices within a given industry. This tends to insure management that competitors are not gaining advantages by hiring cheaper labor or through maintenance of inferior working conditions.

## The labor agreement

The techniques used by labor and management have their effect upon the written agreement between management and the union, the union in this case representing the recognized bargaining unit. This agreement is the result of negotiations that may extend over a considerable length of time. It may cover a single shop and a small number of workers or an entire industry and hundreds of thousands of persons. The usual agreement specifies the extent to which the employer recognizes the union as the representative of the workers. Its provisions cover wage rates and policies, working hours, working conditions, employment and dismissal policies including seniority clauses, vacations, the grievance procedure, and the life of the agreement.

Most agreements are the result of give-and-take negotiation, reflective of union pressure and employer resistance. They may be only a

few pages or may cover more than a hundred printed pages. When negotiating a labor agreement, both management and labor are chiefly concerned with immediate issues. However, if the document is carefully prepared and provides for everyday relations between union and management, a great many administrative difficulties may be avoided.

Among other things the agreement should:

1. Indicate clearly which workers are included and which are excluded.
2. Provide machinery for settling accusations by one group that the other party has violated the terms of the agreement.
3. Establish a procedure for settling disputes.
4. Indicate how management may operate under disputed conditions.
5. Define some orderly procedure for a renewal of the agreement.

*Wage Rates and Policy.* The provision for wages is one of the most important and most extensive in the agreement. The basic wage policy is outlined and details are given. If piece rates are to be paid, the scheme to be used is given; such matters as whether time clocks are to be used and the rates for overtime are stipulated. Sometimes provision is made for a review of wage scales during the life of the agreement without affecting its other clauses.

*Hours of Work.* The normal workday or work week is specified. If there is more than one shift in operation, the time of each shift and the times and methods of transferring workers from one shift to another are given. How overtime is to be calculated (by the day or week), how much time is to be taken for meals, and regulations for making up lost time must be agreed upon. What is to be done about working on Sundays and holidays and what happens when holidays fall on Sundays must also receive consideration.

*Working Conditions.* The degree of sanitation to be maintained, provision and use of restrooms, provisions for safety rules and devices, and the amount of medical care to be furnished are some of the factors that receive consideration in this part of the agreement.

*Employment and Dismissal Policies.* There must be an agreement about the methods to be used in selecting, promoting, and laying off workers. Such questions as the degree to which seniority is to be recognized and how it is to be determined are treated. Rules governing transfer of workers, hiring of temporary workers, and the apprenticeship program are a part of this clause in the agreement.

*Vacations.* The amount of the vacation allowed and when it may

be taken are outlined in the agreement. Whether it is optional with the employee to take the vacation or to work is stipulated. If the length of vacation varies with length of service, the rules for determining the worker's entitlement are enumerated. It is also agreed whether the vacation may be divided or must be taken all at one time.

*Grievance Procedure.* This clause defines what may be interpreted as a grievance and outlines how the grievance policy is administered. The use of shop stewards and grievance committees for handling frictions that may arise is outlined.

*Life of Agreement.* The common term for agreements in this country is one year, though the agreement itself must specify its length of life. Usually the steps to be followed in renewing the agreement are also outlined.[3]

## Settlement of Labor Disputes

The labor agreement usually outlines the grievance procedure that guarantees employees a hearing when they feel they are being treated unfairly. The agreement also indicates the procedure to be followed should differences arise that are not covered by it or should there be a difference of opinion in the interpretation of certain agreement provisions. The methods commonly employed in settling labor-management differences are conciliation, mediation, and arbitration.

### Conciliation and mediation

A conciliator serves as a go-between; he makes every effort to bring the two groups in a dispute together. He encourages them to continue negotiations, trying to get each group to see the other's point of view and helping them settle their differences themselves. In a sense, conciliation represents an effort to correct weaknesses in the labor agreement.

The mediator goes further than the conciliator in that he offers suggestions in addition to those proposed by management and labor. He does not serve in the capacity of a judge, holding hearings and

[3] This treatment of the labor agreement has of necessity been greatly abbreviated. Some of the other clauses frequently included pertain to recognition, representation, health and welfare funds, absenteeism, leaves of absence, holiday pay, production standards, strikes and lockouts, and disciplinary layoffs and discharges. The agreement between the General Motors Corporation and the United Automobile Workers-C.I.O., dated May 29, 1948, for example, has 152 provisions and constitutes 95 printed pages. A more detailed discussion of the labor agreement will be found in Smith, Leonard J., *Collective Bargaining.* New York: Prentice-Hall, Inc., 1946. See also Williamson, S. T., and Harris, Herbert, *Trends in Collective Bargaining,* pp. 49-129. New York: Twentieth Century Fund, 1945.

rendering decisions pertaining to the issues involved. Rather, his task is that of influencing each group to make concessions, helping them to narrow the gap separating their demands, and helping to bring about a compromise acceptable to both groups. Both parties may be made more self-reliant by learning new methods and procedures for settling future disputes.

There is nothing compulsory in conciliation and mediation. They represent efforts of unbiased outsiders to aid the disputants reach an agreement between themselves. They are both constructive processes, for they do not provide an escape by the disputants from the responsibility of making their own decisions and attempting to understand and evaluate each other's position.

*Arbitration.* Arbitration differs from conciliation and mediation in that the third party (or outsider) serves as a judge, rendering decisions relative to the issues involved in the dispute. The arbitrator may be an individual, a committee of several individuals, or a mediation or arbitration board of a municipality, a state, or the federal government. The choice of arbitrators must be agreed upon by both sides in the dispute. There may be voluntary arbitration with voluntary acceptance of the judgment, voluntary arbitration with compulsory acceptance of the decision, compulsory arbitration with voluntary acceptance of the decision, or compulsory arbitration with compulsory acceptance of the decision. Compulsory arbitration results when the two parties are required by law to arbitrate a dispute.

Most collective-bargaining agreements provide for the final determination through voluntary arbitration of specific issues in dispute that are unresolved by all other procedures established by the agreement. The prevailing procedure in collective bargaining is to have the grievance machinery terminate in arbitration.[4] According to a study made by the Bureau of Labor Statistics of 1,254 labor agreements in 14 industries, "three out of four union agreements, covering about 83 percent of the workers under the agreements analyzed, provide for arbitration as the terminal point in the grievance machinery." [4] Of the 1,254 agreements, that is, 915 provided for arbitration. Of the total number of workers covered by agreements containing the arbitration provision, 28 percent were subject to permanently established arbitra-

[4] *Arbitration Provisions in Union Agreements* (Bulletin No. 780), p. 1. Washington: United States Department of Labor, Bureau of Labor Statistics, 1944. See also Desser, Abraham A., *Trends in Collective Bargaining and Union Contracts* (Studies in Personnel Policy, No. 71). New York: National Industrial Conference Board, Inc., 1946.

tion machinery. The remaining 72 percent were subject to procedures calling for the selection of arbitrators whenever the need arose. Of all the arbitration agreements, 93 percent (covering 91 percent of the workers) provided for *automatic* arbitration or arbitration at the request of either party. Under this procedure, arbitration must be carried out if either party requests it, and both parties agree in advance to accept the decision as final and binding.

Several private organizations have been established for the purpose of serving management and labor in the settlement of industrial disputes. One such organization is the Council on Industrial Relations for the Electrical Contracting Industry. It was established in 1920 for the purpose of serving the entire industry. Any segment of the industry, where contractual relations exist between employers and the International Brotherhood of Electrical Workers, may avail itself of the arbitration machinery of the Council. Another such association is the American Arbitration Association. It serves management and labor by assisting in the selection of permanent arbitrators, the appointment of fact finders, and the conducting of polls to determine whether the members of a union approve a collective-bargaining agreement or the representation of the union among the employees of a company. The association also administers arbitration tribunals for the settlement of commercial controversies.

## The role of the government in settling disputes

Industrial disputes have long been the concern of the federal government. Where strikes are called that are detrimental to the public welfare, the government usually steps in and takes over the industry or forces an immediate settlement of the controversy.

Many cities have mediation boards; New York, Newark, and Toledo are noted for their leadership in this respect.[5] Several of the states have conciliation boards that serve in instances that do not fall under the jurisdiction of the National Labor Relations Board.

*Federal Mediation Service.* The National Mediation Board was formed in 1934 to aid in the settlement of disputes arising out of new agreements where railroads and airlines are concerned; the National Railroad Adjustment Board has jurisdiction over disputes arising out of existing agreements. The Federal Mediation and Conciliation Service is available for aiding in the formulation of new labor agreements as

[5] *Municipal Mediation Plans* (Bulletin Series A, No. 5). Urbana, Ill.: University of Illinois Institute of Labor and Industrial Relations, October, 1947.

well as the interpretation of existing ones. It assists in the settlement of labor-management disputes and otherwise aids employers and unions in matters pertaining to labor-relations problems. Requests for such service are usually made by one or both parties to a labor dispute, although the service can enter cases on its own initiative where the public interest requires it. Cases handled by the service fall under these categories:

*Work stoppage*—a strike or lockout.

*Threatened stoppage*—a situation where a definite strike date has been announced or a 30-day strike notice has been filed.

*Controversy*—a dispute that has not reached the stage of a work stoppage or a threatened stoppage.

*Arbitration*—arbitration decisions rendered by arbitrators appointed by the Conciliation Service upon request of both parties to a dispute. These arbitrators are appointed to render final and binding awards that the parties agree to accept in advance of the award.

*Technical activities*—the conducting of surveys upon the joint request of both parties to a dispute and the giving of advice to companies and unions on such technical matters as wage-incentive plans, time studies, and job evaluations.

*Special services*—services provided upon request, such as furnishing labor-relations information, consultation with labor and management on specific problems, and addresses to interested groups concerning the Conciliation Service, labor problems, and related subjects.

The cases with which the service dealt for the fiscal years 1940-41 through 1946-47 are summarized in Table XI-6.

TABLE XI-6. CASES CLOSED BY THE UNITED STATES CONCILIATION SERVICE FOR FISCAL YEARS 1940-41 THROUGH 1946-47.*

| *Type of Case* | *1940-41* | *1941-42* | *1942-43* | *1943-44* | *1944-45* | *1945-46* | *1946-47* |
|---|---|---|---|---|---|---|---|
| Disputes Disposed of: | | | | | | | |
| Work stoppages | 1,535 | 1,781 | 2,086 | 2,843 | 3,207 | 3,206 | 3,047 |
| Threatened stoppages | 1,319 | 2,238 | 2,347 | 2,217 | 2,183 | 5,088 | 6,781 |
| Controversies | 851 | 2,448 | 9,911 | 16,638 | 17,731 | 8,140 | 4,594 |
| Arbitration | 192 | 453 | 1,009 | 1,185 | 1,151 | 959 | 1,008 |
| Technical | 114 | 76 | 148 | 213 | 166 | 123 | 247 |
| Special services | 1,588 | 1,515 | 2,058 | 1,701 | 1,469 | 1,324 | 1,034 |
| Total | 5,599 | 8,511 | 17,559 | 24,797 | 25,907 | 18,840 | 16,711 |

* Source: *Handbook of Labor Statistics, 1947*, p. 151. Washington: United States Department of Labor, Bureau of Labor Statistics, 1949.

*National Labor Relations Board.* Another government organization that aids in the settlement of labor disputes is the National Labor Relations Board, created by Congress in 1935 to guarantee labor the right to organize and bargain collectively. The Board consists of three members appointed by the President, each member serving for a period of five years.

The National Labor Relations Board deals with two types of cases. First, it has power to investigate employers who are accused of unfair labor practices. If the Board finds that the employer is guilty, it orders him to stop interfering with the workers' right to organize; if necessary, it may call upon the federal courts to enforce its rulings.

The second type of case pertains to representation. The Board provides election machinery for the purpose of determining the workers' preferences regarding representation for collective bargaining. According to the policy of the Board, it is the exclusive right of the workers to decide whether they want any union to be their representative and, if so, which union they want, without any interference on the part of the employer. The principle of majority rule is observed; the union that receives a majority of the votes cast is selected as the workers' official representative. The Board also takes steps to initiate procedures for orderly collective bargaining between the selected representative of the workers and the employer.

The National Labor Relations Board handled slightly more than 1,000 cases in the fiscal year 1935-36; over 9,000 cases in 1940-41; and almost 15,000 cases in 1946-47. In 1935-36, only 19 percent of the cases filed with the Board were representation cases and 81 percent involved unfair labor practices. In 1940-41, representation cases accounted for 47.4 percent of those filed with the Board and unfair labor practices, 52.6 percent. In 1946-47 the representation cases comprised 71.6 percent of the total and those involving unfair labor practices only 28.4 percent.[6] These figures show clearly that, whereas originally most of the work of the Board dealt with unfair labor practices, with representation cases playing a minor role, the opposite condition followed.

The government has given considerable attention to labor legislation. Two distinct types of labor legislation have been enacted: The first includes laws covering hours, safety, and health; the second, laws concerning the rights, liabilities, and limitations of labor unions and employers. This legislation will be discussed in Chapter XIV.

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[6] *Handbook of Labor Statistics, 1947,* p. 153. Washington: United States Department of Labor, Bureau of Labor Statistics, 1949.

## Terms for Study

Arbitration
Boycott
Closed shop
Collective bargaining
Conciliation
Controversy
Craft union
Employers' association
Independent union
Industrial union
Injunction
Jurisdictional dispute
Labor agreement
Labor union
Lockout
Mediation
Open shop
Picketing
Preferential shop
Union shop

## Questions

1. Why is it to the advantage of labor to organize into unions?
2. During what 5-year period did labor unions experience their greatest growth (a) in number of members? (b) in percentage of increase?
3. What are some of the objectives of organized labor?
4. What is the chief characteristic that distinguishes a craft union from an industrial union?
5. How do the A.F. of L. and the C.I.O. compare in number of members?
6. Approximately what percentage of all union members are affiliated with either the A.F. of L. or the C.I.O.?
7. Approximately what percentage of all eligible workers in those occupations in which unions are actively engaged in seeking to obtain collective agreements are employed under collective-bargaining contracts?
8. What are some of the techniques used by organized labor to gain its objectives?
9. What is the chief distinction between a closed shop and a union shop?
10. Why is picketing an effective weapon in the hands of labor?
11. What is the difference between a primary boycott and a secondary boycott?
12. What are some of the techniques used by management to combat organized labor?
13. What are the major issues involved in most strikes, and what is the relative importance of these issues?
14. What are some of the principal clauses usually included in labor agreements?
15. What is the difference between mediation and conciliation?
16. What is the difference between conciliation and arbitration?
17. Why is the government interested in labor-management relations?
18. What is the difference between the work of the Federal Conciliation Service and the National Labor Relations Board?
19. What kind of cases constitute the major concern of the National Labor Relations Board?

## Problems and Projects

1. Determine the extent of organization of labor in your community by listing the kinds of jobs in which most of the workers are members of unions, those in which a small percentage of the workers belong to unions, and those in which workers are not organized at all.

2. Ascertain the number of local labor organizations in your community; determine how many are craft unions, how many are industrial unions, and how many are independent unions.

3. Study several current issues of the local papers to see what news they contain pertaining to labor-management relations.

4. Assume a wage scale of 80 cents an hour and a work week of 40 hours. The workers strike for a period of 10 weeks in an attempt to force agreement to a new wage rate of $1.00 an hour; at the end of 10 weeks they accept a compromise wage of 90 cents an hour. Calculate the amount of each worker's loss of wages during the strike period and determine the length of time that will be required at the new wage rate to make up for this loss.

5. In order to become familiar with the kind of bulletins and papers that unions issue, examine several copies of news bulletins and papers issued to members of local unions in your community. List several different kinds of information presented or discussed.

6. Examine two labor agreements that were in effect in the same firm or industry but for periods separated by 5 years. Observe the progress and refinement shown by the newer agreement when contrasted with the earlier one.

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CHAPTER XII

# BANKING AND FINANCE

IN ADDITION TO THE INITIAL DEMAND for capital to establish an enterprise, funds are constantly needed to carry on the business. There are times when a firm needs additional capital for a short time to pay for merchandise or supplies that can be purchased at a reduced price if bought immediately. The payment of special taxes may deplete the working capital; or the businessman may want to develop or promote a new product that shows promise of larger profits.

Although banks are not a business's only source of funds, they are one of the most important and most readily available sources. The purpose of this chapter is to discuss the kinds of financial services rendered by banks, the use of short-term and long-term credit instruments, and other financial institutions from which capital may be obtained for business operations and expansion.

## Banking

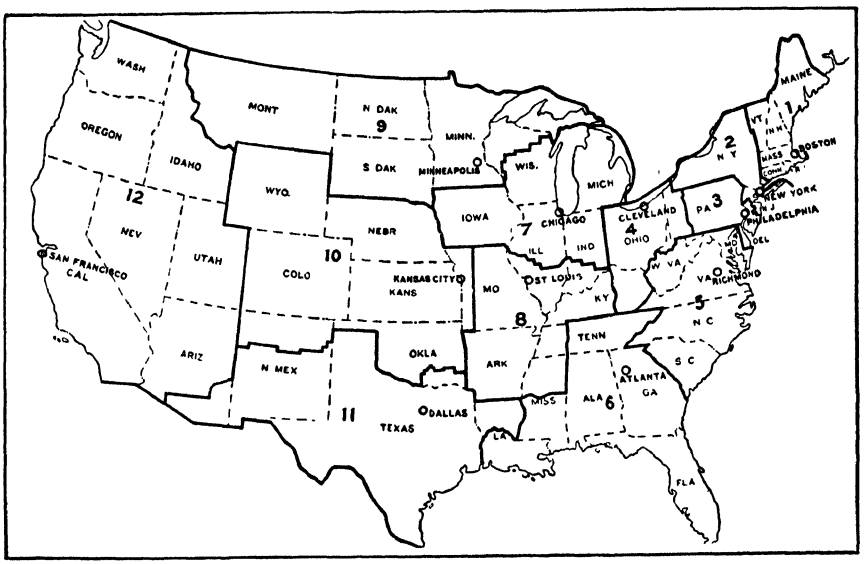
In analyzing the kinds of services rendered by banks to business, it is important to keep in mind the distinction businessmen make between *fixed capital* and *working capital.*

### Types of banks

Banks that specialize in short-term business loans, provide checking-account service, and handle commercial paper are called *commercial banks.* These are the banks from which business obtains a large part of its working capital.

Those organized primarily to encourage savings are known as *savings banks.* Those authorized to engage in trust and long-term investments are called *investment banks.* All banks operate as either private, state, or national banks. Private banks are not authorized by either the state or the federal government, although they are often under the supervision of state banking authorities. State banks are chartered by the state and are under the supervision of state officials. National banks are authorized by the federal government and are examined periodically by national bank examiners.

All national banks are required to belong to the Federal Reserve System, which is an organization of national and state banks established for the purpose of standardizing banking practices and providing business with more extensive credit facilities. The Federal Reserve Act was designed "to provide for the establishment of Federal Reserve Banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes." Figure 12-1 illustrates the way in which the United States is divided into 12 districts. In each district there is a Federal Reserve Bank to serve the member banks.[1]




*Courtesy Board of Governors of the Federal Reserve System*

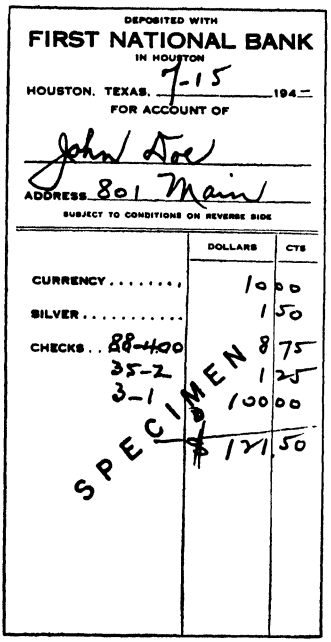
*Figure 12-1. Federal Reserve Districts.*

## Services rendered by commercial banks

Primarily, the commercial bank provides its customers with currency needed for the business. It offers checking-account service and short-term loans, and also acts as collection agency for commercial paper, such as trade acceptances, drafts, notes, and coupon bonds. In foreign trade, these banks serve as agents for the transfer of funds to other nations. For many of these services regular charges are made, but some are incidental to other functions.

[1] An excellent discussion of the Federal Reserve System is contained in Dimock, Marshall Edward, *Business and Government,* pp. 564-568. New York: Henry Holt and Company, Inc., 1949.

*Checking-Account Service.* Money deposited to the account of an individual or business remains in the bank until a check is written by the depositor. A record of each deposit is made on a form known as a *deposit ticket,* illustrated in Figure 12-2. Funds to be deposited should


DEPOSITED WITH
FIRST NATIONAL BANK
IN HOUSTON
HOUSTON, TEXAS. 7-15 194–
FOR ACCOUNT OF
John Doe
ADDRESS 801 Main
SUBJECT TO CONDITIONS ON REVERSE SIDE

| | DOLLARS | CTS |
|---|---|---|
| CURRENCY | 10 | 00 |
| SILVER | 1 | 50 |
| CHECKS 88-400 | 8 | 75 |
| 35-2 | 1 | 25 |
| 3-1 | 100 | 00 |
| | $ 121 | 50 |

SPECIMEN

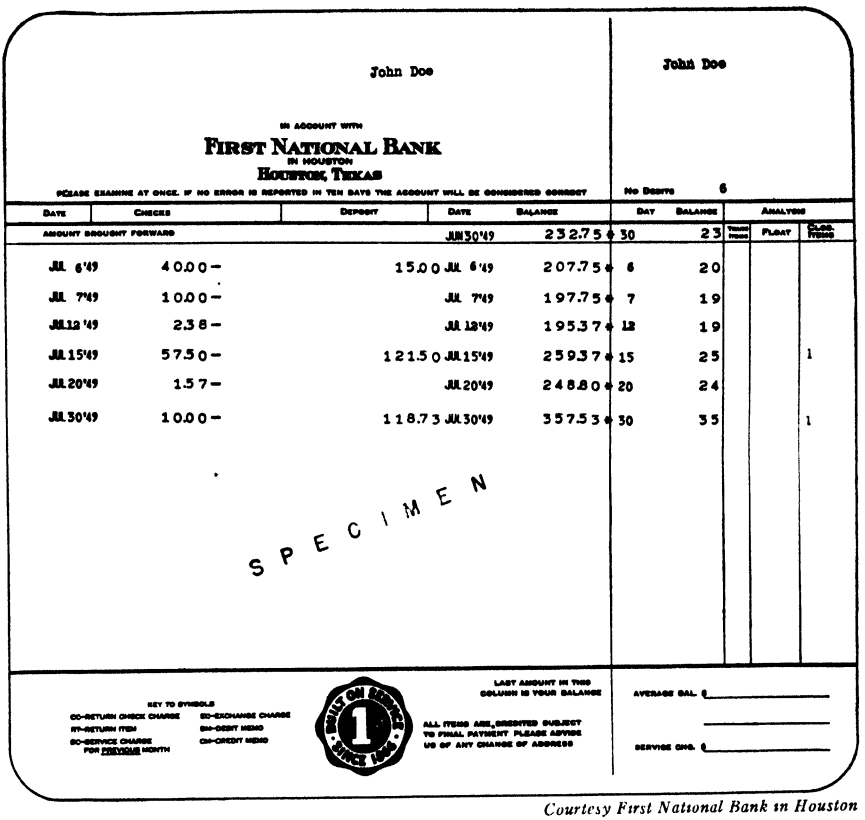
*Courtesy First National Bank in Houston*

*Figure 12-2. Deposit Ticket.*

be arranged in the order shown on the ticket; all checks must be endorsed.[2] Periodically, usually at the end of each month, the bank issues to the depositor a record of all deposits and withdrawals, prepared on a form known as a bank statement and similar to that shown in Figure 12-3.

---

[2] In Figure 12-2, the checks are listed according to the American Bankers' Association numbers. By agreement all banks that are members of the A.B.A. have been assigned numbers to facilitate handling checks. These numbers are printed on the face of the check, usually to the right of the bank name. Certain large cities, known as reserve centers, carry numbers from 1 to 49; states and territories are numbered above 50. Within each center every commercial bank that is a member of the A.B.A. is given a different number. Thus, the check numbers show, first, the city or state number and, second, the bank number. Some banks prefer that checks be identified on the deposit ticket by means of their numbers; others prefer that the name and location of the bank be indicated.



John Doe

IN ACCOUNT WITH

FIRST NATIONAL BANK
IN HOUSTON
HOUSTON, TEXAS

PLEASE EXAMINE AT ONCE. IF NO ERROR IS REPORTED IN TEN DAYS THE ACCOUNT WILL BE CONSIDERED CORRECT

John Doe

No Deposits 6

| Date | Checks | Deposit | Date | Balance | Day | Balance | Analysis |
|---|---|---|---|---|---|---|---|
| Amount brought forward | | | JUN 30'49 | 232.75 | 30 | 23 | |
| JUL 6'49 | 40.00– | 15.00 | JUL 6'49 | 207.75 | 6 | 20 | |
| JUL 7'49 | 10.00– | | JUL 7'49 | 197.75 | 7 | 19 | |
| JUL 12'49 | 2.38– | | JUL 12'49 | 195.37 | 12 | 19 | |
| JUL 15'49 | 57.50– | 121.50 | JUL 15'49 | 259.37 | 15 | 25 | 1 |
| JUL 20'49 | 1.57– | | JUL 20'49 | 248.80 | 20 | 24 | |
| JUL 30'49 | 10.00– | 118.73 | JUL 30'49 | 357.53 | 30 | 35 | 1 |

Items Handled | Float | Class Items

SPECIMEN

KEY TO SYMBOLS
CC-RETURN CHECK CHARGE
EC-EXCHANGE CHARGE
RT-RETURN ITEM
DM-DEBIT MEMO
SC-SERVICE CHARGE FOR PREVIOUS MONTH
CM-CREDIT MEMO

BUILT ON SERVICE SINCE 1865

LAST AMOUNT IN THIS COLUMN IS YOUR BALANCE

ALL ITEMS ARE CREDITED SUBJECT TO FINAL PAYMENT PLEASE ADVISE US OF ANY CHANGE OF ADDRESS

AVERAGE BAL. $
SERVICE CHG. $

*Courtesy First National Bank in Houston*

*Figure 12-3. Bank Statement.*

Some banks charge the depositor a fee for each check written against the amount on deposit; others require him to maintain an average balance above a certain minimum.

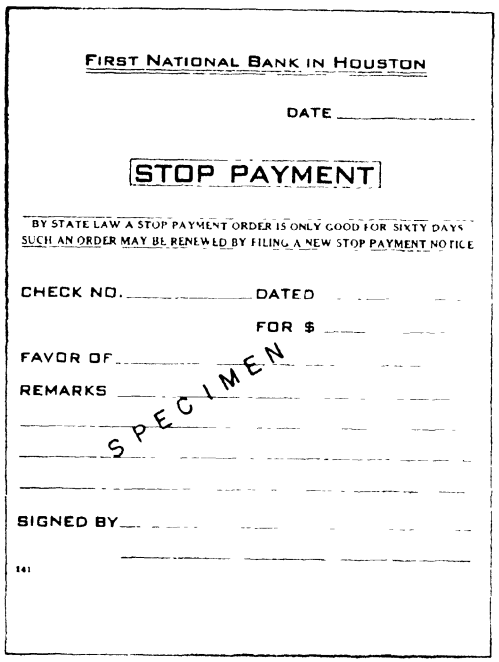
A check is a form of negotiable instrument by means of which a depositor orders his bank to pay from his funds on deposit a specified sum of money to the order of the person named in the instrument or to "Cash" or "Bearer." To cash a check drawn to the order of yourself,

TABLE XII-1. NUMBER OF COMMERCIAL BANKS IN THE UNITED STATES, 1941-1947.*

| *Year* | *All Commercial Banks* | *National Banks* | *State Banks* |
|---|---|---|---|
| 1941 | 14,305 | 5,130 | 9,175 |
| 1947 | 14,183 | 5,012 | 9,174 |

* Source: *Banking and Monetary Statistics*, p. 24. Washington: U. S. Board of Governors, Federal Reserve System, 1943, for 1941 data; *Federal Reserve Bulletin*, January, 1948, Vol. 34, No. 1, pp. 64 and 65, for 1947 data.

you merely endorse it on the reverse side before presenting it for payment. There are times when the maker of a check may wish to stop payment on it, possibly because the check has been lost or because it is discovered that an error was made in writing it. In such a case, the maker notifies the bank by preparing a written form known as a *stop-payment order,* similar to the one shown in Figure 12-4. This order directs the bank on which the check is issued to refuse payment.


FIRST NATIONAL BANK IN HOUSTON

DATE _____

STOP PAYMENT

BY STATE LAW A STOP PAYMENT ORDER IS ONLY GOOD FOR SIXTY DAYS
SUCH AN ORDER MAY BE RENEWED BY FILING A NEW STOP PAYMENT NOTICE

CHECK NO. _____ DATED

FOR $

FAVOR OF

REMARKS

SPECIMEN

SIGNED BY

141

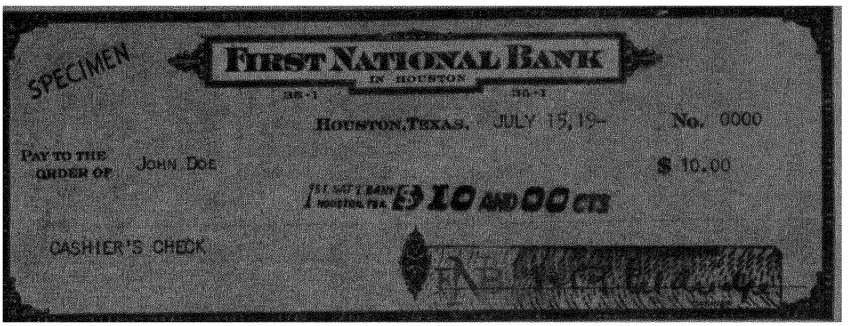
*Courtesy First National Bank in Houston*

*Figure 12-4. Stop-Payment Order.*

*Special Check Forms.* Several different forms of checks are used in business. Many businesses use a *voucher check,* which is a regular check with an attached perforated form for describing the reason why the check is issued. This voucher is detached when the check is presented for payment. The voucher may serve as a receipt and as a record of other information relating to the transaction.

A *cashier's check* is a check drawn by a bank against its own funds. It is so called because it is signed by the cashier. It is often used by a bank to pay its own debts, or it may be obtained by a person who wishes to send a remittance through the mail. Figure 12-5 illustrates a cashier's check. Anyone may obtain a cashier's check for a fee, by de-

positing the required amount of money with the bank and requesting that the check be issued.




*Courtesy First National Bank in Houston*

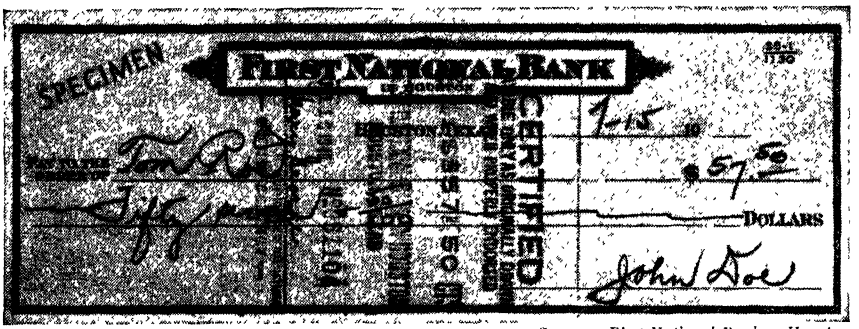
*Figure 12-5. Cashier's Check.*

A *bank draft* is similar to a cashier's check except that it is drawn by one bank on a correspondent bank in another community rather than on itself. A bank in one city that agrees to represent a bank in another city in matters such as collecting its drafts or transacting other business is known as a correspondent bank.

A *certified check* is a personal check that is guaranteed by the bank on which it is written. If there is some doubt that the drawer of the check has sufficient funds in the bank, the payee may request in advance that a certified check be used. Certification is obtained in the following manner: The drawer presents his check to a bank in which he has funds on deposit and asks it to certify payment. The drawer's account is checked to determine whether sufficient funds are on deposit; if so, the bank employee charged with certifying checks stamps the face of the instrument (see Figure 12-6). A bookkeeping entry is made immediately, deducting from the depositor's account the amount of the check. Hence, when the instrument is eventually presented for payment, the amount of money necessary to cover the check will be on deposit. Occasionally, when retail goods are purchased through the mail, the seller will request in advance that a certified check accompany the order. A certified check is regarded as a safe and satisfactory method for paying accounts.

*Short-Term Loans.* Another very important service performed by commercial banks is the issuance of short-term loans to individuals and businesses. Almost every business sometimes needs additional working capital for a short period, such as 30, 60, or 90 days. Loans that fall due in less than one year are known as short-term obligations. Capital

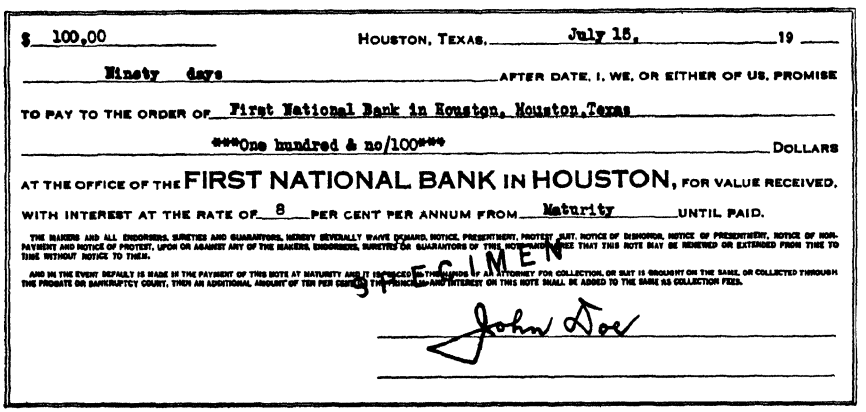
obtained from short-term financing becomes a part of the working fund used to operate the business and may be used for various current expenses or to purchase supplies, materials, or equipment.




*Courtesy First National Bank in Houston*

*Figure 12-6. Certified Check.*

The promissory note is one of the most common forms of negotiable instruments used for short-term loans. A promissory note is a promise to pay a certain sum of money to a specified person at a definite place, on or before a fixed time, with or without a specified interest rate.




*Courtesy First National Bank in Houston*

*Figure 12-7. Negotiable Promissory Note.*

Like other negotiable instruments, it must contain the words "pay to the order of" or "pay to bearer" to be negotiable. For example, in Figure 12-7, John Doe is the maker of the note and it is negotiable because it contains the proper phrasing. In this illustration, the amount is $100, the interest rate is 8 percent per annum, and the note is payable to

the bank 90 days after date. Promissory notes are more often used between individuals and banks than between business firms. When the amount of the loan is extremely large, the bank may require additional security for the loan, such as a mortgage on real estate or personal property.

Business firms accept promissory notes as payment from their customers. When this is done, the firm carries the notes on its records as "notes receivable." If the business needs cash before a note is due, it may endorse the note and sell it to a commercial bank at a discount. At maturity, the bank collects the full amount of the note, including interest. The bank makes a profit by collecting from the maker of the note more than was paid to the business at the time the note was discounted. However, should the maker default in payment, the bank can hold responsible the firm that endorsed the note. Every person who endorses a promissory note assumes liability for the instrument to any subsequent holder.

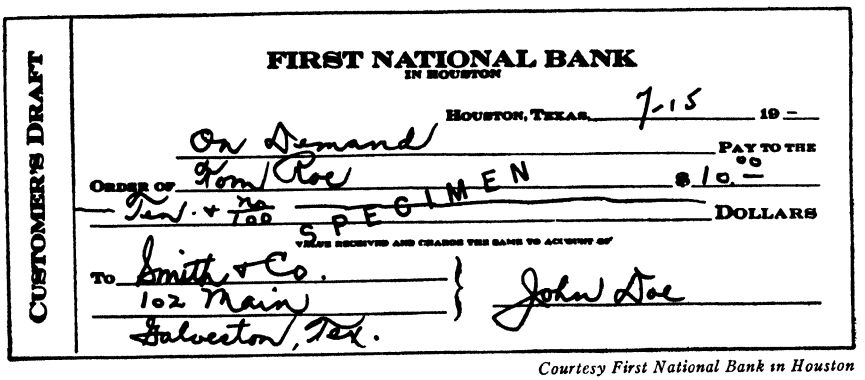
*Bills of Exchange.* Another type of negotiable instrument, the bill of exchange, is defined by the Uniform Negotiable Instruments Law as "an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money, to order or bearer."

The two most common forms of bills of exchange are the commercial draft and the trade acceptance. Bills of exchange differ from promissory notes in that the creditor initiates the instrument by ordering the debtor to pay a specified amount to the bearer either at sight or at some future date. The seller prepares a draft and sends it to the *drawee,* the person from whom payment is to be received. When the drawee accepts the obligation, he is known as the *acceptor.* By writing on the draft "accepted," together with the firm's or individual's name, the acceptor agrees to pay the amount of the draft. This instrument then can circulate in trade channels; when it is presented to the bank by the drawee, payment is made.

When a commercial draft is to be paid upon presentation to the debtor and no certain time is specified, it is known as a *sight draft.* This means the instrument is payable at sight. A sight draft may be used when goods are delivered by freight on a cash basis. The shipper secures from the transportation company an order bill of lading. The transportation agent at the destination point cannot release the merchandise until the bill of lading is presented. The seller, who is the

shipper, attaches a sight draft to the bill of lading and mails both to the bank of the purchaser. To obtain possession of the goods, the buyer must accept the sight draft by paying it. When the draft is paid, the buyer receives the bill of lading and the transportation agent is authorized to release the merchandise to him.

A typical draft payable on sight or demand is the customer's draft illustrated in Figure 12-8. Here John Doe is the drawer of the draft, Tom Roe is the payee, and the firm of Smith & Co. is the drawee. Smith & Co. will pay the amount of the draft from funds on deposit in its account.




*Courtesy First National Bank in Houston*

*Figure 12-8. Customer's Draft.*

A *time draft* is one that is payable at a specified time. Such a phrase as "thirty days after sight" means that the firm accepting the draft agrees to pay the amount at the time indicated.

A draft drawn by one bank upon another bank is called a *bankers' bill.*

The *trade acceptance* is a kind of bill of exchange that is often used when a firm ships merchandise to a customer with which it does not have an open account. Trade acceptances are preferred to promissory notes or drafts because they originate at the time goods are sold. They are not used so extensively as the open account. Competition among sellers for customers generally forces the seller to extend credit on open account rather than demand a trade acceptance at the time of sale.

*Letter of Credit.* Commercial banks provide another type of service known as letters of credit. By depositing money and establishing credit, it is possible to obtain from the bank a letter of credit that can be used when traveling in a foreign country or in any part of the United States

where the issuing bank has established relations with a corresponding bank.

The letter of credit is sent to one or more corresponding banks, which, by special agreement, perform certain banking services. A copy of the letter is presented to the correspondent bank by the individual. This letter introduces the holder to the bank officials and authorizes them to cash a draft for an amount not to exceed the sum named in the letter. The holder of the letter is required to present a signature on the draft that is identical to one in some identifying document other than the letter of credit. The bank that issues the letter of credit makes a service charge for this service (usually from ⅛ to ½ of one percent of the amount authorized in the letter). Letters of credit are often used by businessmen traveling in foreign countries for the purpose of buying merchandise to be resold. Figure 12-9 is a good illustration of this kind of document.

*Chattel-Mortgage Loans.* Commercial banks issue short-term loans with chattel mortgages as security. A common type of chattel-mortgage loan is involved when an individual or business purchases an automobile by making a small down payment and borrowing the remainder from the bank. To secure the loan, the bank requires a chattel mortgage on the automobile. The borrower also gives a promissory note for the debt. In case the borrower defaults, the mortgage holder can secure title to the chattel and sell the automobile for enough to pay off the debt and cancel the note. Chattel mortgages may be taken on both personal and movable property. A large part of the installment sales of durable goods sold in the United States are financed by banks that accept chattel mortgages as security for commercial loans. In states that do not recognize a chattel mortgage on personal property, a conditional bill of sale is used. This type of instrument gives the person who is buying the goods on credit a conditional title to the property until the terms of the sale have been fulfilled.

Commercial banks also accept other types of security for short-term loans. A warehouse receipt issued to the owner of goods stored in a bonded public warehouse may be used. When the receipt contains the words "to bearer" or "to the order of," the receipt is negotiable and may be endorsed and used as collateral for a loan. Likewise, stocks and bonds may be given as security for business loans. If the price of such stocks or bonds declines below the value of the loan, the borrower is required to put up additional collateral. If the maker of the note is unable to furnish additional security, the stocks or bonds are sold and the note becomes payable at once.

EXPORT COMMERCIAL LETTER OF CREDIT

**The Second National Bank**
OF HOUSTON

CABLE ADDRESS SECNATBANK, HOUSTON

JOHN DOE RICE MILLS, INC.
P. O. Box #1
Houston, 1 Texas.

NO. E-3000 AMOUNT U$S 61,250.00 HOUSTON, TEXAS May 20, 194*

DEAR SIRS: SECOND NAT'L BANK $61250 00 CTS

WE ARE INSTRUCTED BY - -Banco de Credito, Havana, Cuba- - -

TO ADVISE YOU THAT THEY HAVE OPENED THEIR IRREVOCABLE CREDIT IN YOUR FAVOR FOR ACCOUNT OF
- -Fulano de Tal y Compania, S.A., Havana, Cuba - - - -
UNDER THEIR CREDIT NO. AB-1234 FOR A SUM OR SUMS NOT EXCEEDING A TOTAL OF
- -SIXTY-ONE THOUSAND, TWO HUNDRED FIFTY U.S. DOLLARS - -
AVAILABLE BY YOUR DRAFTS AT SIGHT DRAWN ON OURSELVES.

TO BE ACCOMPANIED BY -(1) Commercial Invoice in triplicate, original visaed - - - - - - - - - - - - - - - - - -
(2) Consular Invoice in triplicate.- - - -
(3) Negotiable Marine Insurance Policy or certificate, including War Risk.- - - -
(4) Certificate of Origin issued by a State Department of Agriculture or by the U.S Federal Department of Agriculture, visaed by the Cuban Consul - - - - - - - - - -
(5) Full sets of Clean-Board Ocean Bills of Lading to order of bank endorsed, original visaed.

SAMPLE COPY FOR INFORMATION ONLY

EVIDENCING SHIPMENT OF:--5,000 (Five thousand) pockets of AMERICAN RICE at U$S 12.25 per pocket C.I.F. Havana.- - - - - - - - - - - - - - -

FROM:- - -Houston, Texas- - - -TO:- -Havana, Cuba- - - -

SPECIAL STIPULATIONS:- -Partial shipments are not permitted.
- -Shipment must be effected not later than June 10, 194*.- - - - - - -
- -War Risk insurance premium and consular charges are payable in excess of the credit amount.

IMPORTANT

THIS LETTER OF CREDIT MUST ACCOMPANY YOUR DRAFTS TO US OR TO THE NEGOTIATING BANK IN ORDER THAT THE AMOUNT OF EACH PAYMENT OR NEGOTIATION MAY BE ENDORSED HEREON PRESENTATION OF DRAFTS BY ANOTHER BANK SHALL BE A WARRANTY BY THE LATTER THAT SUCH ENDORSEMENT HAS BEEN DULY MADE.

THE ABOVE MENTIONED CORRESPONDENT ENGAGES WITH YOU THAT ALL DRAFTS DRAWN UNDER AND IN COMPLIANCE WITH THE TERMS OF THIS CREDIT WILL BE DULY HONORED ON DELIVERY OF DOCUMENTS AS SPECIFIED IF PRESENTED AT THIS OFFICE ON OR BEFORE June 15, 194*

We confirm this credit and thereby undertake that all drafts drawn and presented as above specified will be honored by us

YOURS VERY TRULY.

EXCEPT AS OTHERWISE EXPRESSLY STATED HEREIN, THIS CREDIT IS SUBJECT TO THE "UNIFORM CUSTOMS AND PRACTICE FOR COMMERCIAL DOCUMENTARY CREDITS" (FIXED BY THE SEVENTH CONGRESS OF THE INTERNATIONAL CHAMBER OF COMMERCE) AND TO THE RELATIVE GUIDING PROVISIONS, ALL AS ADOPTED BY CERTAIN BANKS AND OTHER CONCERNS IN THE U. S. OF A.

VICE PRESIDENT

ASSISTANT MANAGER OF FOREIGN DEPARTMENT

ddb

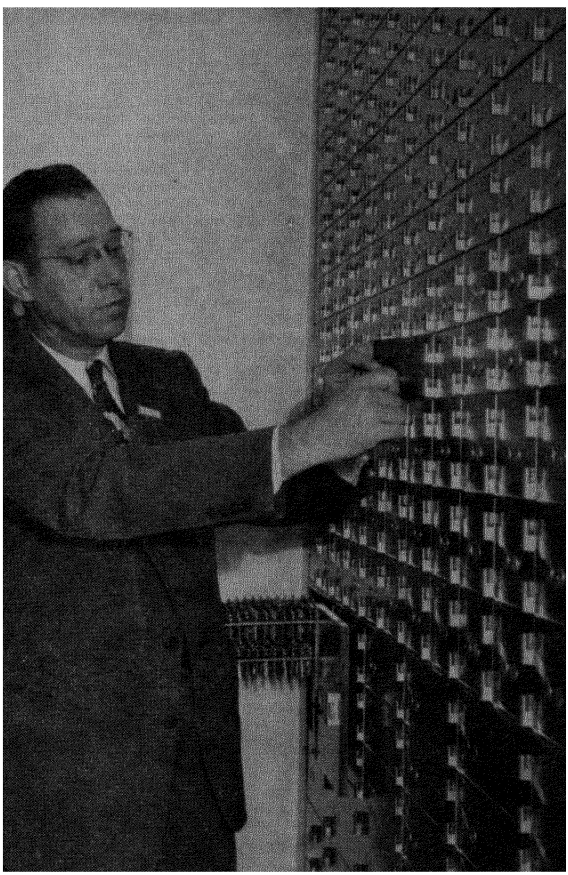
*Courtesy The Second National Bank of Houston*

*Figure 12-9. Letter of Credit.*

*Other Services Rendered by Commercial Banks.* In addition to lending money and providing checking-account services, commercial banks perform other functions. Chief among these are the following:

1. Renting safe-deposit boxes.
2. Selling traveler's checks.

3. Preparing payrolls.
4. Collecting notes, bond coupons, and drafts.
5. Providing financial and confidential information.
6. Serving as trustee.



*Courtesy The West Side State Bank, Fort Worth*

*Figure 12-10.* These safety-deposit compartments, which are fireproof, burglar-proof, and so forth, are one of the many services a bank affords its customers.

## Services rendered by savings banks

Savings banks, unlike commercial banks, are organized primarily to provide their customers with a place to deposit savings. The funds each depositor saves are thus accumulated and loaned to individuals and businesses for longer periods of time than money granted in short-term

loans. Savings banks pay depositors a stated rate of interest.[3] Ordinarily, savings banks do not offer checking-account privileges. Many commercial banks have savings departments that serve the same function as regular savings banks.

**SAVINGS DEPOSIT**

ACCOUNT NO. 000

NAME John Doe

ADDRESS 801 Main

Deposited with First National Bank in Houston subject to the terms and conditions contained in the Savings Account Passbook, and all amendments or additions thereto, and subject to the conditions on the reverse hereof, all of which are made a part hereof

Houston, Texas, 6/15 19 – .

PLEASE LIST EACH CHECK SEPARATELY

SPECIMEN

| | DOLLARS | CENTS |
|---|---|---|
| SILVER | 10 | 00 |
| CURRENCY | | 25 |
| CHECKS | | |
| " 1-8 | 18 | 75 |
| " 2-1 | 100 | 00 |
| " | | |
| " | 129. | 00 |
| " | | |
| " | | |

P.B.$ BAL.

ENT'D BY

MEMO

*Courtesy First National Bank in Houston*

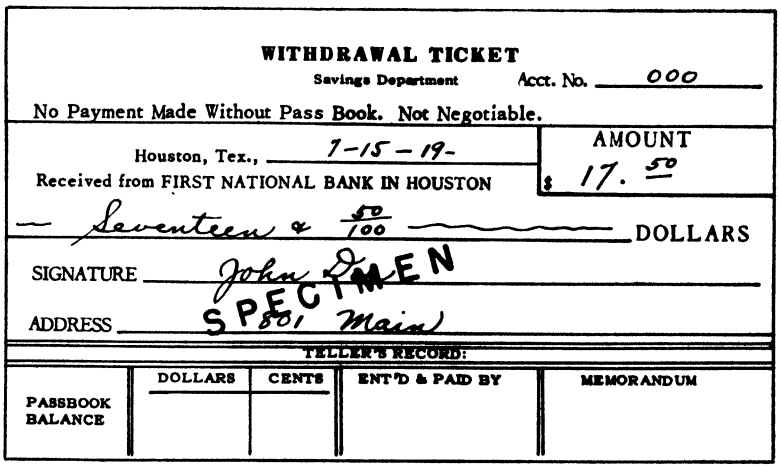
*Figure 12-11. Savings-Deposit Ticket.*

Figure 12-11 illustrates a savings-deposit account ticket used when money is deposited. The form used to withdraw funds is usually identified as a *withdrawal ticket,* an example of which is shown in Figure 12-12. The ticket is not negotiable and cannot be used outside the bank.

[3] The prevailing rate of interest paid by savings banks is about 2 percent a year. Some banks pay compound interest, which means that unpaid interest earns interest the same as the original deposit does. A few banks do not pay interest on deposits under $5.00.

When funds are withdrawn before the interest is due, the depositor loses his interest. Many savings banks pay interest semiannually.

Savings banks provide other services too. They rent safety-deposit boxes, sell traveler's checks, furnish financial advice to depositors, and serve as trustees for estates and in the settlement of wills. All savings banks operating as national banks are required to insure their deposits in the Federal Deposit Insurance Corporation. State savings banks are eligible to obtain FDIC insurance also. This plan will be discussed in Chapter XIV.



WITHDRAWAL TICKET

Savings Department Acct. No. 000

No Payment Made Without Pass Book. Not Negotiable.

Houston, Tex., 7-15-19- AMOUNT

Received from FIRST NATIONAL BANK IN HOUSTON $ 17.50

— Seventeen & 50/100 — DOLLARS

SIGNATURE John Doe SPECIMEN

ADDRESS 801 Main

TELLER'S RECORD:

| | DOLLARS | CENTS | ENT'D & PAID BY | MEMORANDUM |
|---|---|---|---|---|
| PASSBOOK BALANCE | | | | |

*Courtesy First National Bank in Houston*

*Figure 12-12. Withdrawal Ticket.*

## Services rendered by investment banks

Investment banks serve large organizations by helping to raise long-term capital for corporations. Banks of this type sell all kinds of securities, both old and new, such as common stocks, preferred stocks, and bonds.

*Underwriting Securities.* The chief function of the investment bank is to market stock or bond issues for corporations. In this capacity, the investment banker is a middleman, acting as a wholesaler or retailer in placing long-term securities into the hands of the investing public. *Underwriting* means that the bank takes the issue at an agreed price and turns over to the corporation the total cash payment in advance of the sale of the securities. The investment bank then assumes the risk involved in locating buyers of the securities. If the issue represents a very large sum of money, several investment banks may join together

and form a syndicate or group of firms, each agreeing to take a portion of the total securities offered for sale.

The investment bank makes its profit by charging a commission for the sale of the securities or by bidding for the stocks or bonds at a discount and then selling them at a slightly higher price, provided the demand is sufficient to maintain the market price. Sometimes, the price may drop before the entire issue is sold; in such cases, the bank takes a loss on some of the securities.

## Long-Term Financing

We have observed that commercial banks are the principal source of working capital to meet usual temporary financial demands, seasonal variations, and general operating expenses. Many firms need capital to be used over longer periods of time. Money invested in machinery is one example. Borrowing money with the understanding that it will not be repaid for several years is called *long-term financing.*

There are various reasons why long-term financing is desirable. A business may find that the demand for its product exceeds the supply and that its production cannot be increased without adding more equipment. If the business does not have enough funds to buy new equipment, it must resort to a loan. Long-term loans are generally made to purchase new machinery, construct additional buildings, replace obsolete facilities, or carry on a long-range research program.

### Types of long-term securities

There are few possibilities for a single proprietorship or partnership to raise capital by a long-term obligation. The corporation is ideally suited for this plan of expansion. A proprietor may draw on his private wealth to finance an expansion or he may mortgage a fixed asset. He cannot hope to raise more capital by issuing bonds or selling stocks unless he changes the form of organization. Likewise, a partnership may draw upon its partners for additional investments or it may mortgage its assets. Funds raised from these sources are limited to the wealth of the owners or the value of the assets available for mortgage.

A corporation has the advantage of being able to sell additional stock or issue bonds to enlarge its financial structure. A corporation may issue several different kinds of stocks and bonds for any purpose that it may desire.

*Financing by Common Stock.* As was pointed out in Chapter IV, common stock represents direct ownership in the business. In return, the owner expects to receive a proportionate share of the profits in the

form of dividends. Each share carries voting rights in the management of the corporation. Common stock is classified according to value, such as par value, no-par value, market value, and book value. Par value is the amount written on the face of each stock certificate. It indicates the face value or stated value of the stock at the time it is issued. Many states have laws requiring corporations issuing par-value stock to sell the shares at par. If the stock is sold below par, the buyers assume the responsibility for paying to creditors the difference between par value and the purchase price if the business is liquidated. Actually, common stocks are often sold for more than par value; hence the term may have little significance in long-term financing. No-par-value stock is considered to have no stated value when it is issued; however, when it is sold its value becomes the market value. The value of such stock is largely determined by the earning capacity of the company. The corporation is not required to sell it at any particular price.

Book value of stock is its actual value as shown on the corporation books. Assume that a corporation has assets of $85,000 and liabilities amounting to $35,000. Its net worth—the difference between assets and liabilities—is $50,000. If the company authorized 10,000 shares of common stock at no-par value, the book value of each share would be $5.00. If the stock is in great demand, its market value may become $10.00. Should the company fail to show any earnings after a considerable length of time, the market value may drop to less than the book value of $5.00. On the other hand, this stock might have been issued with a par value greater than the book value. There is no necessary relationship between par value and market value.

*Financing by Preferred Stock.* In addition to issuing common stock, some corporations elect to sell preferred stock as a means of raising additional capital. When dividends are distributed, the preferred stockholders receive theirs first. Preferred stock usually pays a fixed dividend rate indicated on the face of the stock certificate. Preferred stock may also be preferred as to assets, which means that in case the corporation is dissolved, the preferred stockholders will receive their portion of the asset values before holders of other classes of securities. Ordinarily, preferred stockholders do not have any voting privileges in the management of the corporation. This is one reason why some corporations find preferred stock a desirable type of security financing, since issuing new preferred stock does not increase the number of persons who have a voice in the management of the business.

Many corporations issue more than one class of preferred stock, one class taking precedence over the next in both dividends and assets.

Usually, these classes are identified as *1st preferred, 2nd preferred,* and so on. Some companies prefer to use the titles *preferred A, preferred B,* and so on. Preferred stocks are also issued as *participating preferred* and *nonparticipating preferred.* Holders of the former receive their stipulated share of dividends ahead of other stockholders and share with the common stockholders in the division of any remaining dividends. Owners of nonparticipating-preferred stock receive only their guaranteed dividend. Any remaining dividends are divided among the other stockholders.

*Financing by Bonds.* As we have seen, a stockholder is a part owner in a corporation, but a bondholder is merely one who has lent money to it. A bond is, in effect, a kind of promissory note. The corporation agrees to repay the bondholder at some time in the future. The corporation also agrees to a fixed rate of interest for the use of his money. It is generally agreed, insofar as the investor is concerned, that bonds are safer than stocks. The most common classes of bonds are:

1. Mortgage bonds
2. Collateral trust bonds
3. Income or debenture bonds

A mortgage is a written instrument that conveys property as security for the payment of a debt. *Mortgage bonds* are secured by a mortgage on property. If the principal cannot be paid when due, the bondholders have a legal right to sell the property and obtain the amounts due them.

If one series of mortgage bonds ranks ahead of others, these bonds are known as *first-mortgage bonds.* Subsequent issues are referred to as *second-mortgage bonds, third-mortgage bonds,* and so forth. It is common for bonds of this type to be issued by public utilities.

In the case of *collateral trust bonds,* additional securities are pledged in the form of stocks and bonds of other corporations or even government bonds. These securities are placed on deposit with a trustee who, under the terms of the agreement, can sell them for the benefit of the collateral trust bondholders if the corporation fails to meet its obligations.

*Income or debenture bonds* are secured only by the prospective earning power of the borrowing corporation. Such issues have a claim on profits before any payments are made to preferred or common stockholders. The debenture bond is easy to market if the corporation has a long record of financial success. Such companies as Consolidated Edison of New York, Standard Oil of New Jersey, and the Coca-Cola

Company have issued debenture bonds at low rates of interest. Buyers have always been willing to buy them because of the sound financial condition of these enterprises.

Since bonds are a corporation debt, they must eventually be repaid. The time factor varies with the issue. Most bonds do not mature in less than 10 years, and some do not mature for 60 years or longer. Railroad bonds frequently have very long durations. Public utility bonds range from 20 to 30 years.

When a bond is fully registered, the name of the owner is shown on the face of the issue and a record of ownership is maintained by the issuing corporation. Interest checks are mailed to the holder whose name is on record when the interest is due. Coupon bonds, on the other hand, do not show the names of the owner, and the corporation keeps no record of who the owners are. When the interest is due, the holder presents a coupon clipped from the bond to the bank authorized by the corporation to make payment.

## Stock Exchanges

As a general rule, stocks and bonds may be sold or exchanged informally under any conditions agreeable to both buyer and seller. Such activities can be carried on more efficiently and more economically, however, by central exchanges. Of the exchanges of this kind that have been established, the New York Stock Exchange is the largest and most influential.

This exchange, which we shall use for purposes of illustration, does not deal directly with buyers and sellers of securities, but rather with its own members, who number approximately 1,800. Only members have the privilege of trading on the floor of the Exchange. In recent years the price of a membership (referred to as a *seat* on the Exchange) has been as high as $97,000. The average member represents approximately 600 brokerage firms. The securities of more than 1,000 different companies, representing almost every branch of American business and industry, are listed on the Stock Exchange.

When a customer wants to buy stock, he places his order with a broker, who handles it on a commission basis and makes the purchase for the customer through a member who buys and sells on the floor of the Stock Exchange and with whom the broker is affiliated. Members make bids and orders orally on the trading floor. The broker sends his customer a confirmation of the contract, and the securities are later delivered. The unit of trading is usually 100 shares.

In addition to the New York Stock Exchange, there are exchanges

in Boston, Chicago, Detroit, Los Angeles, Philadelphia, San Francisco, and other cities. The most recently organized is the Midwest Exchange, which opened for business in December, 1949, in Chicago. This merger of several security exchanges quickly became the third-largest market in the country.

## Financial Planning

Having reviewed the sources of money for short-term loans and the significant types of securities used in long-term financing, we are ready to consider the fundamentals of financial planning. Why do businessmen prefer one type of security to another as a means of raising needed capital? How do they determine whether it is better to borrow from a bank on a short-term loan than to issue additional stocks or sell bonds? What determines the rate of dividends on stock or the interest rate on bonds?

### Fundamentals of financing

Almost all corporate businesses borrow a considerable part of the capital needed to do business. When the loan is desired for a long period, the business may sell bonds. If money is needed for a short time, notes are used. Temporary working capital is usually obtained from banks.

When the future earnings of a corporation are uncertain, it is unwise to issue any other class of securities but common stock. Issuing more common stock does not increase the liabilities of the corporation, but it does provide additional funds that may be needed.

Preferred stock may be issued if the corporation expects its average earnings over a period of several years to be well above the amount needed to pay preferred-stock dividends. Preferred stock is often used to start a new business because it induces investment by giving the holder a claim on the earnings.

Bonds are considered a satisfactory method of raising capital if there is evidence that future earnings will be stable and above the interest requirements. A corporation is said to be fully capitalized only when both bonds and preferred stocks have been issued.

### Factors affecting securities

The rate of interest that must be paid for the use of capital varies according to what the money is used for, the degree of risk, and prevailing business conditions. For instance, during 1928 and 1929 specu-

lators were willing to pay as high as 25 percent for call-money loans because of the high profits they expected from the use of borrowed capital. During the depth of the depression, in 1933, call-money rates dropped to a fraction of one percent because the rate of profit from stock-market transactions involving the use of call money was extremely low.

During periods of low interest rates, many companies think it is wiser to sell bonds than to issue preferred stocks. During the past few years many corporations have refunded bonds with new issues bearing lower interest rates. The successful operation of any plan of financing depends largely on the accuracy with which interest rates are forecast and business conditions anticipated.

Some investors prefer to buy securities that pay well but are subject to a high degree of risk. Others are content to have a smaller return but more security. Hence, a bond paying 3 percent may be preferred to common stock that is expected to earn 5 percent.

Some investors like to speculate by taking long chances in buying stocks where the element of profits is uncertain. Sometimes an investor desires to obtain control over a business and is willing to buy enough stock to dominate the management regardless of the price that must be paid, ignoring both security and income. The control he wants can be obtained only by buying common stock.

When any business is unable to earn a reasonable rate of profit on its capitalization, it is overcapitalized. Being overcapitalized may be the result of changing business conditions that reduce earning power or of overestimating earnings when additional stocks or bonds were sold.

When a large part of a company's capitalization is in bonds and it is no longer able to pay the interest, the usual result is reorganization. Generally, the stockholders lose heavily in any reorganization plan. Claims of bondholders must be satisfied first. If reorganization can be avoided, the company may attempt to induce bondholders to accept a lower rate of interest or to redeem the high-dividend preferred stock outstanding in order to scale down its funded indebtedness. Both of these measures are difficult to accomplish without complete reorganization.

It is important to note the difference between reorganization of a corporation and liquidation of a proprietorship or partnership. In the case of the proprietorship or partnership, no bonds have been issued. Short-term creditors, such as banks and manufacturers, can force im-

mediate liquidation through the sale of all assets. In the case of a corporation, there are so many interests involved that it may be unwise to liquidate immediately. To continue operation and reorganize as rapidly as possible may be the wiser plan.

If a corporation is earning extremely high profits in relation to the amount of outstanding stock, it is considered to be undercapitalized. Such a condition is not regarded as serious.[4]

## Other Financial Institutions

In addition to banks, several other types of financial institutions offer their services to business. These organizations grant short-term and long-term loans to both individuals and business concerns. They are of four principal kinds: (1) building and loan associations, (2) insurance companies, (3) loan companies, and (4) federal government agencies.

### Building and loan associations

These are privately managed associations owned by stockholders who subscribe for various amounts of stock. They are sometimes known as savings and loan associations because they perform two major functions: (1) they assist investors in saving and investing small amounts, and (2) they make loans to individuals for use in buying business property or building homes.

Deposits are accepted from members in much the same way as they are accepted by savings banks. The funds accumulated by the association are lent to those who wish to buy or build property. Some associations are organized under federal laws; others operate under state laws. Those operating under federal supervision are required to insure their deposits with the Federal Savings and Loan Insurance Corporation. Those operating under state supervision may also obtain this insurance.

If a businessman decides to increase the size of his store or to construct new facilities, he may find it advisable to consult with a building and loan association in his community. If a loan is made, the borrower is permitted to pay back the principal and interest on a monthly payment plan, which may be arranged for as long as 100 months. The building and loan association takes a first mortgage on the property as security and, in addition, the association may require the borrower to purchase stock in the association. It is possible to deposit funds in a

[4] See Bonneville, Joseph Howard, and Dewey, Lloyd Ellis, *Organizing and Financing Business*, 3rd ed., pp. 165-166. New York: Prentice-Hall, Inc., 1945, for a more complete discussion of undercapitalization.

building and loan association without becoming a borrower. The extensive use of these associations is indicated by the fact that there are about eight million depositors in the United States who have borrowed from them or are investing in them.

### Insurance companies

Each year life-insurance companies accumulate funds that are not paid out in claims and operating expenses. These funds constitute assets and are invested to earn what they can for the policyholders until they are paid as benefits. These earnings help meet the cost of the holders' policies. Most of these funds are invested in loans to business and industry, government bonds (United States and foreign), state and local bonds, real-estate mortgages, and commercial stocks. Thus, life-insurance companies either lend money to business, industry, and governments, taking bonds as security, or invest in business by the purchase of common and preferred stock. By the end of 1948, 30 percent of the assets of all United States life-insurance companies were invested in United States government securities, 36 percent in securities of business and industry, 19 percent in real-estate mortgages, and approximately 13 percent in miscellaneous investments including real estate, policy loans, and foreign government bonds.[5]

### Loan companies

There are several types of companies that provide individuals and business concerns with capital on short-term and long-term loans. One type operates locally or within a state area and confines its loans to individuals. Such organizations are generally known as personal finance companies, because they specialize in personal loans ranging from $50 to $500. These loans are repaid weekly or monthly. A promissory note is required.

A second type of loan company makes loans to finance business transactions. In the automobile field, for example, the Commercial Credit Company is organized to make loans to Chrysler dealers and to individuals who purchase automobiles from these dealers. The General Motors Acceptance Corporation serves General Motors dealers; the Universal Credit Company makes loans to Ford dealers and buyers. Loans made by these companies are secured by some type of chattel mortgage.

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[5] Institute of Life Insurance, *Life Insurance Fact Book*, pp. 52-70. New York: Institute of Life Insurance, Division of Statistics and Research, 1948.

Privately owned industrial banks are another type of loan company. Both business firms and individuals may borrow small amounts of money without the use of a mortgage as security. A promissory note is generally required and, if the amount is large, cosigners of the note are necessary. The best-known companies of this type are the Morris Plan banks located in many metropolitan areas.

### Federal government agencies

During the past 20 years numerous federal agencies have been created to provide loans to business organizations and individuals. One of the oldest of these is the Reconstruction Finance Corporation, started in 1932 at a time when the United States was in the depth of a financial depression.

The purpose of this agency is to make loans to all types of business enterprises, banks, industrial corporations, railroads, and building and loan associations, for the purpose of preventing financial collapse, buying equipment, or assisting the company to pay off its indebtedness. The R.F.C. is authorized to purchase debenture bonds, notes, or other acceptable securities for a loan. Many large railroad companies have borrowed funds from the R.F.C. Its record of losses over the years has been exceptionally good. The majority of its business loans are long-term obligations. Many have been made to other government agencies.

The Export-Import Bank is another important government credit agency designed to make loans to business. This bank has two functions: (1) to make loans to individuals and companies in the United States who are engaged in exporting and importing merchandise and who cannot obtain adequate financial help from private sources, and (2) to make loans to foreign governments for the purpose of developing their national economy. Loans made by the Export-Import Bank are for short durations. Its funds were originally obtained from the R.F.C.

Federal agencies have been active in helping to finance agricultural ventures. The Farm Credit Administration, which is one of the principal banking institutions in the United States, is a co-ordinating agency for several separate banking associations. For its purposes, the United States is divided into 12 districts. In each district there is a farm credit board, a federal land bank, a federal intermediate credit bank, a production credit corporation, and a bank for co-operatives. The purpose of these banks is to make 3- to 5-year loans to farmers for the purchase

of machinery or to provide emergency funds to tide the farmer over until his crops are sold. The farmers are encouraged to participate in the management of the banks and to invest private capital, particularly in the bank for co-operatives. Since 1946, the F.C.A. program, including the various co-operatives and banks, has made use of more than one billion dollars annually in credit.

## Careers in Banking and Finance

Almost all banks report a shortage of young men and women interested in banking careers. This is probably due to the fact that other business occupations are known to pay higher initial salaries. Furthermore, a sizable part of banking operations are routine in that they involve the daily operations of handling checks, sorting cash, operating machines, verifying figures, preparing statements, and analyzing records. Some persons do not like routine work even though it may eventually lead to a more responsible position.

In some banks the position of chairman of the board of directors is the most important one. Usually someone who has served as president is elevated to this position. The regular elected officers are: president, vice-president, secretary, and cashier. Large banks may have several vice-presidents, each assigned to direct the functions of certain operating departments. Some banks have more than one cashier and several assistant cashiers.

In addition, there are tellers, personnel managers, auditors, tax specialists, and heads of various departments, such as credit, loans, mortgages, accounting, foreign trade, and real estate. Small banks do not have so many specialized departments as large ones, although they may perform many of the specialized functions on a more limited scale. Those who fill these managerial positions generally begin as clerks.

The largest group of employees in banks is made up of those who record information and prepare records and reports from day to day. These are the clerks, machine operators, assistants, secretaries, and messengers.

### Qualifications for banking positions

It is still a common practice to begin as a clerk or bookkeeper. Preparation in such business-administration courses as accounting, business law, business correspondence, commercial credit, economics, finance, investments, money and banking, mathematics, real estate, and statistics is desirable.

All positions in banks are concerned with financial information about persons and business organizations. It is important that bank employees consider this information confidential. Personal qualifications considered essential to a career in banking are honesty, initiative, politeness, ability to meet people easily, and good personal appearance. A person must be willing to work on the job until the day's work is done, since almost all of a day's operations must be completed and summarized before employees go home at night.

Under the sponsorship of the American Institute of Banking, a series of special courses designed to qualify bank employees for advancement is offered in many cities. For example, there is a course in trust functions, taught by trust officers of a bank in evening lectures.

In large banks, the positions most difficult to fill are those of credit manager, real-estate appraiser, personnel manager, investment specialist, and foreign-trade analyst. All these require experience as well as education.

### Investment banker

Investment banking is a type of banking service that has developed because federal and state laws compel the separation of commercial and investment banking functions. The investment banker is a banking specialist who advises corporations concerning the marketing of securities. He gives information about the proper timing of sale, about the type of securities that can be distributed at a minimum cost, and about other facts of a legal and technical nature. When a corporation has decided to sell securities through the investment bank, the banker assumes the responsibility for marketing the securities. Financing a corporation normally requires months of advance planning by the investment banker.

Investment-banking institutions are of two types, wholesale and retail. The wholesale investment banker sells new stock and bond issues to smaller banking firms, bond houses, and brokers, who accomplish direct distribution to the public. Retail bankers sell directly to the public, which may include commercial banks and other institutions.

The investment banker must be a thoroughly experienced business executive with a background in finance and banking. Besides this, considerable personal wealth is required to support the business. The nature of his work is such that he must be qualified to analyze business trends and interpret economic conditions in order to advise clients of the proper time to offer new securities.

## Terms for Study

| | | |
|---|---|---|
| Bill of exchange | Default in payment | Odd lots |
| Cashier's check | Draft | Par |
| Certified check | Fixed capital | Promissory note |
| Chattel mortgage | Investment bank | Sight draft |
| Collateral | Letter of credit | Time draft |
| Commercial bank | Market order | Trade acceptance |
| Correspondent bank | Mortgage | Underwriting |
| Debenture bond | No-par | Voucher check |

## Questions

1. What is the difference between fixed and working capital?
2. What are some of the reasons why a businessman should establish a bank account?
3. What are the differences among a commercial bank, a savings bank, and an investment bank?
4. What is required to make an instrument negotiable?
5. Why should a business demand a certified check?
6. Explain why a cashier's check is preferred to a personal check that has not been certified.
7. For what reasons might a depositor issue a stop-payment order?
8. What is a promissory note?
9. Why is a promissory note considered a short-term business obligation?
10. What are two common forms of bills of exchange?
11. Why is taking a promissory note preferred to selling on open account?
12. What is the difference between a time draft and a sight draft?
13. What is meant by the term *chattel mortgage?*
14. What are some of the services rendered by savings banks?
15. What are the types of long-term securities used by business?
16. What is the difference between par and no-par stock?
17. How does preferred stock differ from bonds?
18. How can a businessman obtain a loan from a building and loan association?
19. What is the difference between an industrial bank and a commercial bank?

## Problems and Projects

1. List the different kinds of business services offered by the leading commercial bank in your community.
2. An acquaintance desires to borrow $100 for three months. Give at least three types of commercial institutions that lend money to individuals. For each type, state the advantages and disadvantages to the borrower.

3. Visit a local building and loan association and obtain complete information about how loans are made on a new store building. Explain to the class how one might finance a $10,000 store building with the help of the building and loan association if he had $3,000 cash and owned a lot.

4. The Fairfax Trading Company in your city has sold a shipment of metal desks to a merchant in Peru, South America, with whom the local company has had no prior business dealings. There is little information available about the credit rating of the firm in Peru. What are the ways the Fairfax Company can be assured of payment before shipping the goods?

5. A friend is employed with a local company. He is a junior executive with a good personal credit rating. He needs $100 for not more than three months and has an automobile to give as security. What are the various sources open to him to make a loan? Investigate in your community to see which would be the least expensive.

6. The management of a small corporation employing about 100 persons is in need of additional working capital. The company officials estimate $10,000 will be required for at least one year. One official has proposed to borrow the money from a local bank, giving as security the physical plant and equipment. The rate of interest on this type of loan would be 5 percent per annum. Another executive wants to issue additional stock, which can be sold locally by a broker for approximately $10 a share. Another proposal involves issuing $100 bonds. The interest rate on the bonds would probably not exceed 4 percent, although it is difficult to sell bonds that run less than 10 years. Which of these plans allows the company the greatest amount of management freedom? Which one would be likely to cost the most?

7. From the standpoint of the corporation, is it better to sell 100 persons $100 bonds or 10 persons $1,000 bonds?

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CHAPTER XIII

# BUSINESS RISKS AND INSURANCE

BUSINESS RISKS are always associated with the production and distribution of goods or services. Some of these risks may be eliminated by good business management, but against many risks insurance is the only satisfactory form of protection. This chapter will discuss the forms of insurance that may be used to shift the burden of risk in business.

## Business risks

*Risks Involving Property.* Almost every business requires the use of property in some form. For instance, buildings are necessary to house the equipment needed to produce goods. Both buildings and equipment are subject to various kinds of hazards. One of the most common of all risks is loss from fire. Insurance to provide protection against such loss is now almost universal, despite the fact that recovery is limited to actual damage to the insured property and does not include secondary losses. Compensation for the slight damage done by a fire to business property might represent only a fraction of the secondary losses resulting from disruption of business activity for which no fire insurance is available.

Other risks to which property is subject are floods, frost, drought, high winds, insects, and so forth. As in the case of fire, insurance may be obtained to shift the loss from the owner to the insurance company. Property is also subject to theft, either by dishonest employees or by outside persons. Careful businessmen endeavor to prevent opportunity for theft, but even the most elaborate system of protection is unable to eliminate this risk. The most satisfactory solution is to share the burden of risk by buying theft insurance.

*Risks Involving Liability to Employees.* Employees may be injured or killed while performing their duties. If the injury or death results from the employer's negligence, the injured person or his estate is entitled to compensation. Insurance of this type is known as workmen's compensation.

*Risks Involving Liability to the Public.* Every business owner may become liable for damages to persons other than himself or his em-

ployees. A third person may be injured by an automobile driven by an employee. Manufacturers of goods must assume liability for losses or damages caused by defects in their merchandise. Restaurants, transportation companies, drugstores, and canning factories are among the many businesses that must assume public liability for the products they produce, process, or handle.

*Risks Involving Credit Losses.* Any business that sells goods or services on credit has losses from bad debts. A few insurance companies issue policies to manufacturers, wholesalers, jobbers, and occasionally to retailers to cover such losses. As a rule, such a policy does not provide full protection; the dealer is required to stand a part of the loss. Credit insurance is generally written for a period of 12 months and is renewable.

*Risks Arising from Death.* By purchasing an insurance policy on the life of its owner or chief executive, a business can indemnify itself against that person's death. The purpose of such a policy is to cover the cost of business expenses that may result from this occurrence.

### Ways to lessen risks

There are four ways by which losses from risks can be reduced or eliminated: (1) by removing the risk or its cause, (2) by establishing a reserve fund in anticipation of loss, (3) by purchasing insurance, and (4) by hedging.

Management may lessen the chances of loss or degree of risk by installing safety equipment on machinery or by replacing devices that constant use has made defective and dangerous. Fireproof structures help to eliminate losses from fire and the subsequent damage by water that frequently occurs. Safety campaigns among workers help to lessen the number of accidents by curtailing carelessness.

The second method is to anticipate losses and set aside funds for self-insurance. This is really noninsurance, because under such a plan a definite reserve fund is built up to cover possible losses. For example, an organization that has plants scattered over a wide area might decide to establish a fund by taking something annually from the income of each plant. Thus, if losses occur, they are met, insofar as possible, by money from the fund. If no losses are sustained during the year, the entire fund is carried over to the following year and more is added to the reserve. This type of plan can be used most successfully by large organizations owning several factories, warehouses, or retail outlets located in widely separated areas.

Self-insurance, which is sometimes used for workmen's compensa-

tion coverage, is based on the theory that a business can profitably assume its own risks by setting up a reserve against the hazards involved, without using an insurance-company plan. During recent years, increased taxes have caused many businesses to change from a self-insurance plan to regular insurance partly because premiums on the latter are deductible as a business expense, whereas funds allocated to a self-insurance reserve are not deductible except to the extent of any losses actually paid out when awarded by state authority, as in claims for workmen's compensation. Then, too, businesses are reluctant to tie up large sums of cash in a reserve fund that cannot be used directly in the business.

Regular insurance, the third method of reducing losses, is the method used most commonly by business. It will be discussed in greater detail later in this chapter.

The fourth method, hedging, involves neither the purchase of an insurance plan nor the creation of a self-insurance reserve. Rather, hedging is the name applied to transactions made upon a commodities exchange market for the sale or purchase of *futures* to balance or offset transactions in *spot,* or actual, goods. For commodities such as cotton, cocoa, corn, cottonseed oil, butter, hides, eggs, sugar, oats, wheat and wool, there are two kinds of markets. One is the spot, or actual, cash market, where the buyer obtains the commodity for immediate delivery. The other is the futures market, where one makes a contract to buy or sell the commodity at some future date.

Hence, *buying futures* means making a contract to pay in full a set price for a specified number of units of a commodity that is to be delivered to the buyer at some future time. *Selling futures* means making a contract to deliver a given number of units at a set price and at a specified date. In hedging both kinds of transactions are used.

Hedging is analogous to what happens when a man wagers that team *H* will win over *Y*, and then makes an equal wager that *Y* will defeat *H*. Regardless of the outcome, he breaks even.

Hedging is used by processors and manufacturers of such foods as wheat, rice, and coffee, and by manufacturers of other commodities, including cotton, cottonseed oil, hides, oats, and wool. The theory is that all purchases or sales of a given commodity are offset by sales or purchases of an equivalent quantity of future contracts for the same commodity. Consider the following as an example of hedging.

In February the Long View flour milling company makes a contract to deliver in May to a baking firm in a distant city so many bags of flour made from 5,000 bushels of wheat. The contract price is based

on what the price of wheat will be in May, the delivery date, and not on the spot price of wheat in February. Now, the price of wheat fluctuates and the miller knows that the financial risk is too great to make a sales contract for the delivery of flour that far in advance without hedging. If the miller fails to buy 5,000 bushels of wheat at the time he signs the contract to deliver the flour, the price may rise and he must take a loss. Perhaps the milling company cannot afford to tie up cash in a large wheat inventory or it may not have adequate storage facilities. Hence, the miller hedges by making in February a futures contract, agreeing to buy 5,000 bushels of wheat in May. This contract is made through a wheat broker operating on one of the grain exchanges.

In May the miller buys his wheat and immediately sells on the exchange his futures contract for May wheat. If prices have increased between February and May, he loses on his flour contract but he gains an equal amount by selling his May futures contract. Conversely, if prices have dropped, his gain on the flour contract is offset by a loss on the futures contract. In either case, by hedging there is neither loss nor gain due to changes in the price of wheat.

Many cotton mills maintain perpetual hedges against their inventories even when markets are normal. As they purchase raw cotton for spinning they simultaneously sell futures, buying back the futures as they sell the finished cloth. As a result, they are always short of futures by an amount equal to their inventory. When a future expires before the finished goods are sold, the manufacturer simply replaces it by another future for more distant delivery.

### Types of insurance companies

Four types of insurance companies write risk insurance: (1) stock companies, (2) mutual companies, (3) Lloyd's, and (4) reciprocal associations.

*Stock Companies.* The stock company is a corporation owned and controlled by the stockholders, who are not necessarily policyholders. The capital subscribed by the stockholders constitutes the company's working capital, and its income is from premiums paid by those who buy insurance policies. A premium is the amount paid by the insured for the type of protection purchased.

The profits made by stock companies go to the stockholders, and these stockholders must sustain any losses in excess of the total premiums collected. If losses are less than premiums, a reserve fund is accumulated for future contingencies. Although policyholders have a

legal interest in reserve funds, they have no claim to the accumulated surplus funds. Requirements for reserves are usually set by state law. In some stock companies the policyholders also share in the earnings after the stockholders are paid dividends.

*Mutual Companies.* In a mutual insurance company the policyholders are the owners. Management of the company is exercised by policyholders. According to state laws, these policyholders are entitled to participate in the company's affairs by exercising voting privileges. A reserve may be set up by subscriptions from policyholders and an assessment may be made on all policyholders at the time losses occur if the reserve is insufficient to meet claims.

If profits are made, each policyholder receives his share in the form of dividends in proportion to the amount of his policy. If, however, the company operates at a loss, each policyholder is assessed a proportionate amount. In most life insurance companies, this practice is seldom followed. As a rule, the maximum assessment at one time cannot exceed the cost of the original premium. Many of the larger mutual companies have accumulated large reserves, making it unnecessary to assess the policyholders when losses are sustained.

*Lloyd's.* Lloyd's of London is one of the oldest insurance associations. This corporation, like the New York Stock Exchange, is composed of members. All insurance contracts are written by individual member underwriters. If any single risk is too great for an association member to carry alone, the contract is shared with one or more additional members on a voluntary basis.

Lloyd's has approximately 1,400 members, many of whom have formed syndicates in order to handle the various types of risks. The corporation transacts business in all parts of the world and handles extremely varied risks. Lloyd's of America is organized like Lloyd's of London, but has no connection with it. The American association handles a relatively small volume of business.

*Reciprocal Associations.* In some respects the reciprocal association is similar to the mutual company. However, instead of being managed by a board of directors elected by the policyholders, the reciprocal company is directed by one person who acts under a power of attorney. Each insurance contract is covered by all the members of the reciprocal in proportion to the amount of premium subscribed by each member. One of the advantages of the reciprocal association is its low operating cost, since the association has no paid officers except the manager. Reciprocal associations handle chiefly fire, automobile, and casualty insurance.

## Insurance policies

An insurance policy is a written contract setting forth the terms under which the company agrees to furnish protection to the insured. The parties to a policy are the company and the insured. Policies are sold by both company agents and insurance brokers. As a general rule, a broker represents several insurance companies, whereas an agent may sell exclusively for one company. The agent may be authorized to act for a company, but a broker serves merely to bring the prospective policyholder and the company representative together.

Before a contract is made, an application form is completed by the agent or broker. The application shows the name or names of the insured, the amount of protection desired, the premium rate, the date on which the protection becomes effective, the duration of the contract, and specific events or conditions that will terminate the contract. Some contracts also specify the procedure for filing claims for losses. Some mutual companies write nonassessable policies, which make it impossible for the policyholder to be assessed for additional payments if the company sustains extraordinary losses.

An important part of every insurance policy is a clause stating under what conditions the contract may be canceled. The insured has the right to cancel the policy before the expiration date simply by notifying the company. Since premiums are paid in advance, a short-rate cancellation table is used to compute the refund due the policyholder. If the insured cancels the policy before the expiration date, an increased charge is made because of the fixed expenses incurred by the company regardless of how long a policy is in force. As an example, for a one-year policy canceled by the insured at the end of 30 days, the company has the legal right to charge as much as 19 percent of the entire premium. Some policies contain a provision that prohibits the company from canceling the contract. However, fraud or misrepresentation of facts may void any insurance policy.

*Insurable Interest.* It is a fundamental principle of insurance that the insured must have an insurable interest in the person or property insured. An insurable interest in property is defined as an interest by reason of which there will be a financial loss if the property is lost, destroyed, or damaged. For example, if you sell an automobile to someone else and you are being paid in installments, you have an insurable interest in the automobile in proportion to the amount of the unpaid balance. The purchaser has an insurable interest in proportion to the amount he has paid. In no case can both parties who have an insurable

interest in the same property collect the full amount of insurance in case of loss.

Sometimes the question of whether the policyholder has an insurable interest does not arise until the loss has been sustained and recovery of damages is attempted. There can be no payment, no matter what the terms of the policy are, unless there exists a legally recognized insurable interest. This is usually determined at the time the policy application is submitted.

In the case of life insurance, only a person who is very closely related to another is held to have an insurable interest in his life. For a business to carry a life insurance policy for its benefit on the life of one of its executives, employees, or partners, an insurable interest must exist. To prove this interest, the unique value of the insured person to the firm must be evident. Usually, his consent to such a contract is obtained before it is issued, regardless of who pays the premiums.

Since a partnership legally terminates with the death of any partner, many insurance policies are issued on all members of a partnership to guarantee fulfillment of credit obligations, production contracts, or settlement of the deceased partner's estate, no matter when the death may occur or to which partner. If the cost of the premiums is borne by the business, it is possible to organize a new partnership quickly after the death of a partner. The insurance death benefit is used in the settlement of the deceased partner's estate, which includes paying his share of the partnership liabilities.

## Kinds of Business Risk Insurance

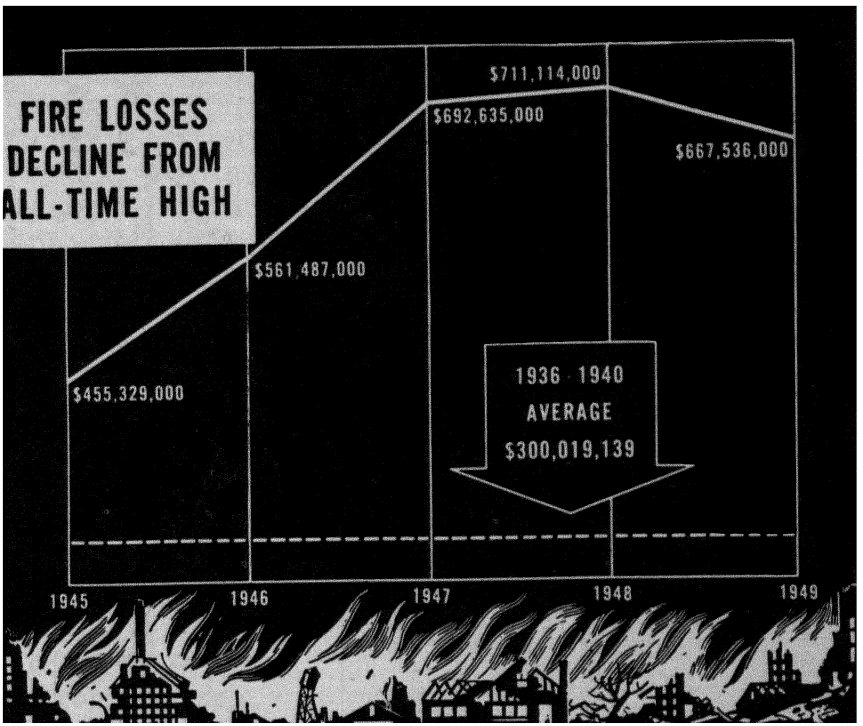
In general, there are five classes of coverage: (1) fire insurance and allied lines; (2) life, health, and accident insurance; (3) casualty insurance; (4) fidelity and surety bonds; and (5) marine insurance.

### Fire insurance and allied lines

The purpose of fire insurance is to indemnify the insured against loss or damage to property from fire. Fire insurance accounts for the largest amount of property insurance in force. Dwellings, factories, store buildings, equipment, and personal property may be insured against fire. Types of insurance that cover damages due to windstorm, tornado, earthquake, water, hail, rain, riot, civil commotion, and explosion are known as *allied lines.*

*Standard Fire Policy.* The standard fire policy covers losses due to direct damage to property caused by fire, lightning, and removal from premises. It also covers damages caused by smoke from a hostile

fire, by water used to extinguish a fire, and by fire resulting from an explosion.[1] If the insured desires protection against such hazards as windstorm, riot, smudge, water, aircraft, and the like, he may obtain it by purchasing insurance under the extended coverage division in a standard fire policy. Figure 13-2 shows the contents of a fire insurance policy.




*Courtesy National Board of Fire Underwriters*

*Figure 13-1. Property Losses from Fire in the United States, 1945-1949.* (SOURCE: *Fire Insurance Facts & Trends,* February, 1950, Vol. VI, No. 1, p. 1.)

The provisions of the standard fire policy are as follows: (1) description of the property; (2) risks that company agrees to assume; (3) conditions under which losses must occur; (4) method of determining extent of losses; and (5) action to be taken by insured in the event of loss.

Fire policies are issued for one, three, or five years. A businessman may reduce the cost of the premium by purchasing coverage for more

[1] Based on the definition of a standard fire policy used by Employers Mutual Fire Insurance Company, Wausau, Wisconsin.

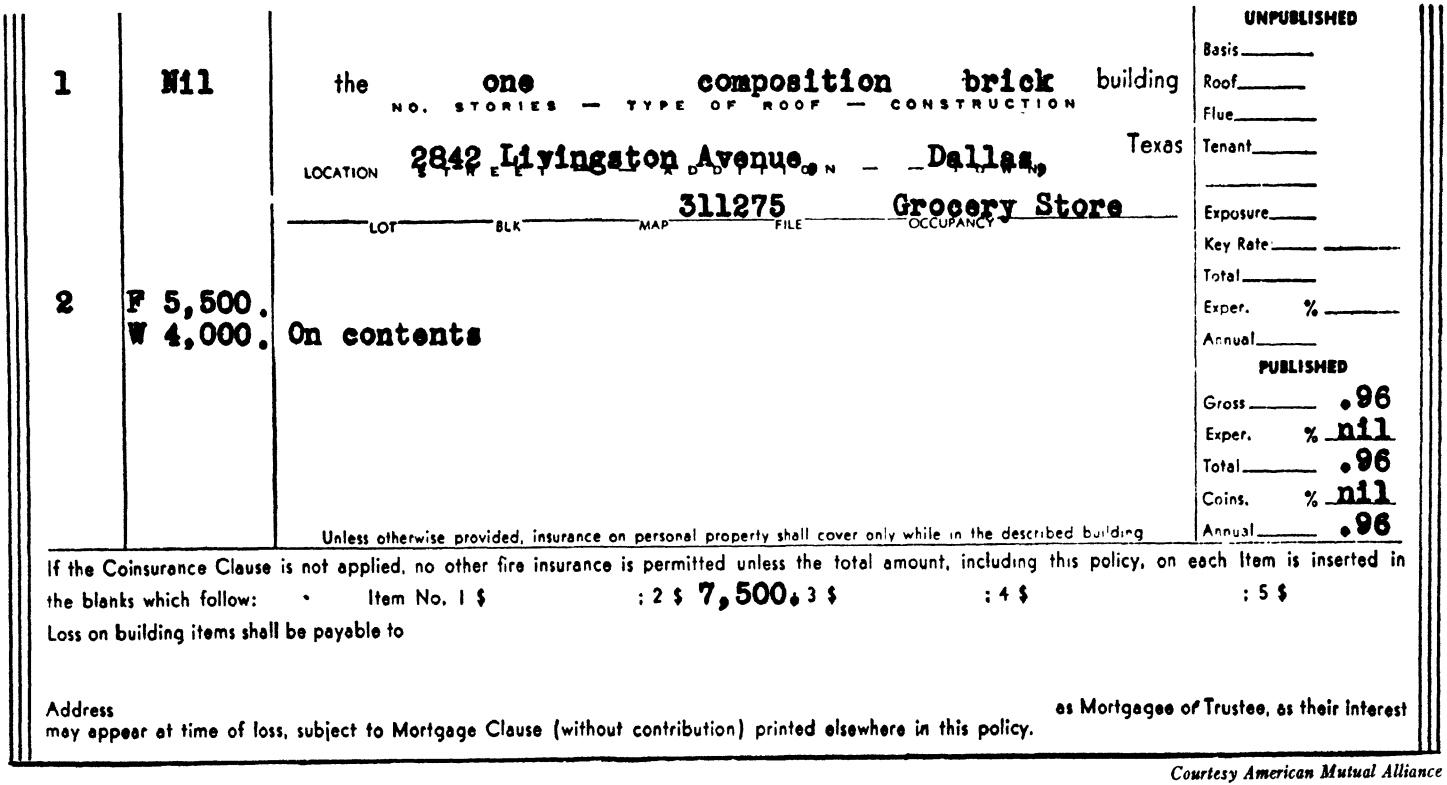
In Consideration of the stipulations and conditions herein or added hereto which are made a part of this policy, and of the premiums provided

DOES INSURE **John Black and wife, Gladys**

and legal representatives. FROM **July 16, 1949** TO **July 16, 1950** AT NOON STANDARD TIME AT THE LOCATION OF PROPERTY against direct loss resulting from any of the *Perils* (listed below) WHICH HAVE A PREMIUM INSERTED OPPOSITE THERETO (Column 6) and only on the property described and located as provided hereon.

| 1 COVERAGE | 2 *Perils* | 3 COINSURANCE APPLICABLE | 4 TOTAL INSURANCE | 5 TERM RATE | 6 PREMIUM |
|---|---|---|---|---|---|
| F | FIRE and Lightning | N11 | $5,500. | .96 | Normal $ 52.80<br>F R. % nil<br>Actual 52.80 |
| E | EXTENDED COVERAGE—Windstorm, Hurricane, Hail, Explosion, Riot, Civil Commotion, Smoke, Aircraft, and Land Vehicles. | | | | |
| X | EXPLOSION | | $ | | |
| W | WINDSTORM, HURRICANE, HAIL | 50% | $4,000. | .20 | 8.00 |
| R | RENTS or Rental Value (Not to exceed $ a Month). | | $ | | |
| | | | | TOTAL PREMIUM $ | 60.80 |

| ITEM No. | AMOUNT OF INSURANCE | DESCRIPTION OF PROPERTY<br>See definitions of Building, Household Goods Stock, Furniture, Fixtures, and, or Machinery, and Contents. | RATE ANALYSIS |
|---|---|---|---|



| | | | |
|---|---|---|---|
| 1 | Nil | the one NO. STORIES — composition TYPE OF ROOF — brick CONSTRUCTION building | UNPUBLISHED Basis Roof Flue Tenant |
| | | LOCATION 2842 Livingston Avenue, (STREET ADDITION) — Dallas, Texas | |
| | | LOT BLK MAP 311275 FILE Grocery Store OCCUPANCY | Exposure Key Rate Total Exper. % Annual |
| 2 | F 5,500.<br>W 4,000. | On contents | PUBLISHED Gross .96 Exper. % nil Total .96 Coins. % nil Annual .96 |

Unless otherwise provided, insurance on personal property shall cover only while in the described building

If the Coinsurance Clause is not applied, no other fire insurance is permitted unless the total amount, including this policy, on each item is inserted in the blanks which follow: Item No. 1 $ ; 2 $ 7,500. 3 $ ; 4 $ ; 5 $

Loss on building items shall be payable to

Address as Mortgagee or Trustee, as their interest may appear at time of loss, subject to Mortgage Clause (without contribution) printed elsewhere in this policy.

*Courtesy American Mutual Alliance*

*Figure 13-2. Example of an Insurance Policy.* This policy provides coverage against fire and lightning, and against windstorm, hurricane, and hail. Note that the two kinds of perils are insured for different amounts.

than one year; however, premiums must be paid in advance for the life of the contract.

Premium rates vary according to the type of building construction, its location in the community, and the record of fire losses for that area. In many states premium rates are set by a state commission.

*Coinsurance Clause.* Many companies require the property owner to stand part of the fire risk. The owner can recover no more than the face value of the policy, and this value is seldom in excess of a certain percentage of the current market value of the property. A clause dividing the loss between the company and the insured is known as a *coinsurance clause.* A common percentage is 80 percent. The following illustrations indicate the manner in which losses are settled under an 80 percent coinsurance clause:

1. Where insurance exceeding 80 percent of property value is carried:

| | |
|---|---|
| Value of property | $10,000 |
| Insurance required | 8,000 |
| Insurance carried | 9,000 |

All losses up to $9,000 are paid in full by the company.

2. Where insurance equal to 80 percent of value is carried:

| | |
|---|---|
| Value of property | $10,000 |
| Insurance required | 8,000 |
| Insurance carried | 8,000 |

All losses up to $8,000 are paid in full by the company.

3. Where insurance of less than 80 percent of value is carried:

| | |
|---|---|
| Value of property | $10,000 |
| Insurance required | 8,000 |
| Insurance carried | 5,000 |

In the event of a total loss ($10,000), the face value of the policy ($5,000) is paid by the company. If a partial loss occurs, the insurance company pays that proportion of the loss that the insurance carried ($5,000) bears to the insurance required ($8,000), or ⅝ of the loss, provided this amount does not exceed the face value of the policy.

The coinsurance clause is an agreement by the insured that insurance on his property will be carried up to a stated percentage of its value. In return for this agreement the company grants the insured a reduced rate. If the insured complies with this agreement by carrying the proper amount of insurance, the coinsurance clause has no effect on

any loss settlement. But if the agreement is not complied with and less insurance is carried than was agreed to be, the company will pay only that proportion of the loss which the amount of insurance actually carried bears to the amount of insurance agreed to be carried. The insured cannot suffer from a coinsurance clause except by his failure to comply with its terms. Actually, the coinsurance clause distributes fire and other property losses equitably among the policyholders to the extent that they have paid premiums. Those desiring to underinsure are prevented from shifting a part of the risk to those who carry adequate protection. The policy illustrated in Figure 13-2 makes a 50 percent coinsurance clause applicable to part of the coverage.

*Consequential Loss.* There are times when losses resulting from the destruction caused by direct fire may be far-reaching and even more costly than the first physical loss due to fire. Consider what would happen to the business of a frozen-food locker plant if its cooling apparatus were destroyed by a fire. Ordinarily, the standard fire policy does not provide coverage on food that might be damaged in a locker under such conditions, but a consequential-loss clause specifically assuming the risk may be added to a policy for an additional premium. When the consequential-loss-and-damage-assumption clause is included, the 80 percent or higher reduced-rate-contribution clause is generally required.

When parts of a product are made at several plants and assembled later, a fire in one plant may hold up continued operations in several others. The usual terms of a standard fire policy do not provide for this kind of loss. Profits lost because of the interruption in production may constitute a consequential loss greater than the actual physical damage caused by fire.

Fire, we have seen, is not the only risk to property. One type of allied coverage protects the property owner against losses due directly to windstorm, cyclone, or tornado. If fire is caused by a windstorm against which protection is not provided under the standard fire policy, loss from this cause is provided in a windstorm policy. As a general rule, the windstorm policy covers losses caused by hail, since the two hazards are contemplated in the same premium cost.

In certain sections of the country business firms buy earthquake insurance. For such purposes, the United States is divided into four zones and the Pacific Coast. Premiums depend upon the zone in which the property is located and the type of building construction.

Flood insurance is written to cover damage resulting from the overflow of a river or a tidal wave. Straight flood insurance is not to be

confused with water damage insurance, which is written against such hazards as leaking water pipes, overflowing water tanks, defective plumbing, and defective water spouts or leaking roofs.

### Life insurance

Life insurance is generally considered more for personal use than for business purposes. Yet a business needs protection for its employees. In this sense, life insurance is important in this discussion. For example, a business may insure its chief executive or one or more of the owners so that, in the event of death, the proceeds will help to pay off the debts of the firm or defray the cost of reorganizing the business. Furthermore, a businessman can use his policy as security for a loan to finance the cost of making business improvements.

Generally speaking, there are four types of life insurance contracts: (1) term insurance, (2) ordinary or whole life insurance, (3) limited payment insurance, and (4) endowment insurance.

Term insurance offers protection on a contract basis for a definite period of years at a minimum annual premium. The policy is payable only if the insured dies within the period stated in the policy. Term policies may be renewed at a higher premium at the end of the contract period without physical examination. As compared with other forms of life insurance, term policies provide only a very limited reserve value.

Ordinary or whole life insurance requires that premiums be paid during the whole life of the insured. The policy has a cash surrender or loan value. It may be converted to other types of insurance.

Limited payment insurance has the unique feature of being paid up after a specified number of years. These policies carry a cash surrender value too. Endowment insurance requires the payment of a definite sum of money to the policyholder after a specified number of years if the holder is then living. Should the policyholder die during the endowment period, the face value is paid to the beneficiary. Endowment and limited payment policies may be written for periods of 15, 20, 25, or 30 years.

*Accident and Health Insurance.* During the past few years, an increasing number of mercantile and industrial organizations have insured their employees against loss of life and loss of salary caused by accidents. This insurance is usually written under a group insurance plan that requires no medical examination for members of the group. Many firms carry on their employees group health insurance, which provides protection against loss of salary caused by ill health. It may

also include hospital, medical, and surgical expenses. Employees may pay a part of the group premium or all of it, or the employer may assume the full cost. Premium rates for group insurance are lower than for accident and health policies purchased individually because of the lower cost of servicing a large number of persons under one contract.

### Casualty insurance

The term *casualty insurance* covers a broad area of risk-sharing. Insurance companies that write casualty policies usually confine themselves to the following kinds of insurance coverages: (1) automobile insurance; (2) burglary, robbery, larceny, and theft insurance; (3) workmen's compensation insurance; and (4) public liability insurance.

Although the fire insurance companies do not write casualty insurance and the casualty insurance companies do not write fire protection, these companies generally have working agreements that enable them to issue joint-coverage policies. The fire underwriter may own a casualty company or co-operate with one. Casualty insurance may provide protection against risk of loss and against liability for loss to the property or bodies of others.

*Automobile Insurance.* Insurance on automobiles may be purchased to cover five types of casualty losses: (1) fire, (2) theft, (3) collision, (4) bodily injury liability and (5) property damage.

1. Fire insurance companies write protection on automobiles for direct loss or damage caused by fire, lightning, and perils of transportation. Unless specifically covered, automobile fire insurance does not include loss or damage to the contents of the automobile, such as personal effects or robes. Automobile fire rates are based on the age of the car, its use (for business or pleasure), and the rate of fire losses in that community or state for a previous period. A fire insurance policy issued in one state is effective also in other states.

2. Automobile theft insurance is coverage to supplement fire insurance. The owner is protected from loss by theft, robbery, or pilferage. Indemnity is based on the current value of the automobile and not on its original cost.

3. Automobile collision insurance is written in two forms: (1) full coverage and (2) deductible. Under full coverage, the insurance company pays the owner the full amount of any loss or damage to his automobile caused by collision with another vehicle or an object, or by upset. The amount paid against a claim is subject to reasonable depreciation. Under the deductible plan, no liability rests upon the

insurance company until the loss from collision or upset exceeds a specified amount. The insurer pays the owner for any damage in excess of this amount. Thus, if a policy is written with a $50 deductible clause and damage due to collision or upset is $75, the owner would be reimbursed by the company for $25. Deductible policies are written in varying amounts ranging from $25 to as much as $500. Some companies write a 20 percent deductible policy, which requires the owner to stand the first 20 percent of the total damage. The company is liable for the remainder.

4. Bodily injury liability insurance provides protection to the insured against claims that result from injury or death to persons for which the owner of a vehicle may be held legally liable. Thus, if a driver collides with another automobile, or hits a pedestrian, or causes injury to the occupant of another car, the insurance company may be obligated to pay the losses up to a certain amount, according to the face value of the policy. Bodily injury liability policies are generally written with a stated limit applicable to injury or death of one individual and with a higher limit applicable to two or more persons injured in the same accident, subject to the same limit on one individual. Thus, a policy written for limits of $5,000/10,000 would cover injury to one person up to $5,000; if two or more were injured in the same accident, $10,000 could be paid in all, but not more than $5,000 to any one person.

This type of liability insurance is a typical example of how the burden of risk may be shifted by an individual to an insurance company. Many states now require all automobile owners to carry bodily injury liability insurance to protect the public. Rates are established according to the four classes of automobile ownership and use: private passenger, commercial, public carrier, and dealers'.

5. Property damage insurance offers protection against claims resulting from damage done by the insured's automobile to the property of others. If his car strikes another automobile or damages a dwelling or other property in some way, the insurance company will settle the claim within the limitations of the face value of the contract. Policies are usually written for a fixed amount, such as $5,000. Property damage insurance does not cover losses sustained by the policyholder's automobile.

*Burglary, Robbery, Larceny, and Theft Insurance.* According to the legal definition, the term *burglary* refers to the taking of property by any person or persons making felonious entry into the premises by

force and violence, when the premises are not open for business. Standardized policy forms require that there be visible evidence such as marks made upon the premises to show forced entry. This requirement is designed to prevent the unscrupulous proprietor from claiming a fictitious loss. On the other hand, robbery is the felonious taking of property by violence inflicted upon a custodian of the property.

The businessman uses insurance to protect himself against such losses. Within recent years a contract known as the "3D" policy has been devised to offer the broadest possible coverage to business firms. This contract, so named because it covers loss from dishonesty, destruction, and disappearance, is popular with firms wishing to cover all losses caused by employees, patrons, guests, and outsiders. Rates vary with type of business, previous record in similar enterprises, and safeguards used.

Individuals and business firms may also purchase theft and larceny policies that offer protection against having property stolen by servants and others who have access to it. There are approximately 14 different types of burglary, robbery, and theft insurance policies.

*Workmen's Compensation Insurance.* Almost every state has workmen's compensation laws that require employers either to carry insurance or to assume the liability of the employee for any occupational injuries or diseases arising out of and in the course of employment. The theory behind these laws is that the burden of industrial accidents or diseases should be charged as a cost of production to be borne by the consumer rather than by the employer or employee. The laws of various states differ in some respects, but the general principle is the same.

State statutes require employers who have more than a certain number of employees (usually three or five) to carry this form of coverage. All employment risks are grouped according to the hazards involved. A form known as the Universal Standard Workmen's Compensation and Employers' Liability Policy is commonly used. Under this policy the liability of the company is adjusted to the state compensation law. The premium is determined by the size of the payroll and the nature of the work. A minimum premium is required and premiums may be paid in advance or periodically.

Laws of the different states require weekly benefit payments in case of injury, or cash settlement in case of death or permanent disability. Payment is made only for injury or death arising from actual employment. Claims are paid regardless of carelessness on the part of employer or employee. Before these state laws were enacted, an employer had

little legal responsibility to his employees for accidents occurring on the job other than those caused by his own negligence. Now, employers carry on continuous safety campaigns to prevent accidents. A good safety record results in lower premiums. In most states a commission administers the act and has authority to direct payment of claims and hear appeals by workers or employers. Likewise, rate regulation and experience rating of employers is lodged with state authorities.

*Public Liability Insurance.* Public liability insurance is not to be confused with automobile bodily injury and property damage insurance. Public liability policies cover a wide variety of business hazards. These include liability for damages resulting from personal injury to outside individuals in an accident that occurs on the premises, or as the result of activities of employees while engaged in performing their regular tasks. Operations and premises policies, independent contractor insurance, elevator insurance, and theater liability insurance cover these kinds of risks.

Another form of this insurance is products liability coverage. Death or injury due to harmful ingredients contained in a product or to faulty construction of an article are examples of the hazards for which public liability protection is provided. Every business, regardless of size, is subject to liability claims by the public.

### Fidelity and surety bonds

Employers who engage persons to handle funds or be responsible for fulfilling contracts involving financial transactions are confronted with the possibility that one or more employees may embezzle money or commit other dishonest acts. As protection against such risks, the employer may purchase fidelity and surety insurance.

There are two types of coverages: (1) the fidelity bond, which covers the employee in case of dishonesty, and (2) the surety bond, covering guarantee of performance of a specific responsibility. The purpose of a *fidelity bond* is to reimburse the employer should the employee misappropriate money entrusted to his care. This bond may be purchased to cover one employee or to cover all workers. A bond that covers a group of employees is known as a *schedule bond* and requires that the names of all employees be listed. Fidelity bonds are usually carried on cashiers, bank tellers, salesmen, and others whose duties require the handling of large sums of money.

The purpose of a *surety bond* is to guarantee contract performance. Contractors for buildings are generally required to post a surety bond to

guarantee completion of the contract within the time limit. Special bonding companies and insurance firms issue both fidelity and surety bonds.

## GARAGE LIABILITY INSURANCE

### Coverage

Provides protection against liability imposed by law upon the named insured and additional insureds for damages caused by accident and arising out of the described operations.

### Definitions

"Operations" -- The ownership, maintenance, occupation or use of the premises designated, including the public ways immediately adjoining, for the purpose of an automobile dealer or repair shop, and all operations either on the premises or elsewhere which are necessary and incidental thereto, including repairs of automobiles or their parts, and ordinary repairs of buildings on the premises and the mechanical equipment thereof; and the ownership, maintenance or use of any automobile for any purpose in connection with the defined operations, and also for pleasure use.

The ownership, maintenance, occupation or use of the premises designated, including the public ways immediately adjoining, for the purpose of an automobile storage garage or service station, and all operations either on the premises or elsewhere which are necessary and incidental thereto, including ordinary repairs of buildings on the premises and the mechanical equipment thereof; and the use of any automobile for any purpose in connection with the defined operations.

The ownership, maintenance or use of (1) any private passenger type automobile, which is subject to call only at the premises designated and rented to others by the insured with a chauffeur employed by the insured in attendance for the purpose of carrying passengers and of (2) any automobile of the commercial type rented to others by the insured for the transportation or delivery of goods, merchandise or other property.

"Bodily Injuries" Includes death, care and loss of services.

"Property Damage" -- Includes injury to and destruction of property, including loss of use thereof

"Named Insured" -- Means any insured named in the declarations and referred to as such.

"Insured" -- The unqualified word "insured" includes the named insured and also any partner or executive officer if such partner or officer is active in the declared operations.

"Automobile" -- Motor vehicle, trailer or semi-trailer.

### Features

Contained in the policy are features of protection which can safely be extended by Employers Mutual because we exercise careful underwriting in the selection of business.

The policy is an agreement to pay on behalf of, rather than an agreement to indemnify, the insured.

The Company agrees:

To investigate all claims and to defend the insured in any legal proceedings even if the suit is groundless, false or fraudulent. To pay all costs, including interest accruing on the entire judgment from entry of judgment up to date of payment by the company of its share of such judgment in accordance with the limits of the policy, as well as premium on appeal and attachment bonds.

To pay expenses incurred by the insured, in the event of bodily injuries for such immediate medical and surgical relief to others as shall be imperative at the time of the accident

To pay the cost of bail bonds required by reason of an accident or a traffic law violation.

To pay these costs and expenses in addition to the applicable limit of the policy

Upon the occurrence of an accident written notice shall be given by or on behalf of the insured to the company or any of its authorized representatives as soon as practicable

The policy applies to accidents which occur within the United States of America, its territories or possessions, Canada or Newfoundland.

The Financial Responsibility clause provides for compliance with the applicable motor vehicle financial responsibility laws

*Courtesy Employers Mutual Liability Insurance Company of Wisconsin*

*Figure 13-3.* This explanation covers the terms and features of garage liability insurance, a kind of casualty insurance.

### Marine insurance

Marine insurance is in a class by itself, since the need arises where water is used as a means of transportation. Ocean and inland are the two types of marine policies. For both types, coverage includes both ships and cargo. Some of the perils of the sea for which insurance coverage is possible include sinking, capsizing, stranding, collision, and destruction as the result of heavy weather. Fire insurance is generally written as a separate part of the contract.

Insurance covering cargoes and boats on inland voyages includes travel on lakes, rivers, canals, and locks, and in addition shipment of goods by rail and motor truck. It is common to sell marine insurance on a voyage basis, although some companies prefer to buy time insurance for ships on a regular scheduled run. For the latter, the rate is somewhat lower.

## Social Security

As a result of widespread unemployment and social distress due to the economic depression that began in 1929, the issues concerning social security received increased attention during the early 1930's. The depression bore heavily upon older persons, many of whom had not made adequate preparation for old-age security or against unemployment. Agitation for a social insurance plan that would offer security benefits resulted in the passage of the Federal Social Security Act in 1935.[2]

This law provided for the following types of benefits: (1) old-age and survivors' insurance, (2) unemployment insurance, and (3) federal grants-in-aid for public health and welfare. The Act is administered by the Social Security Administration, a part of the Federal Security Agency. The central office of the Social Security Administration is in Washington, D. C. The central record-keeping office is located in Baltimore, Maryland; field offices are maintained in the principal cities.

### Old-age and survivors' insurance

Of the several programs operating under the Social Security Administration, only old-age and survivors' insurance is completely federal in administration. The purpose of these benefits is to insure workers

[2] This Act was held constitutional by the Supreme Court of the United States in a series of cases on which a decision was rendered on May 24, 1937: *Charles C. Steward Machine Company* v. *Davis,* 301 U.S. 779; *Helvering* v. *Davis,* 301 U.S. 804; *Carmichael* v. *Southern Coal and Coke Company,* 301 U.S. 811. As a result of these decisions, the law became effective in 1937.

in industry, business, and other occupations covered by the Act against wage losses because of old age. The program also provides supplementary benefits to aged wives or dependent husbands and children under 18 whose parents are insured retired workers under this law. Survivors' benefits are paid to widows, to young children, and sometimes to aged dependent widowers or parents of insured workers. A worker having met the requirements for employment and having reached the age of 65 is eligible to receive a monthly pension of not less than $20 or not more than $80 with a family maximum of $150.

The amount of benefits is based upon the length of time he has paid social security taxes and his average monthly wage. For example, a 65-year-old employee who has contributed to the fund for 30 years and has received an average monthly wage of $200 would receive $65 monthly. The 65-year-old wife of a person receiving benefits may also qualify for old-age security equal to one-half the monthly payments received by her husband if they are living together.

To provide for old-age and survivors' insurance, the Administration collects from both employers and employees in equal amounts an excise payroll tax based on the first $3,600 of the worker's annual earnings. The act covers workers in industry, commerce, "regularly employed" agricultural labor and domestic employees (servants), certain federal employees not already covered by a retirement plan, and self-employed persons in business. World War II veterans are allowed wage credits of $160 per month for each month of duty between September 16, 1940 and July, 1947. The Act does not cover employees of a charitable, religious, educational institution or a state and local government unless the institution and at least two-thirds of its employees elect coverage. Railroad workers are excluded because they have their own retirement plan. When an individual is employed or self-employed in a business that is subject to this tax, it is necessary that he obtain a social security card, which carries a number that is retained permanently by that individual or worker.

The amount of taxable wages paid to each employee is reported to the Bureau of Internal Revenue every three months by the employer, who at that time pays his tax together with the amount deducted from the employee's wages.[3]

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[3] The 1950 Social Security Act establishes a schedule of tax increases for each employer and employee. These increases range from 1½% through 1953 to 3¼% in 1970. Self-employment taxes will increase during the same years from 2¼% to 4⅞%.

### Unemployment insurance

In addition to old-age and survivors' insurance, the Social Security Act established unemployment insurance. This insurance is often referred to as the "first line of defense" against unemployment hazards. The purpose of the compensation is to prevent individual hardship during a period of unemployment by building up a reserve fund taken from business during periods of prosperity.

The Act levied upon each employer of eight or more persons a federal tax of 3 percent based on the first $3,000 of annual wages paid to each worker. In those states that have enacted unemployment insurance laws that meet the provisions of the federal Social Security Act, employers may deduct the amount of the tax paid to the state from that levied by the federal government. In no case does the law allow a deduction greater than 90 percent of the federal tax. In other words, the employers pay a 2.7 percent payroll tax to the state; the remaining 0.3 percent is paid to the federal government to cover administrative costs. In some states employees are required to contribute a tax.

The amount of unemployment insurance paid by various states is generally approximately one-half the worker's regular weekly wages. Length of time payments are made also varies, the average being from three to six months. Three states (New Jersey, Rhode Island, and California) pay unemployment compensation under this plan for temporary disability.

One of the most important provisions of the federal act, which state laws must meet, is the requirement that all unemployment benefits be paid through public employment offices where an unemployed worker must first register for work and must continue to report regularly for an announcement of a position during the time compensation is paid. Every state now has an approved unemployment insurance law and therefore receives tax funds collected for this purpose.

### Federal grants-in-aid for health and welfare

Although the principal benefits of the social security program are in the form of old-age pensions and unemployment compensation, the law provided for grants-in-aid to the states for designated programs in health and public welfare. Thus, funds may be obtained by the states for such purposes as child welfare, public health, and assistance to the needy and aged, the blind, and dependent children. To participate in federal grants, the states are required to establish health and welfare programs for each of these items. Grants are usually allotted on the

basis of financial needs of the state, its population, and the severity of its health problems. A federal grant is often equal to one-half the total sum expended under the approved state plan. There are no special federal taxes levied to support these grants to states.

## Careers in Insurance

The field of insurance offers a variety of occupational pursuits. Because the insurance business is so varied, there is a great deal of occupational specialization. The two main areas of employment are in the *home offices* and in the *field offices* of companies.

### Home-office occupations

Every insurance company maintains a home office where the principal records of all the firm's activities are kept and the major administrative decisions are made by the company executives. Insurance risks are analyzed, policy applications are reviewed for acceptance or rejection, and plans for sales training programs are prepared. All the mortality records of the policyholders are analyzed and prepared at the home office; studies are made of investment securities purchased with surplus funds. To conduct the work of the home office a number of different specialists are required in addition to executives, secretaries, clerks, and typists.

*Insurance Actuary.* One of the most complex and indispensable occupations found in the home office is that of the insurance actuary. The actuary collects, compiles, and analyzes mortality tables, which are statistical records showing the death rate at each age, usually expressed as so many per thousand. The actuary uses mortality tables as a source of information in determining premium rates. He helps to plan new types of insurance policies. Not the least of his duties is to explain complicated problems concerning insurance to other businessmen and to policyholders in language clear enough to be readily understood. Although the actuary cannot operate without a knowledge of the mathematical basis of life insurance, essentially he is a businessman rather than a mathematician.

In training for a career as actuary, mathematics and English are important subjects. The student should also study general business, accounting, finance, and economics. A broad cultural foundation is essential. One important qualification is attained by passing a number of examinations to qualify for membership in a recognized actuarial body. In the United States and Canada, these organizations are the Actuarial Society of America and the American Institute of Actuaries.

Both these societies are private organizations run entirely by their members and have been organized to promote the theory and practice of actuarial science.[4]

*Insurance Underwriter.* Whenever an application is made for a policy, someone must determine the insurability of the applicant. It is the work of the underwriter to make this decision. In life insurance, the underwriter reviews the medical reports on the applicant prepared by the examining physician.

The duties of the underwriter require a high degree of responsibility and judgment, for it is on his recommendation that the application is approved or rejected. Many years of experience are often required to develop sound judgment of insurance risks.

Underwriters specialize in different types of risks. Underwriters are found in companies that write life, fire, casualty, liability, automobile, and marine insurance. Would-be underwriters generally start in a subordinate position in order to learn the nature of the business. A broad educational background plus training in business administration and general insurance or life insurance is essential. The position of underwriter is one of the higher-paid occupations in insurance below the executive level.

*Insurance Statistician.* The insurance statistician compiles and analyzes all kinds of mathematical data about the company and its policyholders. For instance, the statistician compiles special reports pertaining to claim payments, policy renewals, premium rates, insurance losses, and investment earnings. Because the statistician works principally with mathematics, he should have a special aptitude for this subject and thorough training in statistics and higher mathematics. Furthermore, he must know a great deal about the operations of the insurance company where he is employed. It takes infinite patience and an aptitude for details to perform this work. A college education, including a knowledge of business administration, statistics, and insurance, is essential. Every type of insurance company uses the services of a statistician. This position is considered a well-paid occupation, mainly because there is a high degree of specialization and few persons select it.

*Investment Specialist.* Since a portion of the income of each insurance company is derived from dividends and interest, each company requires the services of an investment specialist. His work involves the analysis of all kinds of investments that are regarded as suitable

[4] See "Preliminary Actuarial Examinations," published by the Actuarial Society of America, 393 Seventh Avenue, New York 1, New York, and the American Institute of Actuaries, 135 South La Salle Street, Chicago 3, Illinois.

for insurance company reserve funds. Surplus funds may be invested in real estate, corporation bonds, government bonds, municipal bonds, and mortgages. The investment specialist must be qualified to analyze these securities to determine if they are safe and adequate investments. For this work, one needs extensive training in business finance, economics, accounting, statistics, investments, and insurance. It is necessary to have the ability to write comprehensive reports for review by the company executives. Training in both law and business administration are useful, although the former is not absolutely mandatory. Considerable practical experience is necessary before one can advance to one of the high positions in this field.

### Field-office occupations

The field office of an insurance company is similar to the branch office of a manufacturing concern. The personnel of this office make direct contacts with prospective purchasers of insurance coverage and with policyholders. The function of the field office is one of service.

*Field Agent.* By far the largest number of persons employed in field offices are the insurance agents or salesmen, who contact all prospective policyholders. They are the direct representatives or employees of insurance companies.

Most life insurance field agents specialize in selling either ordinary insurance, industrial insurance, or group insurance. In some companies the field agent is permitted to sell all three types. In the life insurance field, the field agent represents only one company.

To become an agent, it is necessary to obtain a contract from an insurance company, and in many states a license is required. In some instances a written examination must be taken by the agent in order to obtain a license.

The work of a life insurance field agent is highly personalized. He must be able to explain policies and advise the client properly as to the choice of insurance and the benefits to be derived. Thus, the agent must have a thorough knowledge of insurance principles, company policies, and salesmanship techniques. Agents are paid on a salary-and-commission basis or on a straight commission.

Selling life insurance is a career suitable for both men and women. For this career a college education is an advantage. Many companies maintain training schools where new agents are given special courses in insurance and training in salesmanship techniques. A few colleges and universities have organized courses in the field of insurance for those interested in this career.

*General Agent.* Unlike the field agent, the general agent is an authorized representative of a company but not a direct employee. General agents are usually known to represent several companies. They may sell many different kinds of insurance, including fire, casualty, surety, liability, and marine. Furthermore, they may represent two or more companies, each underwriting the same types of insurance risks.

It is a common practice in some states to require a state license to qualify as a general agent. This may entail satisfactory completion of a written examination and acceptable recommendations by individuals of good character and reputation. A background in business administration and an understanding of general insurance are two important educational prerequisites. The U.S. Bureau of Labor Statistics reports there are many opportunities for general agents in the several fields of insurance, especially for those who own their own insurance agency.

## Terms for Study

Actuary
Assessment
Beneficiary
Cash surrender value
Casualty insurance
Coinsurance
Consequential loss
Double indemnity
Endowment policy
Fidelity
Field agent
Full coverage
Hedging
Insurable interest
Larceny
Limited payment policy
Mortality table
Mutual company
Nonassessable policy
Ordinary life policy
Preferred risk
Premium
Reciprocal associations
Risk
Schedule bond
Stock company
Surety bond
Term insurance
"3D" policy
Underwriter

## Questions

1. Are all business risks insurable?
2. What is an insurable risk?
3. How does insurance serve business?
4. What is meant by having an insurable interest?
5. What are the five kinds of business risks for which insurance can be obtained?
6. What are the ways by which good management helps to reduce losses from risks?
7. What are the four types of insurance companies?
8. What are the five classes of insurance coverage?
9. When a standard fire policy is issued, what types of risks are covered?
10. How does term insurance differ from ordinary life insurance?
11. What protection is provided a business when a surety bond is issued on an employee?

12. How does a limited payment policy differ from an endowment policy?

13. What purpose does term insurance serve?

14. What kinds of protection are provided in casualty insurance?

15. How does workmen's compensation insurance serve business?

16. What are the main provisions of the Social Security Act?

17. What are some of the benefits of social security to business?

18. When an application is made for a life insurance policy, who determines the insurability of the applicant?

19. What are the different occupations in insurance?

20. How does the work of the actuary differ from that of the insurance agent?

## Problems and Projects

1. Explain the difference between automobile bodily injury liability insurance and automobile property damage insurance.

2. List the different kinds of property and casualty insurance that could be obtained for the following:

a. Lumberyard in Maine.
b. Garage building in New York City.
c. Department store in any city.
d. Orange grove in Florida.
e. Residence in southern California.
f. Steamship line.

3. Explain how a flour miller uses hedging.

4. The partnership of Johnson and Jackson has remodeled a building at a cost of $25,000, half of which was borrowed from a bank to be paid back in installments over five years. What kind of insurance could the partnership purchase to guarantee payment of the debt should one of the partners die before the debt is repaid?

5. A business owning a fleet of seven trucks desires insurance protection. List all the types of insurance policies the business might purchase to obtain this protection.

6. A bank employs a new clerk who is to handle money. Explain how the bank may protect itself from losses that might involve the new employee.

7. A modern steel and concrete store building valued at $150,000 is insured at 80 percent of its value. Figure the premium if the policy is written for one year at an annual rate of 60 cents per $100. If a 12 percent premium discount were allowed on a three-year policy, how much could be saved?

8. Explain how an 80 percent coinsurance contract operates.

9. Visit a local general insurance agent and prepare a list of every kind of casualty insurance that a businessman in your community would need to protect his business. Describe how each kind can be used.

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CHAPTER XIV

# GOVERNMENT REGULATION OF BUSINESS

A STUDY OF GOVERNMENT REGULATION of business is fundamentally an analysis of the ways by which government seeks not only to aid business but also to control business. It must be remembered that business is conducted under a set of rules referred to as laws, and as conditions change the rules and regulations must also change. One of the major problems confronting the businessman is keeping informed of the changing regulations. Almost every business, large or small, is restrained or directed by some form of legislation. It is essential for those who expect to enter business to have a clear understanding of the basic types of control.

## Why Government Control of Business?

The recognition of property and contract rights is contained in the most important American judicial document, the Constitution of the United States. Any analysis of control over business by the federal and state governments is incomplete without some understanding of the federal Constitution. Under it, the entire American system of government is established.

Two levels of government are provided for, federal and state. All powers and duties not specifically delegated to the federal government are left to the states. For example, Congress has the authority to collect taxes, levy duties, pay the debts of the United States, coin money, and fix standards of weights and measures. The right to establish post offices and roads, to grant franchises, patents, and copyrights, and to make treaties by and with the consent of the United States Senate is also within the authority of Congress. Few powers of Congress are more sweeping than the regulation of commerce among the states. No state is permitted to levy duties on imports or exports.

### Basis of control

The role of government in the affairs of business is not new. From the very beginning of this nation the federal and state governments have exercised administrative and supervisory regulation over economic

affairs. Although the American economy is based on free enterprise, it is a mixed economy consisting of individually owned enterprises, semi-public corporations, co-operatives, and government agencies. The everyday impact of government controls over these organizations serves to raise the issue of the basis for regulation.

Governments intervene in business largely because pressure groups exert influences, for they are the chief instigators of legislation. Nevertheless, the fundamental reason for regulation of modern business is to accomplish the following objectives within the limits of the Constitution:

1. To conserve the national resources, notably forests, fuels, water power, and lands.
2. To protect the welfare of the individual citizens and promote higher standards of public health, safety, well-being, and morals.
3. To maintain free enterprise.
4. To prevent monopolies and combinations of business interests that tend to eliminate competition.

## Regulation versus free enterprise

Some persons view with alarm the tendency of federal and state governments to impose restrictions on business. There are those who fear the misuse of controls will result in destroying the system of free enterprise. The whole problem of control requires more than a single solution. To what extent should government regulate commerce and trade? How far can intervention go without destroying freedom and initiative? In a recent analysis by the Committee for Economic Development, it was stated: [1]

> To substitute direct controls for the price system is to attack the private enterprise system at one of the points where it works best and to induce government intervention in an area where it is bound to be inefficient.... If government attempts to decide in detail what should be produced and how it should be distributed, there will inevitably be unsatisfied demands for some commodities and unsaleable supplies of others.

It is difficult to conceive of governmental intervention in business that does not conflict with some established right. One of the responsibilities of those who enact laws is to balance the relationship in such a way as to eliminate conflicts.

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[1] Research and Policy Committee of the Committee for Economic Development, *The Uses and Dangers of Direct Controls in Peacetime*, p. 10. New York: Committee for Economic Development, 1949.

Although free enterprise is the basis of American business, each year new legislation is passed to curtail aspects of free enterprise. For example, there was a time when a retail store was permitted to resell its goods without restrictions. Recent legislation in many states now requires the owner to conform to a price pattern established by the manufacturer. Under the Robinson-Patman Act the seller is not allowed to discriminate in quoting prices to buyers. Formerly, the seller was free to quote any price.

## Types of Regulations

Certain business practices that might lead to monopoly or result in the promotion of unfair competition have been the subject of federal investigation. Consideration of these practices by legislators has led to the enactment of specific laws—notably the Sherman Antitrust Act, the Clayton Antitrust Act, the Federal Trade Commission Act, the Robinson-Patman Act, and the Miller-Tydings Act.

### Curbing monopolies

The development of modern business practices has been accompanied by the growth of an interesting phenomenon. By combinations of business organizations to control raw materials, assignment of marketing areas, and secret price agreements, individual businesses have become unlawful monopolies. Those practices that bring about a situation where there is but one seller of a certain commodity are known as monopolistic practices.[2] Even where there are two or more sellers of goods, when they unite in such a way to agree on price, quality, production, or other factors, a monopoly is created.[3]

The first federal statute passed to regulate business was the Sherman Antitrust Act. This Act was passed by Congress to prevent business combinations that restrained trade. Prior to its passage in 1890, it had come to light that 40 oil companies had formed a trust and united with the Standard Oil Company. The stockholders surrendered their

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[2] The term *commodity* is defined as goods for which no reasonable substitute exists. For example, a pure monopoly in soap, of which there are many brands, would require that one company control all brands. Pureness of monopoly depends upon the absence of possible substitutes.

[3] In 1936 the Federal Trade Commission directed the Goodyear Tire and Rubber Company to cease selling tires to Sears, Roebuck and Co. at a price differential considered greater than the regular quantity discount savings on Sears, Roebuck and Co. orders. Testimony showed that small firms were being driven out of business by this price agreement. Obviously, the contract was helping to eliminate competition.

stock to trustees in return for trust certificates. Although the stockholders continued to own their original stock, power to control the policies of all 40 oil companies had been turned over to the trustees. The principal purposes of the trust were to eliminate competition, control prices, regulate costs, and in general control the market. As soon as small companies were forced to close, the trust absorbed them. The Sherman Antitrust Act was designed to break up organizations that had become trusts and to prevent others from becoming trusts. To do this, it was necessary to declare that contracts, combinations, and conspiracies operating in restraint of trade were illegal.

Although the Sherman Act was a step to curb combinations and trusts, it did not prove entirely adequate in eliminating many of the related practices. Retailers complained when wholesalers attempted to sell goods directly to consumers. Manufacturers attempted to restrain retailers from cutting the prices of goods. Corporations made secret agreements in purchasing stock of other companies to gain control. It was not uncommon for a director of one company to be elected as director of several competing corporations. The few state laws regulating business combinations were ineffective. When the laws of one state became too difficult to follow, the organization simply moved its office to a state with more favorable laws. Some state courts held that price-maintenance agreements were lawful; others considered them unfair to the public.

As a further effort to curb unfair practices, Congress approved a law to establish the Federal Trade Commission, consisting of a board with authority to study and review practices of business organizations alleged to be engaging in unfair methods of competition.[4] The Commission was empowered to forbid the following types of practices:

1. Obtaining business by bribery.
2. Using deceptive and false labels.
3. Making unfair sales contracts to destroy competition.
4. Circulating inaccurate statements about competitors.
5. Imitating competitor's labels, wrappers, or trade names.

The Wheeler-Lea Amendment was subsequently passed to grant further power to the Federal Trade Commission, particularly in regard to advertising practices, misbranding, and adulteration of merchandise.

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[4] A description of how a case is handled by the FTC is contained in Dimock, Marshall Edward, *Business and Government,* pp. 409-411. New York: Henry Holt and Company, Inc., 1949.

It should be noted that not all monopolies are illegal. Telegraph, electric, bus, and railroad companies are examples of lawful monopolies. Railroad companies are allowed to operate in an area without competition. The assumption is that new competitors would be detrimental to the industry, since they would reduce the older and better-established companies' chances of making a profit. Hence, any new company desiring to establish a railroad line in a specific area where service is already furnished must obtain the consent of the Interstate Commerce Commission. This approval is usually difficult to obtain unless it can be established that the service is needed.

Monopolistic practices are often so closely allied that it is difficult to determine which are unfair and which are fair. Under a recent fair-trade law, a dealer's refusal to sell trade-marked goods at the price established by the manufacturer was considered a violation of the law. At the same time, requiring a dealer to conform to an established price smacks of unfair monopoly.

### Regulation to control quality

In the interest of the public, the federal government and several states have passed laws to control the quality of merchandise. A typical example is the Pure Food and Drug Act, which established minimum standards of quality for goods sold in interstate commerce. This Act also provided for the careful labeling of certain foods and other products.

Other examples of legislation to control quality were the Federal Tea Act, the Federal Import Milk Act, and various Meat Inspection Acts, all of which regulated the quality and purity of products by requiring that they meet minimum standards.

The primary purpose of all federal legislation pertaining to purity of foods, drugs, and cosmetics is to protect the consumer. As early as 1900 it became apparent that as much as $90,000,000 was being spent annually by the public for misbranded and adulterated foods and drugs. Although not all these articles were actually harmful, this constituted a large bill for inferior goods.

Several states attempted to improve the situation by passing restrictive measures. Such laws are effective in controlling the manufacturer or distributor when goods are sold within the state, but they cannot prevent the goods from being shipped outside the state in interstate commerce transactions.

The first pure food and drug bill was passed in 1906. Briefly, it established penalties for shipping in interstate commerce foods and drugs

that had been adulterated. Adulteration was interpreted as adding cheaper or inferior ingredients to an article to increase the volume or quantity. This law did not cover false or misleading advertising in newspapers or in periodicals. Cosmetics and therapeutic devices were not included either.

In 1938 the original pure food and drug law was extended by the passage of the Federal Food, Drug, and Cosmetic Act, otherwise known as the Copeland Act. In addition to prohibiting adulteration, this law forbade mutilation, destruction, or removal of any label from an article held for sale after shipment in interstate commerce. The Food and Drug Administration established under the original law of 1906 was given further authority to inspect, examine, and investigate goods in process or production and in transportation. A person or firm found guilty of violating the law might be fined up to $1,000 or imprisoned for one year or both. More serious violations would involve a fine of $10,000 and imprisonment for three years. These violations include defrauding or misleading a buyer.

The Meat Inspection Acts, the Federal Tea Act, and the Federal Import Milk Act previously mentioned provided for the inspection of these foods by federal authorities. The Department of Agriculture has meat inspectors at all packing plants where meat is prepared for interstate shipments. The Tea Act prohibited importation into the United States of tea that does not meet government standards, and the Import Milk Act required that foreign milk and cream received in this country also meet certain standards of quality and purity.

### Regulation of prices

Federal controls to maintain a reasonable price for goods and services were first applied to railroad freight and passenger rates and next to public utilities. Subsequently, similar regulations were extended to the fields of banking and insurance. Banks and insurance companies were regulated as to the maximum rate of interest that could be charged and the maximum investment return that could be made. All these regulations have been justified as being in the best interest of the public.

The most recent application of the concept of reasonable price is in the control of labor's wages and bargaining conditions. Labor organizations have vigorously opposed legislation intended to restrict the activities of unions. Likewise, industry has offered opposition to any law that curtails its freedom in dealing with labor in matters of wages, hours, working conditions, and other benefits.

Originally, one of the purposes of the Clayton Act was to prohibit price discriminations and exclusive dealings. Both the Clayton Act and the Federal Trade Commission Law supplemented and strengthened the Sherman Antitrust Act. By specifically making it unlawful for persons to discriminate in the matter of price between different purchasers of the same commodity where the effect would be to lessen competition, the Clayton Act strengthened the Sherman Antitrust Act.

In 1936 the Robinson-Patman Act amended the Clayton Act. When first introduced in Congress, the Robinson-Patman Act was proposed as an anti-chain-store measure. In its final form, it covered price discrimination. For example, the Act specifically prohibited the granting of quantity discounts in excess of the savings that can be demonstrated to be obtained from quantity buying. In other words, the Federal Trade Commission was given the power to limit quantity discounts if purchases in large quantities are so few that the price savings would be unjustly discriminatory to competitors or result in creating a monopoly.

Other important provisions of the Robinson-Patman Act intended to broaden the scope of the earlier legislation may be summarized as follows:

1. Any allowances made by a seller to one buyer for services performed must be made in equal proportion to all other buyers.
2. Differences in price can be made when in good faith to meet competition, or where there is evidence of deterioration of products, obsolescence of seasonal goods, distress sales by court order, or discontinuance of the article as a regular line of merchandise.
3. Allowances for brokerage fees are prohibited if such services are not actually performed by a person independent of the buyer.

Chain stores and other large organizations involved in mass distribution have customarily dealt directly with producers and manufacturers. Under present laws, they may not be granted any allowances in lieu of brokerage charges that would have to be added to the cost by dealers buying from a jobber, wholesaler, or commission house. In the past the practice of giving chain stores unfair price concessions for large orders has placed independent dealers at an economic disadvantage. Hence, the law is presumed to correct the practice of the so-called unfair price concessions.

### Unfair methods of competition

As was indicated at the beginning of this discussion, the FTC has the power to forbid business practices regarded as conducive to un-

fair methods of competition. In general, such practices are of two broad types: (1) fraudulent or deceptive acts and (2) resale price maintenance agreements.

Typical of the practices disapproved of by the FTC are the following, which are only some of the 31 different methods declared unlawful:

1. Use of false and deceptive advertising to gain business.
2. Misbranding of goods, including nature of fabric, as to quality, material properties, origin, ingredients, and so forth.
3. Bribery involving buyer or employees to obtain orders or trade secrets.
4. Selling rebuilt or secondhand goods as new articles.
5. Making false statements about a competitor or his merchandise.
6. Misrepresenting the scope and authority of the seller in such a way that, by virtue of his position or relationships, the buyer is led to believe that he is especially fortunate in having an opportunity of dealing with the seller.
7. Giving products misleading names or deceptive titles in order to convey a value associated with other products that are in reputable standing.
8. Establishing agreements among competitors to maintain prices or divide up territories for the purpose of restricting free competition.
9. Using containers deceptive in weight or measure although ostensibly associated because of design with similar products offering standard weights and quantities.
10. Using merchandising promotion schemes based on chance or luck.

The fixing of resale prices by a manufacturer or wholesaler was formerly regarded as an unfair method under the Sherman Antitrust Act. Not until the passage of the Miller-Tydings Act of 1937 was it lawful for businesses to engage in resale price maintenance contracts in interstate commerce.

For years manufacturers of highly advertised brands have sought legal means to maintain the retail price of their goods. Frequently, popular brands are used by retail stores as loss leaders for the purpose of attracting customers. For instance, a well-known brand of toothpaste may be offered for sale at a price below the seller's cost in order to encourage customers to enter the store. The proprietor is willing to take a loss on one item if customers can be induced to come into the store where they can be sold other items to offset the loss on the tooth-

paste. Large firms apparently are financially able to engage in this practice, but small ones contend they cannot afford to do so.

In the past, courts have sometimes held that agreements between manufacturer and retailer to fix the price of an article were in violation of the Sherman Antitrust Act; on other occasions such agreements were declared lawful. The Miller-Tydings Act constituted an amendment to the Sherman Antitrust Act to exempt resale price maintenance agreements from federal antitrust regulation. There is one exception: These agreements are lawful only when allowed by state law. Thus, it is lawful for a druggist to resell a popular brand of toothbrushes at a price established by the manufacturer provided there is an existing law in the state legalizing resale price maintenance agreements. If, however, no state law exists, the Miller-Tydings Act does not permit a resale price maintenance agreement in that state.

On "price-fixed" items, the minimum price tends to become standard, which is exactly what the manufacturer desires. In other words, all merchants selling a particular brand place approximately the same resale price on it. It is said that resale price maintenance tends to discourage striving for business efficiency, since it is not possible to lower the price of goods because of increased operating efficiency. It is likely that the public may pay more for highly advertised brands because of the Miller-Tydings Act.

Legislation legalizing resale price maintenance agreements has been passed in 45 of the 48 states. Only Missouri, Texas, Vermont, and the District of Columbia do not have price maintenance laws. In New York State, which was one of the first to enact this type of law, following the passage of the Feld-Crawford Bill, a leading department store, R. H. Macy & Company, announced a complete line of private-label merchandise to compete with the popular advertised goods covered in the Feld-Crawford Bill. On private-label goods it is possible for the retailer to quote lower prices to consumers than on well-known items that the manufacturer wishes to control. Figure 14-1 presents the general provisions of a state fair-trade law.

In general, the provisions of state laws with respect to resale price maintenance permit the manufacturer of a commodity bearing a distinctive mark or name to control its resale price. With some variations, these laws usually specify: (1) that manufacturers and distributors of trade-marked or branded merchandise may make contracts with buyers to fix the resale prices; (2) that dealers who do not sign resale price contracts must, nevertheless, maintain prices specified in agreements with manufacturers and other dealers; (3) that price-fixing agreements

are not lawful if they are made between groups of producers or wholesalers or if they are made between groups of retailers; and (4) contracts do not apply to damaged goods or goods that are sold in clearance sales.

SENATE BILL 108, known as the "Unfair Practices Act," was passed by the 37th General Assembly of Colorado, and became a law May 20, 1949.

(1) GENERAL· The law makes it unlawful to sell any commodity, or any service or output of a service trade, with the intent to destroy competition. The specific acts prohibited are: Price discrimination between different trade areas, selling below cost as later defined, granting secret rebates, refunds or discounts not extended to all purchasers, or advertising commodities which the vendor is not prepared and able to supply to the consuming public. The law does not apply to leased motion picture films or to the services or products sold by a public utility subject to the Colorado Public Utilities Commission or other regulatory body. (For Unfair Cigarette Sales Act see Ch. 174, S. L. Colo. 1947).

(2) COST: Cost to the vendor is established in the law as being the invoice price or the replacement price plus the cost of doing business. The law specifically requires that "cost of doing business" must include (but is not limited to) the following items of expense: Labor, salaries of executives and officers, rent, interest on borrowed capital, depreciation, selling cost, maintenance of equipment, delivery cost, credit losses, all types of licenses, taxes, insurance and advertising. The law does not provide for a so-called statutory mark-up on the vendor's cost, and each individual must determine his cost of doing business or overhead which is required by the law to be added to the invoice or replacement price. Cost of stock purchased at a bankrupt sale is the replacement cost, unless the stock is segregated from regular merchandise and advertised as such, in which case the invoice cost may be used.

(3) WHEN LAW NOT APPLICABLE· The law does not apply to certain sales such as: (a) Close-out sales of all or any portion of a stock of goods for the purposes of discontinuing trade in such stock or commodities when made in good faith, (b) The sale of seasonal or perishable goods to prevent loss, if notice is given to the public, (c) Sales of damaged goods or those deteriorated in quality, if notice is given to the public; (d) Sales under order of court, and (e) Sales made in good faith to meet the legal prices of a competitor in the same trade area. *A vendor may not meet an illegal price of a competitor.*

(4) LEGAL ACTION: Any person injured by a violation of the Act may institute court action to enjoin such violation and, if damaged, may recover triple damages. Also the Director of Revenue may institute an action for an injunction or may prosecute violators when any person shall, in writing and under oath, submit to the Director a statement setting forth facts sufficient to constitute a prima facie violation of the Act.

(5) COMPLAINTS TO THE DIRECTOR OF REVENUE: Complaints to the Director of Revenue need not be in any particular form, but should set forth the name and address of the person complained of and the specific acts of violation alleged, and must be acknowledged before a notary public or other person authorized to administer oaths. There should be attached to the complaint exhibits of advertisements or hand bills showing the offers for sale, actual records of sales, and the specific identification of the commodity offered for sale, with particular reference to size, quantity and grade.

(6) LICENSES REQUIRED: The Act provides that the Director of Revenue shall license all persons subject to the Act at an annual fee of $1.00 per license. If the business is commenced after July 1 of any calendar year, the license fee for the remaining calendar months shall be 50c. Licenses expire on December 31 of the calendar year in which issued.

(7) CRIMINAL PENALTIES. In addition to the injunctive relief and damages which may be recovered in a civil action, violations of the Act are deemed to be misdemeanors and are punishable by a fine of not less than $100.00 nor more than $1,000.00 or by imprisonment not exceeding six months, or by both, for each single violation upon conviction thereof.

*Courtesy State of Colorado*

*Figure 14-1. General Provisions of a State Law Pertaining to Unfair Business Practices.*

## Regulation of advertising

In the scramble for more business, some concerns have resorted to exaggerations, misrepresentations, and false claims in their advertising. In 1938 the Wheeler-Lea Act amended the Federal Trade Commission Act in part by providing the FTC with jurisdiction over advertising pertaining to foods, drugs, cosmetics, therapeutic devices, and other commodities sold in interstate commerce. It also provided a penalty for the misbranding and adulteration of these articles. The Act also authorized the Federal Trade Commission to take action in cases where the interest of the public might be injured by such practices. In short, it tried to protect both the honest businessman and the consumer.

CITY OF HOUSTON

*Department of Public Health*

PERMIT

***Issued under Ordinance No. 2922 as amended governing inspection of meat in and around the City of Houston.***

***Type of Permit:*** WHOLESALER

*(Abattoir, wholesaler, cold storage facilities or horse meat dealer)*

***Issued To:*** REPUBLIC PACKING COMPANY

*(If permit holder or holders doing business under an assumed name, permit should issue as in following examples: "John Smith d/b/a Smith Packing Co."; "John Smith and Richard Jones d/b/a Smith Packing Co" If a partnership, all partners must be named. If a corporation, state full corporate name)*

***Addresses of Plants:*** 10 "J" Street

***Fee Paid:*** Ten Dollars

***This permit expires January 1, 19 52 and is subject to revocation for violation of said ordinance at any time.***

*Director of Public Health*

*Figure 14-2. Permit to Operate a Wholesale Business.*

Following the general pattern set by the federal government, almost all the states now have legislation similar to the Wheeler-Lea Act. In many of these states, the work of the Better Business Bureaus, the American Medical Association, and trade associations has helped to identify violators.

Form U PA—1—35M—3-49

STATE OF COLORADO
DEPARTMENT OF REVENUE
Capitol Annex Building
Denver 2

VALIDATION NUMBER

APPLICATION FOR LICENSE FOR CALENDAR YEAR 1949

# "UNFAIR PRACTICES ACT"

DO NOT WRITE IN THIS SPACE

Check_____
Cash_____
Money Order_____
Other_____
Rec'd by_____ Disposition_____

**NOTE: Application for License will be rejected unless all questions are fully answered and $1.00 license fee paid for each place of business. If operation started after July 1, 1949 the fee is .50c each. Remittance must be in the form of a check, draft or money order and made payable to the Treasurer of the State of Colorado, attached to this application and transmitted to the Department of Revenue, Capitol Annex, Denver 2, Colorado.**

1. License to be issued in the name of_____
2. Trade name under which business is to be conducted_____
3. Mailing Address_____
   Street Address or Rural Route — Postal Zone — City or Town — State
4. Nature of business_____
5. How many places of business do you operate in the state of Colorado?_____

List separately:

| Beginning date | Name | Address | City | County |
|---|---|---|---|---|
| | | | | |
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(If additional space is needed attach separate sheet)

Signed_____ (Do not write in space below)

By_____
(Signature)

_____
(Title)

Date_____ 19____

(Over)

SEE REVERSE SIDE FOR EXCERPT OF LAW

*Figure 14-3. An Application Form for a State Business License.* The reverse side of this form is shown in Figure 14-1.

### Licenses, permits, and franchises

All states have laws that require persons who engage in certain occupations, professions, and businesses to be licensed. Physicians, dentists, attorneys, druggists, electricians, real-estate brokers, restaurateurs, and morticians are typical examples.

To conduct a grocery store, it is usually necessary to have special permits to sell milk, butter, meat, tobacco, gasoline, and fuel oil. These permits may be required in addition to a retail license. Figure 14-2 shows a typical permit. Barbers, beauty-shop operators, garage owners, accountants, and teachers generally must be licensed. Before engaging in any kind of business, one should consult with local officials to ascertain what is necessary. Any agreement made with or by an unlicensed person is void.

There are special kinds of businesses for which a franchise is required. A franchise is a particular type of permit that allows a person or group to conduct a special type of business. Franchises are granted by cities, state governments, and federal agencies, usually for periods longer than one year. Such businesses as bus companies and broadcasting companies must have franchises.

### Patents, copyrights, and trade-marks

When a person invents a mechanical device or discovers a formula, the federal government allows him the right to make, use, and sell the invented article. This privilege is called a patent. It is granted by the Patent Office, Washington, D.C., and it is good for 17 years. It must be applied for in accordance with the procedures required by the Patent Office. Anyone who violates a patent privilege is subject to penalties provided by law. A patent, like other property, may be sold. Fees vary according to the type of article.

A copyright is a right granted to an author to use, sell, or otherwise dispose of his written works. The owner of a copyright has an exclusive right to the use of his materials; no one else may use them without his consent. A copyright is granted, for a fee, by the Register of Copyrights, Washington, D.C., for 28 years and may be renewed for a similar period.

A trade-mark is a distinctive symbol, title, or identifying mark used by a business to distinguish its product or name from others. Registering such a mark with the Patent Office prevents its use by others for 20 years, and the right may be renewed for a similar period. The Fed-

eral Trade Commission has authority to stop the unlawful use of a registered trade-mark.

### Taxation and business regulation

The federal government derives its power to tax from Article I, Section 8, of the United States Constitution and from the Sixteenth Amendment. Cities, counties, and other subdivisions within a state receive their power to tax from the state legislature.

Modern business is confronted with many different kinds of taxes. These taxes may be classified as follows: (1) taxes on property, tangible and intangible; (2) taxes on personal and corporation incomes; (3) taxes on consumer goods at time of purchase; (4) customs duties; (5) inheritance, estate, and gift taxes; (6) social security taxes; and (7) use taxes.

Although taxes serve primarily as sources of revenue, they are often devices for economic regulation. Almost every form of tax has some effect upon business and the consumer. A tax on luxury items tends to discourage their purchase. A high sales tax on cigarettes may encourage persons to buy more pipe tobacco or cigars and fewer cigarettes. High income taxes on corporations may be the deciding factor in causing a change from the corporate form of organization to a partnership or individual proprietorship. Some taxes are primarily regulatory in nature. For example, a state tax on chain stores has been adopted by some 17 states. This tax was not designed to destroy chain stores, but it has served as a regulatory measure in its intent to equalize competition between the chains and independent concerns. The federal tax on colored oleomargarine discouraged the sale of this product as a substitute for butter. Increased taxes on liquor and narcotics, and more recently the so-called use tax imposed by states upon the use or storage of tangible personal property are examples of other regulatory taxes. The net effect of taxes is generally reflected in the prices of goods or services, since most enterprisers seek to pass the tax on to the consumer.

Some taxes are levied primarily to raise revenue. Typical of these are the following:

| | | |
|---|---|---|
| Amusement tax | Income tax | Sales tax |
| Cigarette tax | Luxury tax | Social security tax |
| Gasoline tax | Property tax | Unemployment tax |

### Regulation of public utilities

Public utilities are businesses that furnish services to the public and operate under a special permit or franchise that requires service to all

alike and in accordance with an acceptable standard and rate. Companies that furnish electricity, gas, water, telephone and telegraph service, and transportation are public utilities. These businesses are subject to supervision by local, state, and federal agencies. For instance, a street-railway company is subject to regulation by the community issuing the franchise. A telephone company operating within a state is required to meet state laws. Railroads, bus lines, and gas transmission companies operating in various states are subject to both federal and state controls. Since no single federal agency exercises supervision over all types of interstate utilities, supervisory authority is distributed among several governmental agencies according to the nature of the utility.

*Railroads.* The first federal law passed to regulate a public utility was the Interstate Commerce Act of 1887. This Act established the Interstate Commerce Commission, a body of men appointed by the President of the United States subject to the approval of the United States Senate. The principal functions of the Commission are to see that reasonable rates and fares are maintained; to prevent discrimination among shippers engaged in interstate commerce; to prescribe uniform accounting methods and systems; and to investigate complaints against railroad companies.

Although the original Act was intended to prohibit discrimination and unreasonable charges, it was not until the Hepburn Act of 1906 and the Mann-Elkins Law of 1910 that the ICC received sufficient authority to enforce rate-making policies. The Mann-Elkins Law reinstated the long- and short-haul clause applied to rates and brought pipe lines carrying oil under the jurisdiction of the ICC.

The Transportation Act of 1920 established federal control over the issuance of railroad securities, notably stocks and bonds, and in 1935 interstate trucking and bus transportation were brought under the direction of the ICC. Water carriers in domestic commerce, except the so-called contract carriers of bulk goods on the Great Lakes, were made subject to the ICC by the Transportation Act of 1940.

*State Regulation of Railroads and Bus Lines.* Individual states have passed laws regulating commerce within the following areas:

1. Safety precautions, rules, and regulations.
2. Minimum train crew requirements.
3. Health regulations pertaining to sale of food on trains.

*Regulation of Airways.* The Air Mail Act of 1934 placed supervision and control of airlines under three government agencies: (1) The Department of Commerce was placed in charge of safety, development, and maintenance; (2) the Interstate Commerce Commission was given authority to set rates; and (3) the Post Office Department was given authority to negotiate mail contracts.

The failure of the Air Mail Act of 1934 to provide satisfactory control over revenue led to the passage of the Civil Aeronautics Act of 1938, which set up the Civil Aeronautics Authority (CAA) and gave it extremely broad powers to regulate carriers in scheduled flights, determine rates, and issue certificates for entrance into operations. In 1940 the Civil Aeronautics Authority was transferred to the Department of Commerce, but the organization retained its independence as an administrative tribunal under the title of the Civil Aeronautics Board (CAB). Thus, the control of air transportation is separate from the control of other means of transportation under the Interstate Commerce Commission's jurisdiction.

*Communications.* The three major classes of communication utilities operated by private enterprise in the United States are telephone, telegraph, and radio broadcasting companies. To a great extent, telephone companies are subject to state regulation, since these companies operate primarily within a state. Telegraph and broadcasting companies are controlled chiefly by federal agencies, because their services are interstate.

Under the Post Roads Act of 1866, Congress provided construction rights over the public domain to telegraph companies. In 1888 government-aided telegraph companies were subject to ICC regulations as common carriers. The Mann-Elkins Act of 1910 gave general regulatory power to the ICC over wire communication carriers to ensure reasonable rates. Finally, in 1934, Congress enacted the Federal Communications Act, which consolidated the authority of previous regulations and placed it under the newly established Federal Communications Commission.

The Commission has jurisdiction over interstate telephone and telegraph rates and services. One purpose of the Act is to maintain competition in the field of interstate and foreign communications. Thus, combinations of radio and wire communication companies are forbidden. Officers and directors of one company may not hold positions with another without the Commission's approval. The Commission has authority to prescribe depreciation rates and accounting systems and to investigate the management of a company.

Some idea of the impact this regulatory authority has on business may be deduced from the size of the American Telephone and Telegraph Company, which is one of the corporations subject to the FCC. The American Telephone and Telegraph Company controls more than 200 corporations and supervises between 80 and 90 percent of all local telephone companies in the United States. In addition, it has responsibility for 98 percent of all long-distance telephone service and all transoceanic radio service. Western Union Company, Postal Telegraph Company, and all broadcasting systems operating as interstate companies are likewise governed by the FCC.

One interesting provision of the Act is the requirement that the FCC "study new uses for radio, provide for experimental use of frequencies, and generally encourage the larger and more effective use of radio in the public interest." More recently, the Commission has been confronted with the problem of considering the large number of applications for television stations.

Many states have active commissions that supervise public utilities. However, a state commission is limited in that its authority cannot extend beyond the boundaries of its own state.

### Regulation of financial organizations

Deriving from the Constitution its authority to enact legislation to control banking, Congress in 1913 passed the Federal Reserve Act. Under this Act, banks of all kinds holding membership in the Federal Reserve System are subject to periodical examinations by examiners. Besides reviewing the nature of the bank's assets, these examiners also attempt to discover illegal or unsound practices that affect the security of deposits. This Act provides a system to control the kinds of commercial loans upon which member banks may borrow from the federal reserve district banks. Rules for buying and selling commercial paper and government securities and for the determination of reserves are provided. This legislation is the basis for the present banking system.

Under the Banking Acts of 1933 and 1935 member banks of the Federal Reserve System are forbidden to participate in the underwriting of new securities issued by private companies. This provision is intended to prevent bank officials from selling private securities promoted by their bank.

The Federal Deposit Insurance Corporation Act of 1933 was passed to provide depositors insurance on their checking accounts. All banks belonging to the Federal Reserve System are required to participate. State banks may also obtain this type of insurance. More than

90 percent of all banks in the United States, including commercial banks, savings banks, and building and loan associations, are members of the FDIC.

*Securities and Exchange Acts.* The period during the late 1920's will be remembered as an era of investment speculation. Common stocks replaced bonds as popular investments for conservative investors. Corporations, seizing upon the opportunity to increase their capital structure, issued stocks and bonds without adequate security. The record of many investment banking concerns led to public criticism. Congress sought to protect the public from a recurrence of such conditions by passing the Securities Act of 1933 and the Securities and Exchange Act of 1934.[5] The former Act made investment bankers, along with corporation executives, accountants, and others who sign a registration statement of new securities, liable for losses incurred by those who purchase these securities if there has been an omission of material facts or the inclusion of a misleading statement in the registration certificate. As a further precaution, this law required investment banking firms to furnish complete information about the financial condition of corporations whose securities they sell. This information was required to be printed in what is known as a prospectus when a new issue of stock is advertised for sale.

The Securities and Exchange Act of 1934 was designed to accomplish three purposes:

1. To provide the public with current information concerning the financial condition of corporations whose securities are traded on the security market.
2. To prevent manipulation of stock market transactions by corporations for the purpose of giving misleading information about the popularity of a stock.
3. To prevent a disproportionate amount of the reserves of a financial institution from being spent on stock market securities.

The Securities and Exchange Commission (SEC) was given the right to supervise stock exchanges as well as brokerage firms and security dealers. The methods by which a corporation solicits proxies were also placed under the scrutiny of the Commission. Procedures for handling stock tradings were prescribed, and all brokers had to be li-

[5] See Fainsod, Merle, and Gordon, Lincoln, *Government and the American Economy,* pp. 407-409. New York: W. W. Norton & Company, Inc., 1948. This publication contains an interesting discussion entitled "Abuses in Investment Banking and the Securities Market."

censed by the SEC. All the organized exchanges were required to supervise their members by enforcing these regulations. Failure to do this might cause a fine to be levied against the entire exchange. The Maloney Act of 1938 provided for the organization of voluntary associations of investment bankers, brokers, or dealers engaged in over-the-counter markets. These associations were required to supervise their members and draw up specific regulations. In 1939 the National Association of Securities Dealers, Inc., including a majority of over-the-counter dealers, was approved by the SEC.

*Investment Trusts.* More recent legislation adding authority to the SEC was the Wagner-Lea Act, otherwise known as the Investment Company and Investment Advisers Act of 1940. This Act further limited the activities of brokers and investment counselors. For example, all sources of dividends paid by investment companies had to be revealed. This was to prevent investment companies from paying dividends out of capital, as is often done to misrepresent the earning power of the company. Rigid requirements were made for accounting records and independent audits. Before an investment company could issue new securities, it became necessary for the plan to be approved by the stockholders.

Mergers, consolidations, and reorganizations of investment companies must now be approved by the SEC. No investment trust can be organized with a capital of less than $100,000. Likewise, funds of one investment trust cannot be invested in another. The types of securities that the trust can issue are subject to the Commission's approval.

*Commodity Exchanges.* In 1936 the commodity markets were also brought under federal supervision by the Commodity Exchange Act. Among the Act's numerous provisions, an especially important one forbade certain practices. For example, manipulation of the market by causing false activity by means of such transactions as wash sales was prohibited. A wash sale is a prearranged fictitious sale of a security to influence the market. The sale is unlawful because there is no intent to make delivery of the stock. Manipulating prices by obtaining a corner on a commodity was also forbidden. A corner occurs when one individual or a group own sufficient quantities of a commodity to require others desiring to buy to deal with them.

By departmental order, the Secretary of Agriculture in 1947 created the Commodity Exchange Authority with jurisdiction over the activities of the exchanges. All dealers, brokers, and commission merchants engaged in the sale or purchase of these commodities had to be registered with the CEA.

## Labor legislation

Two distinct types of legislation affecting labor and employers have been enacted. The first includes legislation pertaining to working hours, wages, safety regulations, and health; legislation of the second type concerns the rights and responsibilities of labor unions and employers. In this discussion we shall be concerned mainly with federal laws.

*Hours, Wages, Safety, and Health.* The earliest control to regulate working hours applied to women and children. In 1924 a constitutional amendment was submitted by Congress to the states to provide Congress with the power "to limit, regulate, and prohibit the labor of persons under 18 years of age," but an insufficient number of states approved it. However, by 1936 a total of 43 states had passed some social legislation affecting the number of hours women and children could work in industry and business. Many states have also fixed minimum wage rates for women and children. A few have laws regulating minimum wage rates for men.

In 1938 Congress approved the Fair Labor Standards Act, the first federal law to establish a minimum hourly wage for employees in certain industries. Passage of this Act, frequently known as the Wage and Hour Law, was the first attempt by Congress to establish a floor under wages and a ceiling on working hours for certain industries in interstate commerce. During the ten years that followed, industry experienced many difficulties in meeting its provisions. In an attempt to improve the original law, Congress passed a second bill, known as the Fair Labor Standards Act of 1949, which became effective January 25, 1950.

This law included the following general provisions: (1) it increased the minimum hourly wage from 40 to 75 cents; (2) it provided the Wage and Hour Administrator with power to sue employers for employees' unpaid wages if employees authorize the suit; (3) it stiffened child labor restrictions; (4) it increased the scope of the law to include workers in industries not previously covered; and (5) it authorized employers to continue using learners, apprentices, and handicapped workers at an hourly wage of less than 75 cents. No change was made in the provisions limiting the work week to 40 hours unless the employee receives overtime compensation at a rate of not less than 1½ times the regular rate. More than 21 million workers were covered by the law, including an estimated 1½ million employees who had

been earning less than 75 cents an hour. Two important industries, agriculture and retailing, were still excluded.[6]

*Laws Protecting Employees.* Within two months after the National Industrial Recovery Act of 1933 was declared unconstitutional by the U. S. Supreme Court, Congress enacted the National Labor Relations Act of 1935, popularly known as the Wagner Act. This Act guaranteed labor the right to organize and to bargain collectively and defined "unfair labor practices," in which employers are forbidden to engage.[7]

Following the enactment of the Wagner Act, pressure for legislative action to regulate labor practices began to appear. By the middle of 1946 there was a breakdown of the price-control system. Movement was strong for a second round of wage increases. The Republican victory in November of 1946 intensified the movement for union regulations. So, in June, 1947, the Labor-Management Relations Law was passed, partly as an amendment to the Wagner Act and to clarify certain practices further. This law is more commonly known as the Taft-Hartley Act, after the names of the bill's two sponsors. In general, the Act guaranteed the right of workers to choose their own representatives, to bargain collectively, and to join unions, and it prohibited certain practices by unions. Previously only employers could be found guilty of an unfair labor practice.[8]

The third law affecting the benefits of employees is the Social Security Act of 1935, which has since been amended to include additional benefits. These provisions have been discussed in Chapter XIII.

## Regulation of fuel industries

Another large segment of American business is the fuel industry. These are the enterprises that discover and develop certain natural

[6] For a complete analysis of the Act, see *Fair Labor Standards Act of 1949.* New York: Prentice-Hall, Inc., 1949.

[7] "Unfair labor practices" include: (1) interference with employees in preventing collective bargaining or self-organizing activities; (2) dominating labor organizations by financial support; (3) discouraging membership in unions; (4) discharging an employee or discriminating against him for testimony in labor disputes; and (5) refusing to bargain collectively with labor unions.

[8] Labor unions registered strong protest against this law. They objected chiefly to the following provisions: (1) Contributions by labor unions to candidates in federal elections were prohibited; (2) a "cooling-off" period of 60 days was required at the end of a contract negotiation before a strike could be called by the union; (3) an annual financial report of the union had to be filed with the National Labor Relations Board; and (4) the closed shop, in which union membership is a condition of employment, was forbidden, and the union shop, in which workers are required to join a union after they are hired, was allowed only if a majority of the employees eligible to vote approve it.

resources used to operate factories, heat homes, lubricate equipment, and produce electricity. Oil and coal are the two basic fuels. Natural gas is closely related to the oil industry.

*Conservation of Natural Resources.* Conservation is by far the most important reason for federal and state supervision over the fuel industries. In addition, the public is interested in seeing that unfair exploitation of the consumer through monopolistic practices does not occur. The fact that someday this nation may be without adequate reserves of oil, gas, or coal is not a comforting one. To safeguard the future economy of this nation, legislative controls have been enacted as protective devices and conservation measures.

*The Oil Industry.* No one knows exactly how much oil there is in the United States. Recent estimates indicate a possible 18- to 20-years' supply unless new fields are discovered. Approximately 1,500,000,000 barrels of oil are produced annually. It is little wonder that there has been a growing interest in oil conservation and regulation as well as production stabilization.

Since oil was first discovered in the United States in 1859, common-law rules governing the rights of landowners and leaseholders to drill and produce oil not only have failed to encourage conservation but actually have succeeded in encouraging waste. Recognizing the need for conservation measures, Pennsylvania and New York were the first to pass state conservation laws. Oklahoma, Texas, California, Illinois, and Kansas have since followed.

One provision of the National Industrial Recovery Act of 1933 was intended to restrict the shipment of oil as a conservation measure. When this law was declared unconstitutional, the restriction was no longer effective. In 1935 the Connally Act was passed to replace the part of the NIRA that related to oil. This law prohibited all shipments in interstate commerce in excess of the individual state quotas. Previously, states producing oil had established production quotas. The Connally Act created a Federal Petroleum Agency and a Federal Tender Board. All shippers of petroleum in interstate commerce must register their shipments with these agencies. Their doing so provides the federal government with information about how much oil is produced and whether or not production conforms to state quotas. There are those who believe that the oil industry should be given the same status as a public utility, especially in view of the fact that pipe lines are already under the supervision of the Interstate Commerce Commission.

*The Coal Industry.* Bituminous is the technical name for soft coal

and anthracite for hard coal. Soft coal is found in many states, whereas hard coal is mined chiefly in a restricted area. Soft coal is a common fuel for many different industries; hard coal has a limited commercial use. Hence, the problems of marketing and the needs for regulation differ.

Unlike that of oil, our known supply of coal is enormous. Whereas consumption of oil has increased, that of coal has declined. Besides suffering from overproduction, the coal industry has had repeated labor disturbances that have encouraged consumers to change to other fuels. Strikes have resulted in higher consumer prices for coal. The failure of the industry to regulate itself has resulted in public demand for federal intervention.

As in the case of oil, attempts made through the NIRA to control the coal industry proved unsuccessful. Despite this, coal operators gained considerable practical information from the "unfair practices" section of the coal code in the NIRA. Subsequently, the Bituminous Coal Conservation Act of 1935 was declared void in parts.[9]

Finally, the Bituminous Coal Act was approved in 1937. The main provisions of this Act called for minimum and maximum prices of coal sold in interstate commerce. Minimum prices appeared helpful in supporting wages of miners, and maximum prices provided protection for the consumer. To administer the law, the Bituminous Coal Commission was created. Later, President Roosevelt abolished the Commission and substituted a Coal Division in the Department of the Interior.

The act declared that certain unfair methods of competition are violations of the law. For example, the unauthorized use of trade-marks, trade names, or slogans to advertise coal is forbidden. Price discrimination that might result from prepayment of freight charges is prohibited. According to the Act, employees have the right to organize and to bargain collectively.

Some groups have objected to this Act, claiming that because of the abundance of coal regulation is unnecessary. Nevertheless, the policy to regulate the coal industry has been accepted by many as compatible with the general philosophy of conservation in the interest of the public.

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[9] *Carter* v. *Carter Coal Company*, 298 U.S. 238 (1936).

## Terms for Study

Antitrust
Copyright
Deception
Distress sales
Exaggeration
Interstate
Intrastate
License
Loss leader
Misrepresentation
Obsolescence
Over-the-counter securities
Patent
Price discrimination
Price-fixed
Prospectus
Public utilities
Quantity discount
Trade-mark
Wash sale

## Questions

1. What is the basis of authority for government regulation of business?
2. Why is government regulation of business considered necessary?
3. In what ways are taxes a form of regulation or control?
4. What kinds of businesses must obtain a franchise?
5. In return for a franchise, what is a business expected to render to the public?
6. What does a patent provide the owner?
7. How does a trade-mark differ from a copyright?
8. What are some of the more common forms of taxes that retail merchants pay?
9. Name the types of business that are subject to the authority of the Federal Trade Commission.
10. Why are some monopolies illegal and others not?
11. What are some of the private organizations that regulate advertising?
12. What is price discrimination?
13. In the absence of a state law legalizing resale price maintenance agreements, is the Miller-Tydings Act applicable for resale price agreements?
14. Why were the Pure Food and Drug Acts passed?
15. Name some of the unfair practices considered illegal by federal law.
16. How has the regulation of banks by the federal agencies helped business?
17. What are some of the rules the SEC has imposed on brokers, stock exchanges, and commodity exchanges?
18. What are the main objections advanced by labor against the Taft-Hartley Act?
19. How does the regulation of natural resources help business? How does it help the consumer?
20. Why are state laws controlling natural resources less effective than federal laws?

## Problems and Projects

1. Mr. James Rogers proposes to form a corporation to construct a building and operate a supermarket. He plans to carry a general line of mer-

chandise, including meats, dairy products, tobacco, lubricating oil, gasoline, and small electrical equipment for household use. He also intends to furnish delivery service. You are asked to make a study of all the different kinds of city and state licenses and permits he will have to buy, the cost of each, where they can be obtained, and how often they must be renewed. He also wants to know if there are any state or federal regulations applying to retail prices. If he employs nine persons in addition to the owners, what are the kinds of taxes that the corporation must pay? Assume the business is to be located in the city and state where you live.

2. List the advantages and disadvantages of Federal Deposit Insurance to banks and to depositors. State the requirements banks must meet to obtain this type of insurance.

3. Describe how a business uses loss leaders and state what regulations prevail in your state affecting resale price maintenance.

4. What are the main provisions of the Robinson-Patman Act?

5. Prepare a report on the kinds of service rendered by the Better Business Bureau in your community or in a neighboring community.

6. Compare the provisions of the Colorado Unfair Practices Act shown in this chapter with those of the one in your state or with those of the one in an adjoining state.

7. From among current periodicals select a recent case of a company cited by the Federal Trade Commission for violating a business practice. Prepare a review of the case giving the details.

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## Chapter XV

# PRODUCTION IN MODERN BUSINESS

When some people purchase something, they do not stop to think that many hours of labor were expended by others in order to satisfy their wants and needs. It is the purpose of this chapter to show how American business hinges upon production, to discuss the characteristics of production work, and to consider the problem of co-ordinating those activities that combine to constitute industrial production.

The term *production* is used here to mean *the process of co-ordinating men and machines to create from raw materials physical goods to satisfy human needs and wants.* Materials, men, and machines must all be available in one place in sufficient quantities to make production possible and profitable. The complex problem of properly combining them in the production process in such a way as to make goods in a form, at a price, and at a time acceptable to consumers, is the concern of management.

In later chapters we shall see that transportation creates *place* utility and storage creates *time* utility; factory processes create *form* utility.

### Production the Cornerstone of American Business

With the exception of the fresh fruits and vegetables we eat, almost everything we use has been through one or more production processes. The clothing we wear has been through several, most of which took place in separate buildings and probably in different cities. The raw cotton, wool, or silk had first to be spun into thread, then woven into cloth, dyed, and finally tailored into some specific articles of clothing, such as shirts, trousers, skirts, or dresses. The chairs and tables used in the home and the desks used in schools and offices were all once metallic ore, trees, and other raw materials. These raw materials were processed several times before the finished product was completed. Even the food we eat, for the most part, has been processed; the canning of vegetables and fruits in tins or jars is a production process. The containers themselves were manufactured in buildings constructed from bricks, stone, concrete, steel, and wood, all of which had to be

produced. Wheat is milled into flour, which is combined with other ingredients by the baker and made into bread that finally comes to our tables.

More people are employed in manufacturing than in any other major industry. Manufacturing offers jobs to many different kinds of workers—the unskilled laborer, the semiskilled machine operator, the machinist, the engineer, the stenographer, and the production manager. It directly supports approximately one-fourth of all those gainfully employed in the United States.

The importance of production to American business is also brought out by figures showing the total wages paid by manufacturing industries and the amount by which the manufacturing process increases the value of the materials put into production. For example, in 1947 the total wages paid to production workers amounted to 30,248 million dollars. In addition, manufacturing industries paid 9,433 million dollars in office and administrative salaries, making the total paid in salaries and wages 39,681 million dollars.[1]

In 1929, raw materials valued at 37.4 billion dollars were, by manufacturing, increased in value to 67.9 billion dollars, an increase of 82 percent. In 1939, raw materials worth 32.2 billion dollars were, by manufacturing, made into goods worth 56.8 billion dollars, an increase of 76 percent. For the year 1947 the value added by manufacturing was 74.3 billion dollars.[2] The 1939 and 1947 figures for some of the principal industries are shown in Table XV-1.

## Characteristics of Production

As production progressed from the handicraft stage to the increased use of machines, industries became large and complex business structures. Modern business applies scientific principles to work processes, and present-day manufacturing industries require well-trained and experienced executives in industrial management. Several characteristics describe production in modern American business: (1) mechanization, (2) large-scale operations, (3) standardization, (4) specialization, and (5) research procedures.

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[1] *Census of Manufactures: 1947,* Preliminary Industry Report, p. 3. Washington: U. S. Department of Commerce, Bureau of the Census, 1949.

[2] *Statistical Abstract of the United States, 1948,* p. 825. Washington: U. S. Department of Commerce, Bureau of the Census, 1948; *Census of Manufactures: 1947,* Preliminary Industry Report, p. 3. Washington: U. S. Department of Commerce, Bureau of the Census, 1949.

TABLE XV-1. CENSUS OF MANUFACTURES STATISTICS BY MAJOR INDUSTRY GROUP: UNITED STATES, 1947 AND 1939.*

| Major industry group | 1947 | | | | | | 1939 | | |
|---|---|---|---|---|---|---|---|---|---|
| | | All employees | | Production and related workers | | | | | |
| | Number of establishments (units) | Number (average for the year) (thousands) | Salaries and wages, total (millions) | Number (average for the year) (thousands) | Wages, total (millions) | Value added by manufacture † (millions) | Number of establishments (units) | Number of production and related workers (average for the year) (thousands) | Value added by manufacture † (millions) |
| ALL INDUSTRIES, TOTAL | 240,801 | 14,292 | $39,681 | 11,918 | $30,248 | $74,364 | 173,802 | 7,808 | $24,487 |
| Food and kindred products | 39,904 | 1,440 | 3,799 | 1,098 | 2,583 | 9,022 | 43,667 | 802 | 3,485 |
| Tobacco manufactures | 1,087 | 112 | 206 | 104 | 176 | 643 | 765 | 88 | 350 |
| Textile mill products | 8,110 | 1,233 | 2,833 | 1,147 | 2,449 | 5,334 | 6,388 | 1,081 | 1,818 |
| Apparel and related products | 30,905 | 1,081 | 2,530 | 974 | 2,020 | 4,423 | 20,275 | 753 | 1,386 |
| Lumber and products, except furniture | 26,324 | 639 | 1,347 | 599 | 1,188 | 2,513 | 13,208 | 423 | 731 |
| Furniture and fixtures | 7,687 | 322 | 824 | 283 | 654 | 1,379 | 5,178 | 189 | 418 |
| Paper and allied products | 4,103 | 450 | 1,281 | 389 | 1,011 | 2,875 | 3,328 | 270 | 888 |
| Printing and publishing industries | 28,987 | 715 | 2,277 | 438 | 1,318 | 4,269 | 24,878 | 324 | 1,765 |
| Chemicals and allied products | 10,073 | 632 | 1,883 | 467 | 1,226 | 5,360 | 8,839 | 276 | 1,819 |
| Petroleum and coal products | 1,387 | 212 | 740 | 170 | 559 | 2,017 | 1,227 | 108 | 697 |
| Rubber products | 875 | 259 | 783 | 215 | 615 | 1,303 | 595 | 121 | 406 |
| Leather and leather products | 5,307 | 384 | 874 | 349 | 725 | 1,485 | 3,505 | 327 | 583 |
| Stone, clay, and glass products | 11,650 | 462 | 1,211 | 406 | 995 | 2,307 | 6,678 | 267 | 856 |
| Primary metal industries | 5,363 | 1,157 | 3,601 | 1,010 | 2,981 | 5,775 | 3,512 | 672 | 2,169 |
| Fabricated metal products | 16,729 | 971 | 2,828 | 822 | 2,184 | 4,918 | 9,532 | 451 | 1,401 |
| Machinery (except electrical) | 17,907 | 1,546 | 4,807 | 1,244 | 3,595 | 7,817 | 8,860 | 536 | 2,037 |
| Electrical machinery | 3,973 | 801 | 2,274 | 639 | 1,647 | 3,894 | 1,979 | 248 | 942 |
| Transportation equipment | 3,706 | 1,180 | 3,713 | 985 | 2,934 | 5,860 | 2,012 | 545 | 1,773 |
| Instruments and related products | 2,599 | 232 | 665 | 182 | 468 | 1,080 | 1,292 | 85 | 333 |
| Miscellaneous manufactures | 14,125 | 464 | 1,205 | 397 | 920 | 2,090 | 8,084 | 242 | 630 |

* *Census of Manufactures: 1947,* Preliminary Industry Report, p. 3. Washington: U. S. Department of Commerce, Bureau of the Census, 1949.

† Value added by manufacture is computed by subtracting cost of materials and supplies from value of shipments.

### Mechanization

Modern business in America emphasizes the use of machines. Whereas the machine was once secondary to the worker, the worker now supplements the machine. For example, all shoes were once made by hand; the shoe industry is now almost completely mechanized with semiskilled labor operating the machines. Some expensive boots, especially those made to order for cattlemen in the Southwest, are still made by hand. Furniture manufacturing is another example of an industry that is largely mechanized, although some expensive custom-built furniture is still hand-made.

The bituminous coal industry has been modernized with power machines replacing the pick and shovel. Whereas almost all coal was once cut by hand, in 1949 "more than 91 percent of production was mechanically cut and 60 percent was mechanically loaded." [3]

Automobiles, office appliances, and clothing are still other examples of almost completely mechanized production processes. Laborers are used in large numbers, but they are employed to operate machines and supplement the work of the machines. The manufacturing process is built around the machine rather than the man.

This mechanization of industry not only gives greater production but also increases the productivity of each worker. The principal advantages of mechanization are that it gives a higher quality of product, a greater degree of accuracy in production, and a more uniform product.

### Large-scale operations

The use of machines makes it possible to manufacture goods by mass production. Because overhead charges do not vary in direct proportion to volume, the trend has been toward larger business units. Mass production has brought about lower unit costs. Lower prices for raw materials, resulting from the purchase of larger quantities, and lower unit costs for labor have further helped to bring about lower sales prices for the articles. Lower prices have helped to increase demand, and this supported the increased production volume. Mass production has also made it profitable to manufacture useful by-products from substances that were formerly waste material. Where the production was small, there was not sufficient waste material to justify attempts to salvage it.

[3] Personal letter dated August 12, 1949, from Mr. T. A. Day of the Bituminous Coal Institute.

For example, let us assume the following production costs for the manufacture of 10,000 units of an article:

| | | |
|---|---|---|
| Raw materials | $50,000 | ($5.00 per unit) |
| Labor cost | 30,000 | ($3.00 per unit) |
| Overhead | 10,000 | ($1.00 per unit) |
| Total cost | $90,000 | ($9.00 per unit) |

Production is increased fivefold. Raw materials are purchased at a slightly lower figure because of volume purchases. Also, mass production makes possible lower unit labor costs because larger and faster machines can be used. Overhead increases only 20 percent. The increased volume of materials also makes possible the recovery of a small sum from the sale of waste material. The following figures represent the costs for 50,000 units:

| | | |
|---|---|---|
| Raw materials | $225,000 | ($4.50 per unit) |
| Labor costs | 100,000 | ($2.00 per unit) |
| Overhead | 12,000 | ($0.24 per unit) |
| Total cost | $337,000 | |
| Less recovery from sale of waste | 2,000 | |
| | $335,000 | ($6.70 per unit) |

Whereas the cost was $9.00 per unit in 10,000 lots, it is only $6.70 per unit in 50,000 lots.

In contrast to bringing about advantages, large-scale production, of course, magnified the number and degree of problems of management. The larger the business, the greater the need for co-ordination, organization, administration, and supervision.

## Standardization

Standardization in industry involves the determination of one uniform method for the performance of each task and thereafter always following that method. Standardization includes more than method; equipment, machine parts, products, procedures, processes, and techniques are all made to conform to uniform patterns. Standardization makes it possible to utilize specialization and to reduce costs through quantity purchases of raw materials.

One of our earliest records of standardized manufacturing processes was in the production of firearms. Eli Whitney suggested that gun parts be standardized to make it possible to interchange parts and thus avoid having to throw away guns for which there were no parts to replace those worn out. This idea was greatly extended during World War I; the War Industries Board, for example, encouraged standardi-

zation of materials and supplies. After World War I, the American Standards Association encouraged co-operative efforts toward increased standardization of products. During the Second World War the same standards for war supplies and material were used by several allied nations.

*Courtesy Automobile Manufacturers Association*

*Figure 15-1.* Large-scale industry employs the methods of mass production.

Frederick W. Taylor, whose contributions to scientific management were discussed in Chapter V, suggested that it is necessary to standardize raw materials, tools, machinery, and supplies before work methods can be standardized. Standardization of work methods will be discussed more fully later in this chapter in connection with the section on production control through motion study.

## Specialization of labor

When this country was first settled, the family was an almost self-sufficient unit. The members of each family raised their own food,

made their own clothing, and built their own homes. Today, a contractor is employed to build homes; he then hires plumbers, carpenters, painters, and unskilled laborers, each to do a specific type of work. This same principle applies to an even greater degree in modern industry. One worker not only restricts his activities to the operation of a lathe, for example, but also machines only certain parts. One person inserts bolts in a machine casing and starts the nuts on the bolts; a different person tightens them. One has only to examine the *Dictionary of Occupational Titles* to realize the degree to which industry is

*Courtesy Burroughs Adding Machine Company*

*Figure 15-2.* Modern factory work is specialized; each man has a certain job to do.

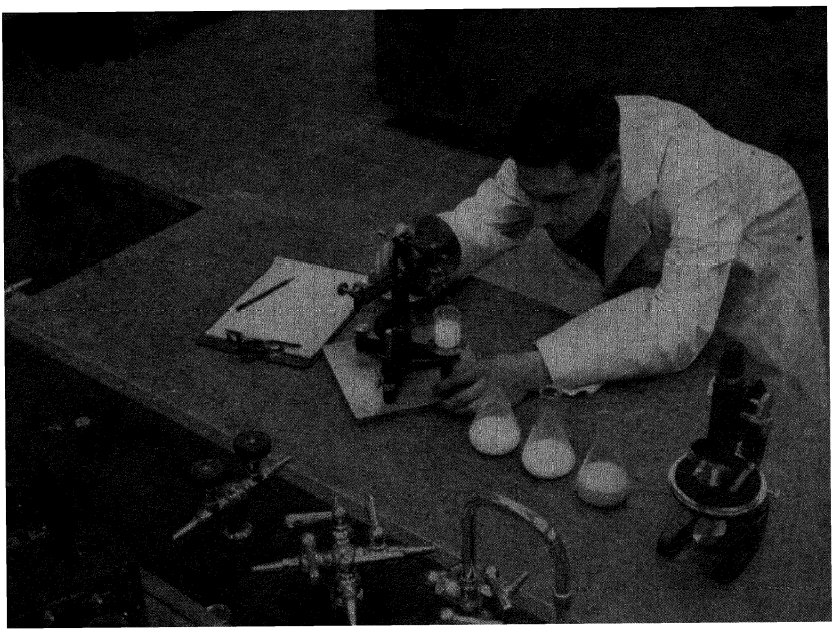
specialized. Pages 81 to 129 inclusive of Volume II (March, 1949, edition) are devoted to occupations in manufacturing and related activities, with from 15 to 25 different jobs described on each page. As an example of the degree of specialization given, there are 23 different types of machinists in addition to fitters, instrument makers, layout men, job setters, diemakers, toolmakers, lathe operators, and milling machine operators, all of whom are in a sense machinists also.

Figure 15-2 illustrates specialization, each worker having a different work to perform but all working together to complete the finished

product. Mechanized, large-scale, standardized production goes hand in hand with specialization of labor.

## Research procedures

Business management recognizes the importance of research, as was shown in Chapter VIII. In addition to market research and research to develop new products, there is research that has as its objective the perfection of new production machinery, the development of new production processes, the reduction of waste by utilization of a larger percentage of raw material, and the development of new designs and styles for the finished product.



*Courtesy The Firestone Tire & Rubber Company*

*Figure 15-3. Technician at Work in Research Laboratory.*

Large businesses spend millions of dollars on research; many of them have new buildings equipped throughout for carrying on research. The research laboratory of the Goodyear Tire and Rubber Company was built during World War II at a cost of one and a quarter million dollars. Their research and development organizations employ more than 1,000 persons. The Johns-Manville Corporation spent 1.7 cents per dollar of sales, or $2,414,000, for research during the

12-month period ending May, 1948, and announced plans for increasing this expenditure to 2 cents per sales dollar.[4] The annual report of the International Business Machines Corporation for 1948 showed "development and engineering expenses" of slightly over three and one-quarter million dollars. The iron and steel industry spends approximately one-half million dollars per year on industry-sponsored research. This is in addition to sums spent by individual steel companies.[5] The trend is toward greater appropriations for research, and research budgets are among the very last to be curtailed.

## The Nature of Production Processes

The process of manufacturing a finished product is begun after the raw materials are assembled. A finished product in one industry may be considered a raw material by another that uses it in the manufacture of a more complex product. For example, a copper mine is concerned with separating the mineral from the earth. Naturally, there is a lot of slag included with the ore; the smelter takes the end product of the mine and separates the pure copper from the slag. This finished product of the smelter is raw material for other industries that use copper in manufacturing wire, cooking utensils, and other articles.

There are several different types of production processes. Most of them would be included in one of the following groups: extractive, analytical, synthetic, assembling, or fabricating.

### Extractive processes

One of the basic types of production processes is that of extracting minerals from the earth. Examples of extracting industries are salt, coal, copper, lead, zinc, silver, and gold mines; and refineries where sugar is extracted from sugar cane and sugar beets.

### Analytical processes

Analytical processes involve the breaking up of one substance into several. After petroleum is extracted from the earth, it is piped to refineries where it is broken up into several products: gasoline, which is in a sense almost a by-product; lubricating oils; and bases for several oil products, such as fuel oil, petrolatum, coke, asphalt, and paraffin.

The meat-packing industry is another excellent example of the ana-

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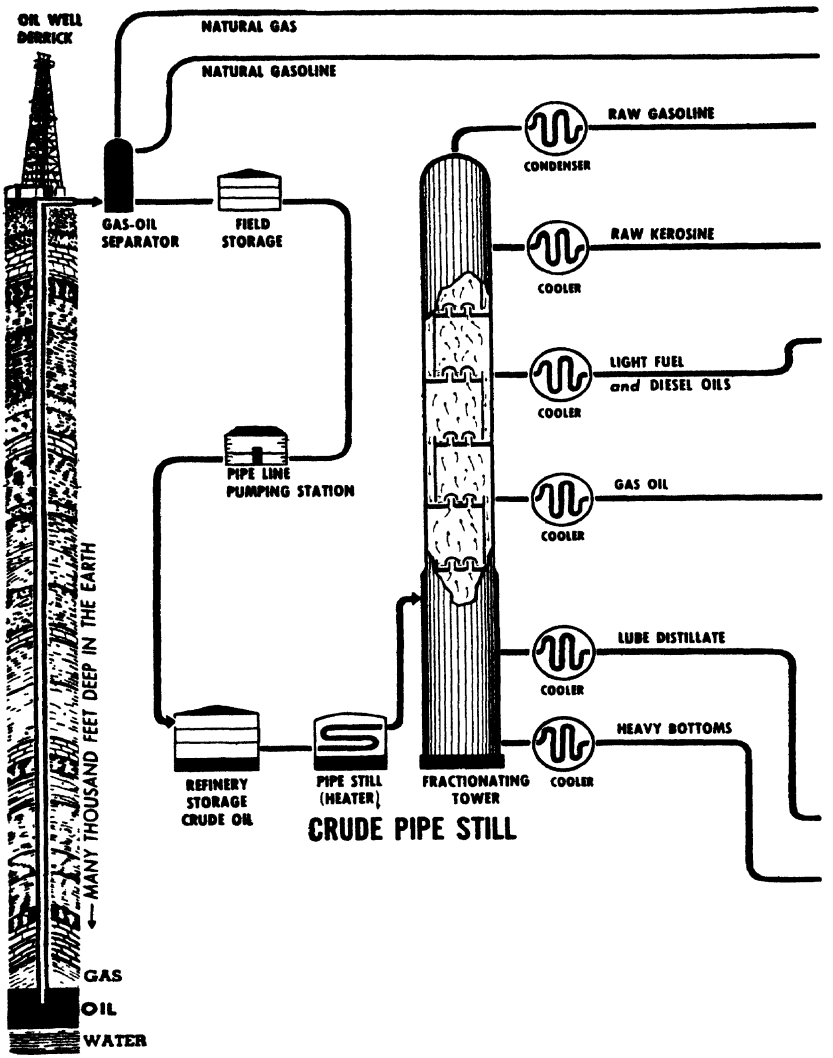
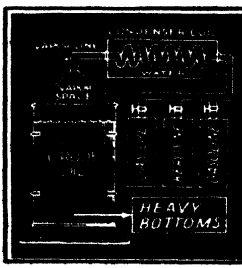
[4] *Stockholders News,* May, 1948, p. 15. New York: Johns-Manville Corporation.

[5] Personal letter dated July 19, 1949, from Mr. George S. Rose, Secretary, American Iron and Steel Institute.



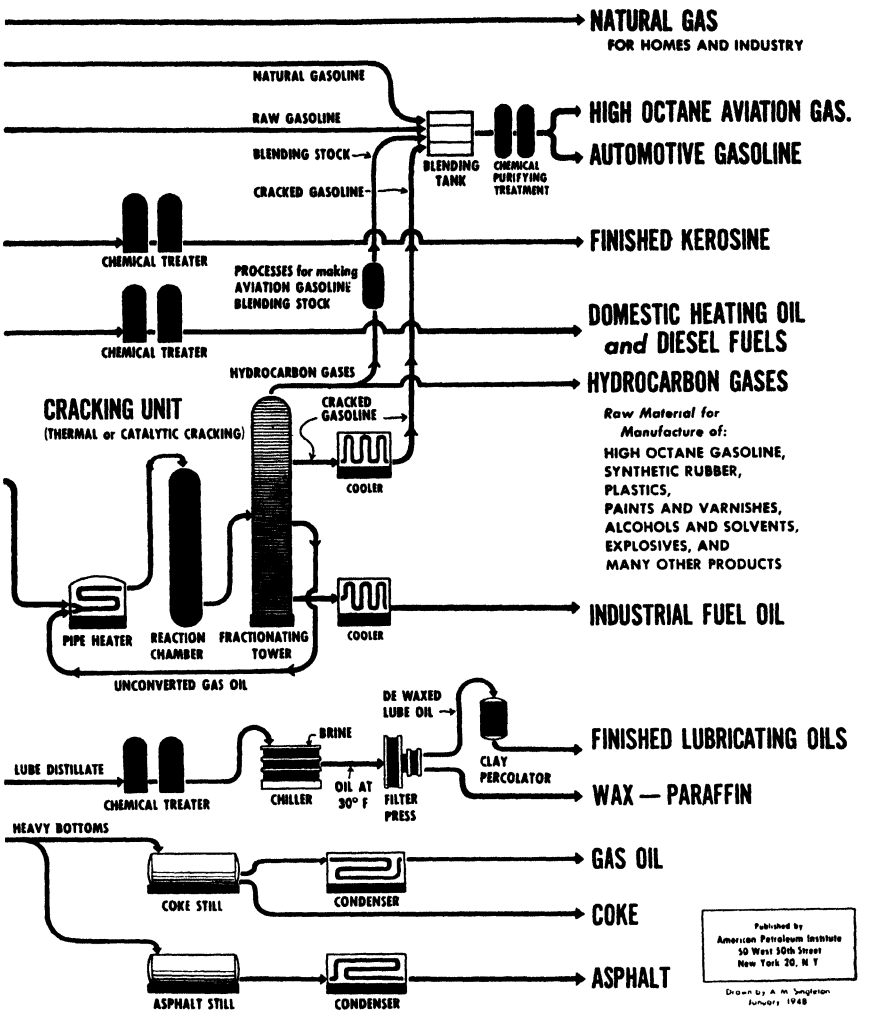

## CRUDE PIPE STILL




IN ITS SIMPLEST FORM the process of petroleum refining consists in heating the crude oil in a still to its boiling point, passing the vapors from the boiling oil thru condensing pipes and condensing the vapors into liquids.

APPROXIMATE YIELD OF PRODUCTS FROM 100 GALLONS OF CRUDE OIL

| | |
|---|---|
| GASOLINE | 44 Gallons |
| FUEL OILS | 16 Gallons |
| MISCELLANEOUS (Coke, Asphalt, Wax, etc. | 8 Gallons |
| KEROSINE | 6 Gallons |
| LUBRICANTS | 3 Gallons |
| LOSS | 3 Gallons |
| Total | 100 Gallons |




*Courtesy American Petroleum Institute*

*Figure 15-4. Typical Flow Chart Tracing Crude Oil from Well to Finished Products.*

lytical process. The main product is dressed meat; the hides, from which finished leather is made, are considered a by-product; from the wastes are manufactured many products, such as fertilizers, soaps, chicken feed, and dog food.

One of the problems faced by management in industries where analytical processes are employed is getting all products to come out even, not in the sense of equal volumes, but from the standpoints of production time and marketing problems. The processing of the main product would undoubtedly support a full complement of workers continuously. On the other hand, some of the minor products may be produced irregularly; men must be employed to work with them, but they are kept busy only irregularly, and during the interims other work must be provided. In some cases production of a main item may produce larger quantities of minor products than the company is able to market.

### Synthetic processes

To synthesize means to put together. Synthetic production processes are those in which several raw materials are combined to make one article. In a sense, they are the opposite of analytic processes. Alloys, concrete, rayon, rubber, and plastics all involve synthetic processes.

The fact that such processes require several different types of raw materials in varying quantities may give rise to serious storage problems. Care must be exercised to insure that adequate supplies of all needed materials are on hand. The problem of purchasing and storing raw materials will be discussed later in the chapter.

### Assembling processes

The term *assembling* is used here to refer to the gathering together of individual parts and fitting them together into one product. The manufacture of most types of machinery involves assembly processes. Parts are manufactured first, many of them usually by synthetic and fabricating processes; then these parts are put together to form an operating unit. Automobiles, adding machines, and machine-made furniture are all examples of assembling processes. Auto manufacturers have plants where parts are not made but only assembled, as well as factories where parts are both manufactured and assembled. In 1949 the automotive industry in this country had 112 final-assembly plants, located in 77 cities in 24 different states.[6] As a general rule, producers

[6] *Photo Catalog*, p. 11. Detroit: Automobile Manufacturers Association.

of intricate machinery manufacture most of their own parts but let out subcontracts for the manufacture of small parts and accessories and assemble all of these into a finished product.

### Fabricating processes

The word *fabrication* refers to manufacturing processes by which materials are changed or converted into different forms. Automobile and aircraft plants take sheet metal and shape it into the forms required to make up the body of a car or plane. Manufacturers of glass products change the shape or sometimes the texture of their materials to suit the needs of the article being produced. The making of shoes, steel files, and metal tables and chairs involves fabricating processes.

## Choice of Plant Location

Every new business is confronted at the outset with the problem of choosing the best possible location. The choice is important because location determines to a great extent its ability to compete advantageously with other business enterprises. It was mentioned in Chapter VIII, "Statistics and Research in Business," that a retail business is interested in the number and type of people who normally pass along the street in front of different sites as one of the factors in choosing a location. Proper location is as important to the industrial establishment as it is to the retail store, and possibly even more important, because several factors that do not concern the retail establishment are very important to the manufacturing firm. Some of these are: (1) nearness to raw materials, (2) proximity to markets, (3) adequacy of transportation facilities, (4) availability of labor, and (5) supply of cheap fuel and power. It is impossible to rank these in order of importance because, whereas for one type of industry raw materials may be most important, for other types different factors may take precedence. The best location can be determined by striking a proper balance among all the factors.

### Nearness to raw materials

The cost of raw materials, on the average, constitutes more than half the value of the finished product, as was brought out by the figures presented early in this chapter. In addition to such materials as cotton, wool, and iron, which enter directly into the finished product, auxiliary goods, such as chemicals, mill supplies, and packaging materials, are also used.

The nature of the material used in the production process and the

size and bulk of the finished product, in relation to the bulk and weight of raw materials going into that product, are the most important factors that determine whether a factory must be close to the source of its raw materials.

### Proximity to markets

The market for a product is one of the most important factors considered by industrialists when choosing a plant location. It is important that most products be manufactured near the market area but this is not essential in the case of those products that have a high value for a small bulk, such as jewelry, fountain pens, and cutlery. It must be remembered that proximity to markets is more important in terms of the time and expense required to ship a product to customers than in terms of actual mileage.

One reason that nearness to markets is important is that it enables the manufacturer to give better and quicker service. For example, promptness is essential in the manufacture of paper stock for newspapers; in the case of supplying fuel, especially oil and coal; and in maintenance service on machinery and equipment, such as refrigeration units in drugstores and meat markets, and elevators in warehouses and office buildings.

A second reason why it is important to locate near markets is to reduce distribution costs of finished products. To transport weighty products of small value great distances could easily double their cost and make it impossible to compete with factories located near the market area. Manufacturers of auto accessories are located near auto factories for both these reasons: in order to give prompt service and to avoid excessive transportation costs. Delicate machinery must be well packed, and the weight of heavy crates increases shipping costs.

The perishable or fragile nature of some manufactured goods is a third reason for locating near markets. Producers of bakery goods and ice cream must of necessity be located near their buyers. The furniture industry is located near markets because of the difficulties encountered in packing furniture as well as the high cost of its transportation.

### Adequacy of transportation facilities

Transportation has been mentioned as a cost factor in both the preceding sections. A company must meet the prices and service of its competitors. Where transportation costs are an important factor, a location near markets or raw materials or both is mandatory.

Manufacturing and transportation are interdependent; industrial

areas both depend upon transportation facilities and attract them. There is no doubt that such cities as St. Louis, Chicago, and New York have become increasingly important as trade and industrial centers because they are well served by transportation facilities. Where several methods of transportation are available, such as by air, rail, highway, and water, both urgency and economy must be considered in choosing the particular method to be used.

### Availability of labor

Although there is usually an adequate supply of unskilled labor in any large city, skilled labor has a tendency to concentrate in areas where specialized training and skill are needed. For this reason, industries that require a particular type of skill usually locate in regions where the specialized type of skilled labor needed is concentrated. Examples of such skilled workers are diemakers, patternmakers, and foundry workers.

Industries in which the cost of unskilled labor is a large part of the total production cost are interested in areas where low labor rates prevail. This accounts in part for the location of the cigarette industry in the South and the migration of the textile industry from New England to the South.

In the past, industrialists looking for new plant sites preferred areas where labor unions were not highly organized. Three factors now operate to make this a rather unimportant consideration. One of these is the continual progress toward unionization of formerly unorganized areas. A second is the increasing recognition by industrial management of collective bargaining as desirable and as possessing advantages for management as well as labor. A third factor is the trend toward wage rates for unorganized labor in most areas that are more nearly equal to those for organized labor.

### Supply of cheap fuel and power

Industries that use heavy machinery must choose locations in communities where a large supply of cheap power is available. Many of our earliest industries located along the swift streams of New England, where water power was available. Industries that are dependent upon coke and coal, such as the steel industry, locate near abundant coal fields. Other industries locate near sources of cheap electrical power, such as the Niagara district and the area serviced by the Tennessee Valley Authority. Gas, for fuel and power, is making inroads upon coal as a source of power.

## Other factors

Several other factors help to determine not so much the geographical area as the community and particular building site. One of these is the ease of securing financial backing from loaning institutions. Another is the advantage of low property taxes and even exemption from taxes for an initial period of from one to five years. Another is the special inducements offered by some communities in the form of land donated for building sites. Construction costs, zoning regulations, availability of housing for employees, and nearness to competitors are other factors in choosing industrial locations.

## Geographical distribution of manufacturing

All these factors combine to make certain geographical areas most desirable for factory locations. A tabulation of the distribution of wage earners and the value added by manufacture for nine geographical areas is presented in Table XV-2. The data in this table show that,

TABLE XV-2. GEOGRAPHICAL DISTRIBUTION OF MANUFACTURING: 1939 AND 1947.*

| *Division* | *Percentage Distribution of Wage Earners* | | *Percentage Distribution of Value Added by Manufacturing* | |
|---|---|---|---|---|
| | *1939* | *1947* | *1939* | *1947* |
| New England | 12.1 | 10.5 | 9.8 | 9.3 |
| Middle Atlantic | 28.5 | 27.3 | 29.8 | 27.9 |
| East North Central | 27.8 | 29.9 | 31.5 | 31.5 |
| South Atlantic | 12.5 | 11.3 | 9.1 | 9.3 |
| East South Central | 4.5 | 4.7 | 3.4 | 3.9 |
| West South Central | 3.3 | 3.8 | 3.3 | 4.1 |
| West North Central | 4.9 | 5.3 | 5.5 | 5.5 |
| Mountain | 0.9 | 1.0 | 1.1 | 1.1 |
| Pacific | 5.5 | 6.2 | 6.5 | 7.4 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 |

* Percentages were calculated from data contained in *Census of Manufactures: 1947*, Preliminary Industry Report, p. 4. Washington: U. S. Department of Commerce, Bureau of the Census, 1949.

geographically, manufacturing is concentrated in the northern states running from the Mississippi River to the Atlantic seaboard. (There are important elements also in the South and on the West Coast.) Factories in this northern group of states employed 68.4 percent of all production workers in 1939 and 67.7 percent in 1947. Factories in this

area accounted for 71.1 percent of the total value added by manufacturing in 1939 and 68.7 percent in 1947.

## Plant Layout

After a plant location is chosen, the problem of plant layout must be solved before construction can begin. In fact, the amount of space needed for the most efficient arrangement of plant and equipment frequently plays an important part in choosing the building site. Management is concerned with producing quality merchandise at low unit costs, and this necessitates proper planning for plant layout and the placing of equipment. To keep unit costs low the plant and equipment

*Courtesy The Austin Company*

*Figure 15-5. Modern Ore Beneficiation Plant of the Manitoa Corporation, Designed by The Austin Company.*

arrangement must permit a free flow of work, a minimum investment of capital, and desirable working conditions for employees. Some of the factors that must be considered are: (1) the nature of the manufacturing process; (2) the extent and nature of mechanization; (3) provisions for heat, light, and power; and (4) provisions for flexibility and future expansion.

The type of building needed is very closely related to plant layout. They are actually planned simultaneously, each influencing the other. Where the building is purchased or leased, the layout must be adapted to the building as it will appear when alterations are completed. On the other hand, the layout required will determine the nature and extent of plant alterations. Whether the building is purchased or leased will make some difference in the amount of remodeling that will be permitted. The most ideal situation is the construction of a new building planned in terms of the layout desired.

### Nature of manufacturing process

If only one or two stock products are made, it is possible to plan for a continuous production process where machines are arranged in a production sequence. On the other hand, if many products are manufactured and adaptations for special orders are needed, it is usually preferable to group similar machines together. In this case, there is no single uniform process and no continuous assembly-line technique. Plants that manufacture rayon, steel, and glass exemplify continuous production processes; a job-order printing establishment is an example of a "jobbing" type of industry. The differences in manufacturing processes necessitate different layouts of plant and equipment.

### Extent of mechanization

Where most of the work is performed by machines, the arrangement must be conducive to a free flow of work from one stage of production to another, with a minimum of handling. If there are many workers such as machinists or carpenters, there must be provision for freedom of body movement, and the amount of handling of materials is expected to be greater.

### Provisions for heat, light, and power

It was shown in Chapter X, "Personnel Management," that working conditions are important to worker morale and efficiency. Good lighting and color, for example, give lower unit costs and result in fewer

accidents, less fatigue, less spoilage and waste, lower turnover rates, and increased productivity.

We have seen earlier in this chapter the importance of fuel and power in determining plant location. This factor is equally important in planning plant layout; interruption of the power supply causes idleness of both men and machines. It is essential that proper wiring and fuse installations be provided to handle a peak load. Special power engineers should be consulted to insure that the layout will be adequate and efficient to provide for whatever may be necessary in the way of power usage.

### Flexibility and future expansion

Except where production procedures are standardized and there is little likelihood of change, possible future changes in layout should be considered. Installations of new and larger machines at a future date may require more floor space. Future growth of the business may necessitate shifting departments and adding to plant facilities. The extent to which these changes can be anticipated and planned for originally will in large measure determine the degree of efficiency in layout possible with new and enlarged production facilities. Buildings should be designed in such a way that additions can be made with a minimum of disruption and expense. Plant layout can be so planned that present facilities need not be changed when the building is enlarged.

### Other factors

Whether the building is all on one floor or occupies several floors makes a difference in placing heavy machinery and planning for storage space. The amount and type of elevator service available is another important consideration. The existence of loading docks and railroad spurs or the possibilities of building them must also be taken into account.

## Materials Purchases and Inventory Control

The expenditure for raw materials is the largest cost item in most production businesses. It was pointed out earlier in the chapter that, on the average, the cost of materials constitutes more than half the value of the finished product. It is important to buy materials at a favorable price and to exercise control over them to prevent loss, waste, and theft.

### Purchasing problems and procedures

The responsibility for making purchases should be delegated to one person in order that effective control may be exercised. Requests for purchase of materials should come to him, and perpetual inventories of materials should be maintained. The purchasing agent must not only know the needs of his firm but must also be acquainted with the market and price trends. Some of the problems connected with purchasing are: (1) familiarity with materials needs; (2) purchasing policies; and (3) purchasing routines.

*Familiarity with Materials Needs.* Purchasing for production is concerned almost exclusively with buying to meet specifications. The specifications are supplied to the purchasing agent by the engineering staff; the agent places the orders and follows through to see that the materials are delivered. Such items as lumber, bars of iron, and raw wool have specifications that are standard throughout industry. The person responsible for making purchases must know and understand the manufacturing processes employed by the company and for what purposes materials are to be used, in order to buy intelligently. He must know the different qualities available and what qualities are needed. He must also be watchful for new products, improvements, and acceptable substitutes.

*Purchasing Policies.* When prices tend to remain stable or when prices are increasing, a company is likely to buy in relatively large quantities. When prices are fluctuating considerably and when prices are declining, orders for materials are smaller and are placed more frequently. One must know how to strike a proper balance between volume buying and "hand-to-mouth" purchases. The availability of needed goods and the amount of capital to be invested in materials inventories are important factors to be considered. Quantity discounts that may be taken and storage facilities that will be required must also receive attention.

Whether to purchase the company's total needs for a particular item from one firm or to split it among several, thus maintaining contacts with several companies, is a matter of company policy that must be decided. Are customers to be given preferences—that is, are materials to be purchased from customers whenever possible? Is it advisable to make a contract with a particular firm, agreeing to purchase from it for a relatively long period of time? Is speculation to enter into purchasing or are all risks connected with price fluctuations to be covered by hedging? All these factors enter into the determination of company

policies, which the purchasing agent carries out after they have been established. He must take care to maintain a supply of materials slightly above the amount required to meet current needs. He must place his orders and time their delivery in such a manner as to correlate delivery with production schedules.

*Purchasing Routines.* Under a centralized purchasing system the *purchase requisition* is used as the initial device to secure additional materials. It sets forth the specifications for the new materials to be ordered.

The purchasing department should maintain a file giving needed information on all available suppliers. This information should include the name and address of the supplier, descriptions of materials, prices, terms, and discounts. It may be deemed advisable to ask for bids before placing large orders.

The next step is to prepare the *purchase order.* Whereas the purchase requisition is an intracompany form, the purchase order is sent to the supplier. It contains information taken from the purchase requisition relative to quantity, price, and description or specifications.

It is customary practice to follow up on purchase orders for materials in order to insure delivery according to schedule. The reason for this is that orders are placed and delivery dates set to assure the arrival of materials before they are actually needed but not early enough to cause a congestion in the storage departments. The person responsible for following up on the order contacts the vendor a few days before delivery is expected in order to make sure that shipment is planned according to the original schedule.

When the goods are received, they are checked by the receiving clerk against the vendor's invoice and also against the purchase order. (A copy of the purchase order is customarily sent to the receiving department when the order is initiated.) The receiving clerk is responsible for seeing that quantity and quality are correct and for reporting discrepancies to the purchasing department.

## Storage

Materials must be stocked in sufficient quantities to support an uninterrupted flow of work. This makes the problem of storage an important one. Some of the different types of storage that must be provided are facilities for the following:

1. Raw materials, such as minerals, lumber, and cotton, that enter directly into production.

2. Supplies, such as oils, chemicals, and abrasives, that are consumed in the production process.

3. Service materials, such as tools, cleaning fluids, janitorial supplies, and replacement parts for machinery.

4. Office supplies and records.

5. Goods-in-process—goods partially manufactured but awaiting completion. (Such facilities are needed only when the product being manufactured is not completed in one continuous process.)

6. Cartons, boxes, and metal containers in which finished goods are packed or crated for shipment.

7. The finished goods themselves while awaiting shipment.

It must be remembered that storage is an important production cost because capital is invested in all the items for which storage is provided. Management is faced with the problem of striking a proper balance among several factors, such as keeping adequate stores on hand to assure a continuous flow of work, purchasing in quantities that afford attractive prices and discounts, and keeping the capital investment in storage facilities and materials to a minimum. The problem of labor costs in handling materials is also an important one.

### Inventory control

Control over inventories of raw materials and supplies is of great importance to management. This must necessarily be so if a shortage is to be avoided, if production is to be kept moving, and if investment in inventories is to be kept at a minimum. Consequently, when materials are received, accurate records are prepared and systematic procedures are followed to keep management fully informed about how much material is in the factory and what progress it is making. When materials and goods-in-process pass from one department to another, accurate records are kept of such transfers. Adequate control of inventories requires several procedures:

1. Accurate records of stores, prepared by the receiving department as materials are received.

2. Systematic classification and storage in separate compartments.

3. Maintenance of perpetual inventory records of all stores on hand.

4. Verification, at intervals, of perpetual inventory records by physical inventory count.

5. Maintenance of separate inventories for raw materials, supplies, and goods-in-process.

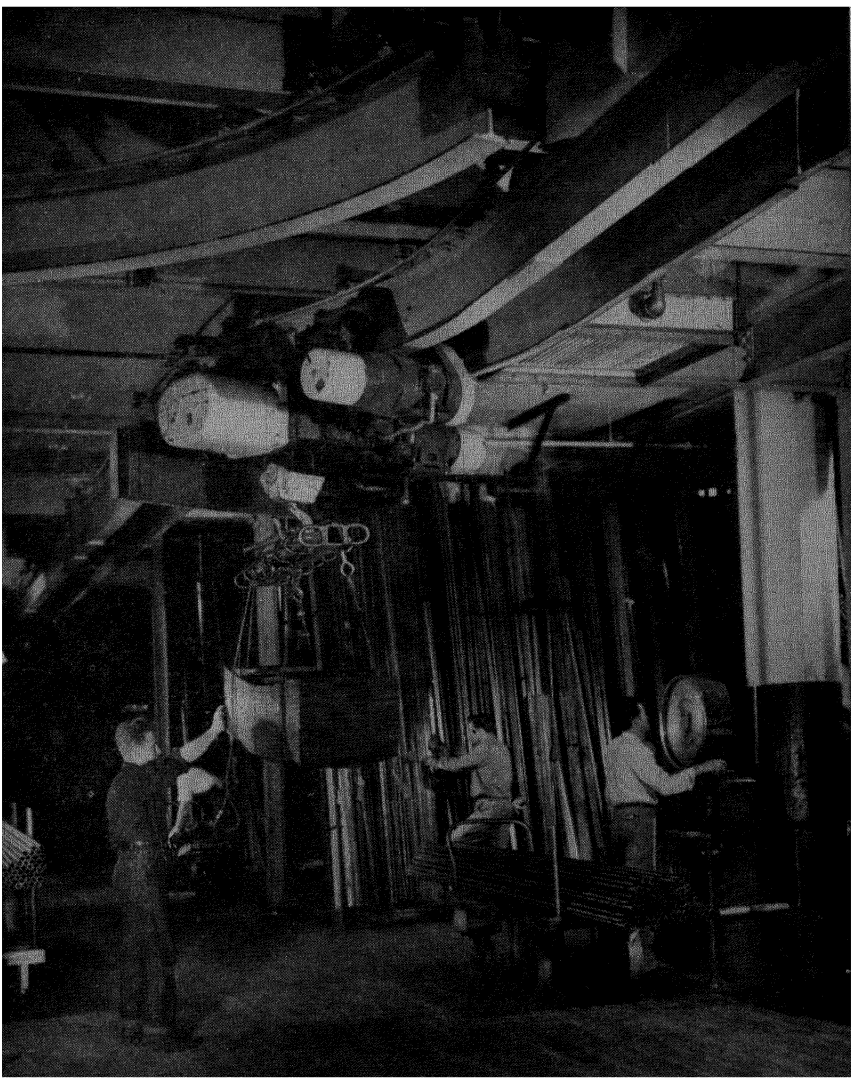
6. Issuance of raw materials and supplies by written requisition only.

These requisitions should be dated and signed; they should show exactly what was issued, when, to whom, and for what purpose.

7. Standardization of materials and parts where practicable.

8. Establishment of upper and lower limits within which inventories are to be maintained. These must fluctuate to a certain extent, for they are based upon production rates.

9. Close co-ordination of inventory records and purchasing activities.



*Courtesy Burroughs Adding Machine Company*

*Figure 15-6.* Proper control requires accurate accounting for all raw materials.

It is important that production, purchases of materials, and investments in inventories be geared to sales. Management must be alert and the organization plan must be flexible and adaptable to market demands. Careful planning and accurate estimates of future needs are called for.

## Production Control

The purpose of production control is to maintain a smooth, constant flow of work from raw material to finished product, making it possible to complete the product in the shortest possible time and at the lowest possible unit cost. The accomplishment of this task requires co-ordination of all the factors that enter into the production process—materials, machines, men, and methods.

### Control through planning and procedures

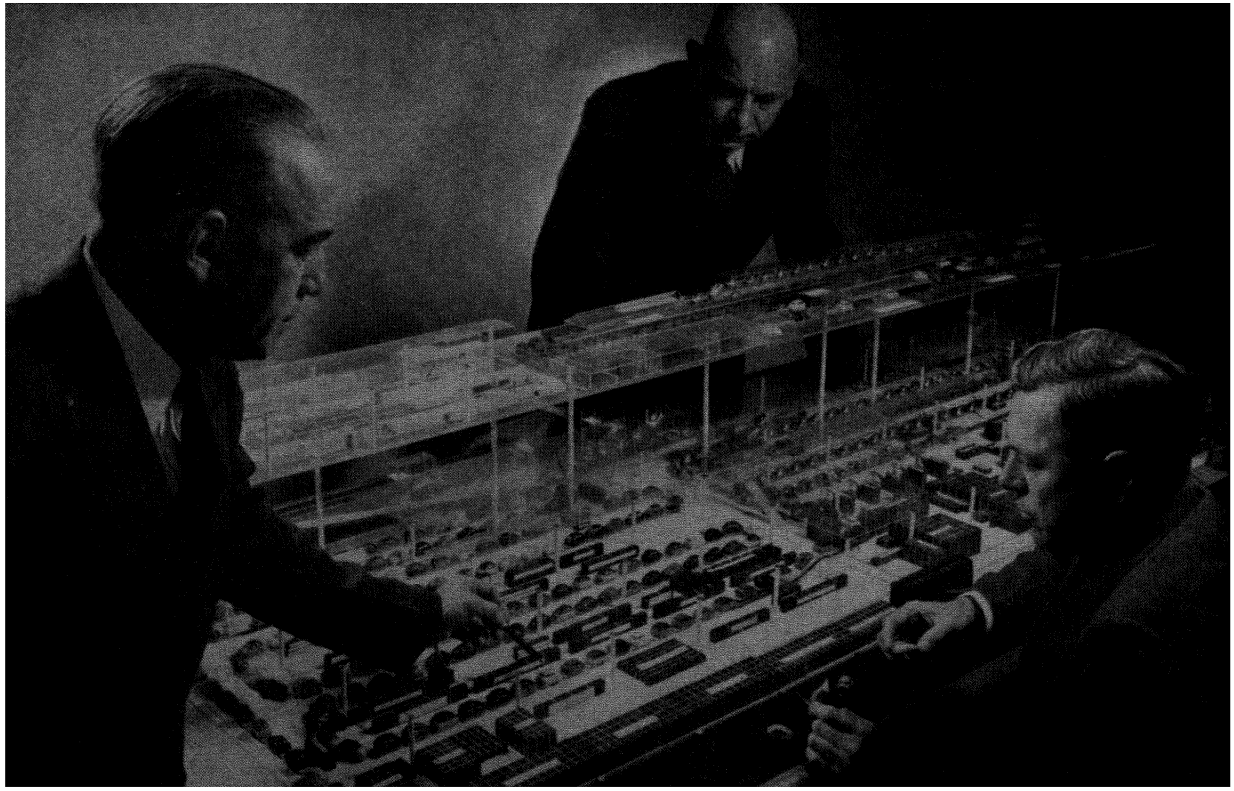
The steps in production control are (1) planning, (2) routing, (3) scheduling, and (4) dispatching.

*Planning.* The basis of efficient production is organization and planning. Proper routing, scheduling, and dispatching are dependent upon proper planning. The versatility of the plant's operations must be understood; the plant capacity and total amount of work in process must be known at all times.

For several items specific plans must be made. In the first place, the type and quantity of materials that will be needed must be determined. Where a large order is involved, it is necessary to check the inventory records to see if sufficient quantities are on hand. Secondly, if finished parts manufactured by other firms are to be used, the number of each kind needed must be determined. Purchase requisitions must be issued to the purchasing department for these parts and for any materials needed that are not on hand.

In addition to planning for materials and parts, the work must be distributed to the different departments, the number of men required must be determined, the number and types of machines required must be decided upon, and the time for the completion of each stage must be assigned.

In a small industrial plant employing only a few workers, this planning may be done by the foreman in an informal manner; this is particularly true where the production processes are standardized. On the other hand, in a large industry, such as the automobile industry, where dozens of different materials and many finished parts from other factories are assembled, a planning department is established.



*Courtesy Automobile Manufacturers Association*

*Figure 15-7.* Such a scale model of a new plant as the one shown here helps in planning production methods.

Each model manufactured is a separate planning problem. Many different operations are performed simultaneously; some parts pass through only one process, whereas others go through several operations before being completed.

*Routing.* Routing through the plant involves the sequence of operations performed in connection with a particular article being made. It is important because some articles involve the use of several machines and some machines must be used for several different processes. Also, several different jobs are "in process" at the same time.

Routing determines in what order the different operations are to be done, which personnel are to do the work, and which machines, tools, and supplies are to be used. The route for each individual part produced and its relation to the other parts in process are shown. Route cards are issued to each department showing the sequence of operations for each part that passes through that department. Detailed drawings are made to chart all necessary production processes and assemblies.

*Scheduling.* The purposes of scheduling production work are to insure a smooth flow of work through the production process, to avoid conflicts and delays in the utilization of men and machines, and to set timetables for the arrival of needed materials and the shipping of finished goods in such a way as to keep storage costs to a minimum. Scheduling is necessary in order to finish stock items at a rate that will avoid the depletion of items on hand, and in order to meet time limits on job-order work.

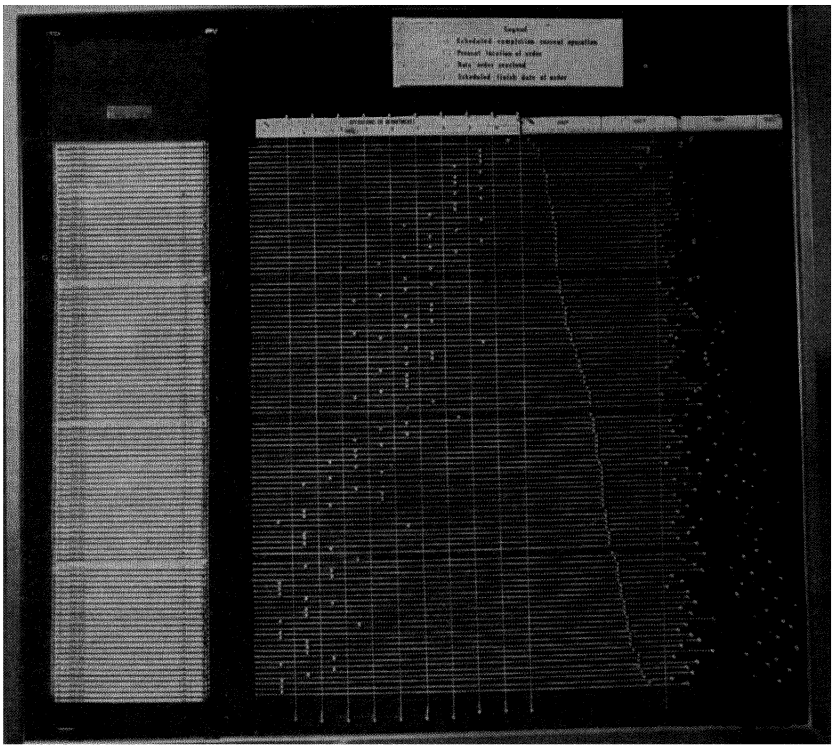
For stock items a master schedule is prepared; it shows the number of items expected to be completed during each week or month. For job-order work the schedule can be worked backwards from the desired delivery date and a definite time determined as the date on or before which each operation or part must be completed. If the schedules for the different jobs are known, rush orders can be accommodated and jobs that permit an extra allowance of time can be used to avoid idle periods and thus keep costs down.

Some of the things that should be observed when preparing schedules are:

1. The amount of plant capacity already committed to jobs in process.
2. Balancing work assignments to different departments, thus avoiding overloading.
3. Where finished parts are assembled, co-ordination of the arrival

of parts from other plants with the completion of parts within the factory, so that all the necessary parts are available at the same time.

4. Avoidance of peak or overloaded periods for the most frequently used transportation facilities in order to avoid delays in deliveries of both raw materials and finished goods.



*Courtesy Wassell Organization, Westport, Conn.*

*Figure 15-8. Produc-trol.* This graphic chart is used as an aid in controlling production.

*Dispatching.* The issuance of work orders for each job is necessary for the planning to be carried through, for proper routing to be arranged, and for the schedule to be maintained. The preparation and issuance of these work orders, which entails considerable clerical work, is known as *dispatching.* Furthermore, requisitions for needed materials and supplies must be prepared and the required tools must be assembled.

Follow-up routines must be used to keep abreast of the progress of each job. Times of starting and completing each task must be recorded.

Work orders must be delivered and reports of completion must be submitted. Messengers, pneumatic-tube conveyors, and dispatch boards are used by the dispatch clerk for delivering and receiving records. He must have a systematic filing plan for each type of record. The dispatcher is also responsible for seeing that work progresses in accordance with the routing cards and time schedules. He must avoid idle time for machines and men by issuing new work orders for those who have completed their tasks. The dispatcher's is a responsible job, for he determines the degree to which previous planning is carried to completion.

### Operational control

*The Planning Board and Progress Charts.* When several types of work are in progress and dozens of different types of machines are involved, it is impossible to exercise control without the planning board. It shows the plans for three classes of work: (1) jobs in progress, (2) jobs to be started when the work in process is completed, and (3) job orders not yet scheduled. A separate record is kept for each machine. The shop foreman can see at the beginning of the day or week exactly what has been planned ahead for his department.

A progress chart serves much the same purpose as a bar graph. It shows at a glance the dates on which each job is to begin, the number of units to be produced, and the date by which each job is to be finished. It is possible to draw lines on the chart to indicate whether it is on schedule, ahead of schedule, or behind schedule.

*Motion Study.* The purpose of motion study is to discover and eliminate waste motions and to develop the most effective method of performing each job. When such an analysis is made, the work is broken down into all elementary motions used, such as reaching, selecting, picking up, putting together, and replacing on the conveyor belt. All separate motions and the operation as a whole are analyzed for rhythm of movement, distances covered, co-ordination, and sequence. After the study is made, distances are shortened, some movements are eliminated, rhythm is sought, timing is perfected, and the proper sequence of steps is determined.

*Time Study.* Time study is usually associated with motion study. When the whole operation is broken down into the elementary motions that comprise the worker's performance, the time required for each separate motion is determined by using a stop watch. The observer selects a location that permits him to see every action of the worker. As each motion is made, the observer times it and records that

time on the observation sheet. Several timings (usually from 30 to 50) are recorded. The observer also records all work stoppages or delays; in fact, he notes whatever seems to be significant. Every elementary motion made by the worker during the completion of one unit of work (that is, during what is referred to as the job cycle) must be timed many times. The average of all these timings for a single movement becomes the base time for that motion, and the total of the averages for all the separate motions involved in one operation becomes the standard time for the complete job cycle.

If motions too rapid for the human eye make it impossible to do an accurate job with a stop watch, cameras may be used in what are called micromotion studies. A large clock with its face divided into hundredths of seconds is placed behind the worker. The motion-picture camera records the movement and the time required is determined from the series of pictures.

It should be pointed out that success in time and motion studies requires the full co-operation of the worker being studied. If he is not in sympathy with the idea of making such a study, the results obtained are very likely to be invalid. Care should also be taken to insure that typical workers are chosen; workers who are exceptionally slow, fast, efficient, or inefficient should not be selected for such studies.

It is a good practice to invite representatives of labor to participate in time study. Labor must be given assurance that the study is not to be used to force more work in less time just to save production costs. If workers feel that the result will be higher standards to meet for the same pay, they are most likely to be nonco-operative.

*Inspection.* The most important function of inspection is to enforce standards. The most carefully prepared plans and the most carefully observed schedules are of no value if the product is not acceptable when finished. The establishment of standards is of no avail unless steps are taken to insure that they are met and maintained.

In addition to maintaining quality standards, inspection serves at least three other functions:

1. By catching defective material or workmanship early in the production process, the waste of additional labor later on in the process is prevented.
2. Careful inspection at various stages during the completion of a product aids in discovering points of weakness in the manufacturing process.
3. Thorough inspection of the finished product helps to maintain

goodwill and a good reputation among customers by preventing the shipping and delivery of defective or substandard products.

Inspection is necessary at several stages during the production process. In addition, it is necessary to inspect raw materials when they are accepted by the receiving department and tools and gauges should be inspected at intervals to make sure they are still up to standard. Since the maintenance of previously set standards is one of the chief purposes of inspection, it is necessary to hold the worker responsible for poor-quality workmanship. In all fairness to the worker he must be supplied with sound materials and given effective machinery; he cannot be held accountable otherwise.

The extent to which goods are to be inspected, where the inspection is to take place, and by whom it is to be done, are matters of policy. They are dependent somewhat upon the nature of the articles being manufactured and the production processes involved. For example, moving parts in machinery must be given more careful and more frequent inspection than such products as toys, pencils, or paperweights. For intricate machine parts that have to be accurate to .005 of an inch, great care in inspection must be exercised. For most work a sampling inspection is all that is necessary, but in some cases there must be a 100 percent inspection.

The foreman is intent upon keeping schedules and pushing production ahead. Consequently, he would be inclined to be lax in his holding to quality standards if he were also the inspector, for this would slow up his production rate. Likewise, a high rejection rate would be a reflection upon him and his department. Therefore, it is advisable to have the inspection crew responsible to the works manager rather than to the shop foreman.

There are two types of inspection: *centralized inspection,* where the inspectors are grouped together, and *floor inspection,* where the inspectors take their places along the assembly line. Each plan has its advantages and shortcomings.

Testing is one phase of inspection, especially of mechanical products. Cans are tested under pressures and at high temperatures; automatic washing machines are put through test runs before being crated for shipment. Testing is one of the best means of inspecting finished articles.

## Careers in Production Work

Production is an excellent field for a business career. In the first place, production gives employment to a larger number of people than

does any other phase of business. In the second place, there is a wide variety of types of production industries. This means that one has an opportunity to exercise a choice in selecting a business career. Also, production industries have all the phases of business available to those in nonmanufacturing enterprises (office jobs, for instance, and jobs in accounting, statistics, selling, and advertising) and, in addition, opportunities nonexistent in a service or retail business.

From the standpoint of advancement, there are all the phases of management to which one may be promoted in a nonmanufacturing business (personnel, office, finance, and merchandising) as well as opportunities in production management, planning, and development, and plant management. In the field of personnel management, one's opportunity is greater than in the nonmanufacturing field because the large number of skilled, semiskilled, and unskilled workers employed greatly magnifies the work to be done in the area of labor-management relations. The problems of accounting are broader also, involving cost-accounting procedures that usually do not exist in other businesses.

In other words, production industries seem to offer all the career opportunities available to those in a service business and in retail merchandising, and additional experiences and broader opportunities also.

## Terms for Study

Analytical
Assembly
Dispatching
Extractive
Fabrication
Industrial
Installation
Inventory control
Manufacturing process
Motion study
Overhead
Plant layout
Raw materials
Requisition
Routing
Scheduling
Specialization
Synthetic
Time study

## Questions

1. In what respect is production the cornerstone of American business?
2. In what ways does manufacturing today differ from manufacturing in the nineteenth century?
3. What type of manufacturing employs the greatest number of workers?
4. Approximately what percentage of the dollar value of manufactured goods represents manufacturing costs other than cost of materials?
5. What are the chief characteristics of production?
6. What are some examples of standardization in industry?
7. How does mass production make possible a lower-priced article?
8. How do the different types of production processes differ from one another?

9. What is the difference between continuous production processes and intermittent processes?

10. Why is the choice of a desirable location for a factory more difficult than for a retail store?

11. Explain how nearness to raw materials helps to determine the location of a manufacturing plant.

12. What geographical area has the greatest amount of production?

13. What factors must be considered when planning for the greatest possible utilization of space and equipment?

14. In what ways is the purchase of raw materials related to problems connected with storage and inventory control?

15. What factors enter into wise purchasing policies and procedures?

16. How is control over raw materials brought about?

17. What is the nature of the work performed by a dispatcher?

18. What procedures and techniques are used by management in coordinating the four factors that enter into production processes?

19. How is production controlled through planning?

20. Explain the importance of time and motion studies in industry.

## Problems and Projects

1. Secure from the local Chamber of Commerce information on the advantages of the region in which you live (and particularly your local community) that make it an attractive location for industry.

2. Determine the principal types of industry in your community or state; also, learn the reasons why your community or state is especially desirable for those types of industry.

3. Determine from your local railway freight agent the principal types of raw materials and finished goods shipped to and from your community.

4. Plan a class visit to one of the principal factories in your community. Watch for the various things you have studied about in this chapter on production.

5. Determine approximately how many different classifications of workers are engaged in production work in your community.

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CHAPTER XVI

# MARKETING

MARKETING AND PRODUCTION are closely interrelated. Either of them embraces almost all other business activities, including transportation, storage, standardization, finance, and risk-bearing.

Marketing includes all direct and indirect buying-selling relationships. It is a process of getting tangible goods to consumers. In contrast with productive processes, it does not necessarily involve changes in the physical properties of goods.

Marketing processes accomplish three things: (1) transfer of ownership of goods, (2) arrangement for physical distribution, and (3) facilitation of transactions. The first of these includes all facilities involved in changing ownership from seller to buyer. Within this area there are two subdivisions: (1) demand creation and (2) assembly. Demand creation is a selling job and involves finding a good market and presenting accurate descriptions and information about merchandise in such a way as to inspire sales. Assembly provides desired goods of the right variety, quality, and quantity, at prices that customers can afford to pay.

The second accomplishment includes all facilities involved in the physical transfer and storage of goods received from producers—factories, mines, and farms. Geographical problems of location often create many cross-hauls, but the distribution process can be economically accomplished through the use of storage warehouses. These warehouses deal in bulk shipments and from their supplies smaller orders can be routed to local markets.

The third process does not directly contribute to transferring ownership of goods; neither does it relate to physical problems of distribution; yet it is indispensable by way of financing, insuring, and standardizing goods that are marketed.

In a narrow sense, we might treat the scope of marketing in terms of retailing, house-to-house selling, or mail-order merchandising, but in its fullest sense, marketing involves much more than these. Markets extend far beyond domestic realms: they are world-wide.

All business activities that foster marketing processes are inter-

dependent. Raw materials create supply, labor and machines change the form of supply, middlemen find buyers and distribute goods, people consume them, and the costs are fed back through the cycle of production and consumption as capital, wages, profit, and so forth.

We may appreciate the importance of marketing as a business function through four indexes: (1) volume of goods handled, (2) number of people employed in marketing occupations, (3) cost of marketing goods and services, and (4) social changes effected through marketing activities. All these indexes are involved in the discussion throughout this part of the book, but an amplification of one—the cost aspect—may well emphasize the importance of the marketing process.

## Cost of marketing processes

If consumers are price-conscious, they inevitably ask: "How much does it cost to market a certain product?" Or, "What can be done to eliminate some middlemen and lower the price of merchandise by shortening the distance between producer and consumer?"

In 1870 the cost of distribution was 25 percent of the consumer's dollar. In 1930 the cost of distribution had risen to 50 percent. Nine years later the Twentieth Century Fund made a thorough study of distribution costs and found the average to be 59 percent of the consumer's dollar. Yet, in 1939 it cost more to market goods than it did to manufacture them; production costs were $28.9 billion, whereas marketing costs were $29.4 billion. An analysis of the levels at which the $29.4 billion were spent is seen in Table XVI-1.[1]

TABLE XVI-1. ESTIMATED COST OF MARKETING GOODS, 1939.*

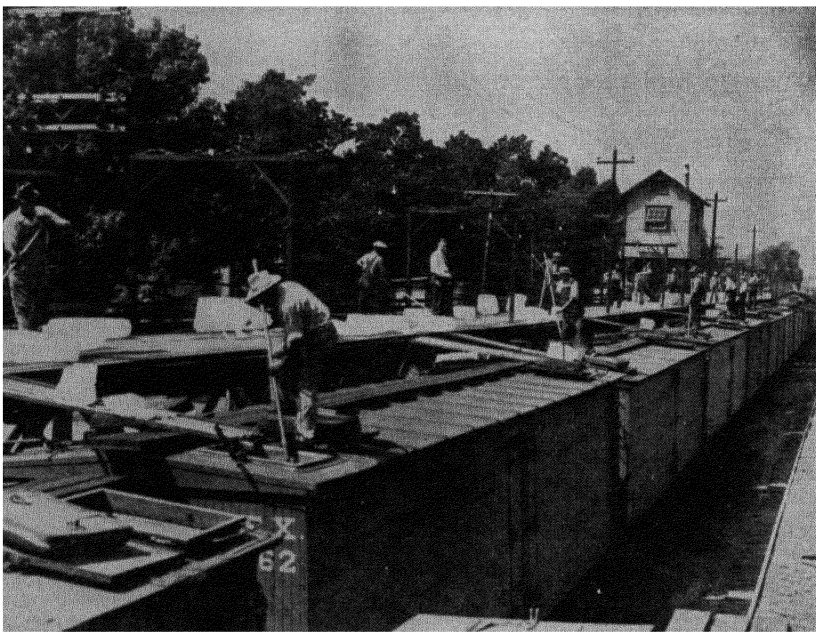
| *Cost of* | *Billions of Dollars* | *Percentage of Total* |
|---|---|---|
| Retailers | 12.2 | 41.5 |
| Wholesalers | 6.1 | 20.8 |
| Manufacturers | 5.7 | 19.4 |
| Transportation | 3.6 | 12.2 |
| Other † | 1.8 | 6.1 |
| Total | 29.4 | 100.0 |

* Source: Converse, P. D., "The Total Cost of Marketing." *Journal of Marketing*, April, 1946, Vol. X, No. 4, p. 389. From an earlier study by Stewart, P. W., and Dewhurst, J. F., *Does Distribution Cost Too Much?*, pp 117-118. New York: Twentieth Century Fund, 1939.

† Includes marketing cost in connection with mines, quarries, and oil wells; timber products; farming; and construction.

[1] Adapted from Phillips, C. F., *Marketing Principles and Methods*, p. 11. Chicago: Richard D. Irwin, Inc., 1948.

In comparative analysis, we can see the consumer's dollar through the marketing processes involved in the case of seven representative commodities. Table XVI-2, an adaptation from a lengthy statistical analysis of commodities, significantly shows accurate percentages for the retailer, wholesaler, distributor, and manufacturer.[2] Note that retailers do not make the same margin on all seven commodities.




*Courtesy Fruit Growers Express Company and Association of American Railroads*

*Figure 16-1. Railroad Icing Station.* Refrigeration cars provide a simple and effective means of preserving perishables in transit. At this icing station cars are being prepared for a fruit shipment.

Women's dresses allow 52.5 percent, whereas expensive motor cars permit only 16.7 percent. Wholesalers make a 4.7 percent margin on meat products, whereas retailers make 25.1 percent. Obviously, the price, size, perishability and other characteristics of the commodity, as well as the service that is expected from dealers by consumers, are all factors that influence the margin allowed at each point in the marketing cycle.

[2] *Ibid.*, p. 12.

TABLE XVI-2. PERCENTAGE DISTRIBUTION OF MARKETING COSTS FOR SELECTED PRODUCTS.*

| | *Consumer Pays* | *Retailer's Margin* | *Retailer Pays* | *Wholesalers' Margin* | *Wholesaler Pays* | *Mfg. Distr. Cost* | *Mfg. Gets* | *Total Cost of Distb.* |
|---|---|---|---|---|---|---|---|---|
| 1. Lumber products | 100.0 | 26.6 | 73.4 | 12.5 | 60.9 | 14.0 | 46.9 | 53.1 |
| 2. Meat products | 100.0 | 25.1 | 74.9 | 4.7 | 70.2 | 4.7 | 65.5 | 34.5 |
| 3. Expensive motorcars | 100.0 | 16.7 | 83.3 | 10.8 | 72.5 | 8.2 | 64.3 | 35.7 |
| 4. Tires and tubes: through wholesalers | 100.0 | 28.1 | 71.9 | 17.1 | 54.8 | 6.1 | 48.7 | 51.3 |
| 5. Butter | 100.0 | 24.6 | 75.4 | 8.1 | 67.3 | 5.6 | 61.7 | 38.3 |
| 6. Coffee | 100.0 | 24.6 | 75.4 | 8.1 | 67.3 | 15.5 | 51.8 | 48.2 |
| 7. Women's dresses, $39.50 | 100.0 | 52.5 | 47.5 | — | — | 15.8 | 31.7 | 68.3 |

* These figures do not include all the transportation costs that should be recognized for some of the products. Therefore, some costs may be slightly incorrect but are substantially correct enough to warrant their use. Source: Phillips, C. F., *Marketing by Manufacturers,* p 16. Chicago: Richard D. Irwin, Inc., 1946.

A more detailed evaluation of the cost of marketing *one* commodity, oranges, is reflected in Table XVI-3.[3]

TABLE XVI-3. DISTRIBUTION OF THE CALIFORNIA-ORANGE DOLLAR

| | |
|---|---|
| Orange grower (while fruit on trees) | 26.3% |
| Pickers and transport people | 2.8 |
| Packers | 10.1 |
| Selling organizations | 2.5 |
| Transportation cost of finished product | 23.3 |
| Jobbers or wholesalers | 5.7 |
| Retailer | 29.3 |
| | 100.0 |

The cost of distribution in terms of percentages can sometimes be misleading, because large-scale production and distribution may actually lower the retail prices paid by consumers. Many items such as automobiles, electrical appliances, accessories, and personal items that carry high distribution costs are heavily advertised and yet sell for less and less as the volume of sales increases. At the same time, quality is not sacrificed.

As a simple illustration, suppose that under the handicraft system a consumer paid $10.00 for a pair of shoes, 25 percent of which was needed for marketing and distributing and $7.50 of which the cobbler received for his labor and materials. Assume that after mechanical devices were introduced in shoe factories, shoes of the same quality could be manufactured for $2.50. If the cost of marketing and distributing remained $2.50, this cost would be 50 percent of the retail price of shoes, yet the consumer would pay only $5.00 for the shoes that formerly cost him $10.00.

Notwithstanding our ability to produce more efficiently in factories, authorities hold little hope that marketing costs will decline appreciably in the future.

## Functions of Marketing

There are *many* marketing functions, but for simplicity we shall list here and briefly describe only the more important ones. The following chapters will enlarge upon those functions that give a comprehensive understanding of the widest possible range of business activity. Distribution facilities will be discussed in Chapter XVII, the facilitative function of transportation in Chapter XVIII, marketing through retail

[3] Adapted from Converse, P. D., and Huegy, H. W., *Elements of Marketing*, 3rd rev. ed., p. 5. New York: Prentice-Hall, 1946.

outlets in Chapter XIX, and the influence of directed sales planning and advertising in Chapters XX and XXI, respectively.

To facilitate an introductory analysis, we shall reduce marketing functions to seven basic areas, which can be described chiefly in terms of merchandise. They are:

1. Creating consumer demand and selling merchandise;
2. Analyzing the market—discovering and interpreting consumer wants;
3. Procuring supplies of merchandise for resale;
4. Risk-bearing;
5. Standardizing and grading merchandise;
6. Finance; and
7. Transporting and storing merchandise.

### Creating consumer demand and selling merchandise

Probably the most important function of marketing is to create consumer demand and then sell the goods or services. Other functions seem subordinate to these. They will be discussed in Chapters XX and XXI.

### Analyzing the market—discovering and interpreting consumer wants

Chapter II, which deals largely with consumership statistics, should be consulted here as a background for understanding the second function of marketing. Briefly, most market analyses are built around the information contained in answers to these questions:

1. How many people are in the market?
2. Where do the people live?
3. What are their occupations?
4. How much income do they receive?
5. How much of their income do they spend?
6. What are their spending characteristics?
7. What are the types of consumers who make up the market, and what are their wants, mannerisms, and customs?

A basic marketing chart of the United States by geographic divisions, Table XVI-4,[4] serves splendidly to illustrate how market data are classified. First, the geographic divisions tell where the people live, what

[4] Duddy, Edward A., and Revzan, David A., *Marketing and Institutional Approach*, p. 124. New York: McGraw-Hill Book Company, 1947.

percentage of the total population each group represents, and what degree of concentration in population is evident. Income per capita and income relative to total U.S. income are presented in Columns 4 and 5. Columns 6, 7, 8, and 9, which give information about life insurance and appliances, simply express standards of living for the markets evaluated.

*Market Changes.* It is evident to everyone that changes in market conditions are inevitable. By way of demonstrating the dynamics of these changes, the following summary of changes in the 8-year period 1940-48 is given:

1. Population increased about 11.1 percent. More buyers were thus in the market.
2. Consumer units increased more than 23 percent.
3. Consumer units with annual incomes of more than $3,000 increased nearly 250 percent. The amount available for spending was more.
4. Retail sales increased 173 percent. Business activity boomed.
5. Passenger-car registrations increased a little more than 19 percent. Prosperity seemed to be indicated.
6. There were 80 percent more telephones.
7. There were nearly 100 percent more electric refrigerators. Great acceptance of appliances and willingness to spend were indicated.
8. Population shifted from rural areas to the metropolitan areas (50,000 people or more). There were in 1948 about 242 metropolitan areas in the United States, and they made up more than half of our population.
9. Weekly earnings of nonagricultural workers increased considerably. (The New York Federal Reserve Board compiled statistics showing that a number of nonagricultural industries had reported increases of approximately 81 percent during this period. This figure included an approximate increase of 91 percent for wage earners and 59 percent for clerical and professional workers.)
10. Growth in per-capita volume of exchange cor[illegible]mplicity ... increased during this period.

*Sources for Market Research.* Plans for marketing projects should provide accurate, dependable, and recent sources of information. The two general sources of information are: (1) published reports, and (2) research studies made by public and private agencies.

Library sources are the most commonly used in doing market research because of their accessibility, accuracy, and low cost. Govern-

TABLE XVI-4. A BASIC MARKETING CHART OF THE UNITED STATES BY GEOGRAPHIC DIVISIONS.

| 1. *Geographic division* | 2. *Percent of civilian population Mar. 1, 1943* | 3. *Civilian population per sq. mi., Mar. 1, 1943* | 4. *Income per capita, 1942* | 5. *U. S. incomes, 1942* % | 6. *Life insurance sales per capita, 1943* | 7. *Electric and gas-engine washers,* % *wired homes* | 8. *Electric refrigeration* % *wired homes* | 9. *Electric ranges,* % *wired homes* |
|---|---|---|---|---|---|---|---|---|
| New England | 6.38 | 129.4 | $1,026 | 7.70 | $68 | 57.41 | 64.40 | 11.23 |
| Middle Atlantic | 20.59 | 262.7 | 1,061 | 25.17 | 71 | 56.44 | 75.85 | 7.01 |
| East North Central | 20.35 | 106.5 | 928 | 22.16 | 62 | 80.29 | 70.01 | 15.78 |
| West North Central | 9.68 | 24.3 | 778 | 8.97 | 60 | 97.30 * | 69.45 | 14.19 |
| South Atlantic | 13.96 | 66.7 | 657 | 10.83 | 42 | 45.92 * | 77.07 | 19.08 |
| East South Central | 7.99 | 56.8 | 467 | 4.51 | 28 | 47.17 | 71.94 | 18.03 |
| West South Central | 9.83 | 29.2 | 613 | 7.28 | 40 | 51.60 | 72.64 | 4.65 |
| Mountain | 3.13 | 4.7 | 803 | 2.87 | 53 | 74.50 | 64.76 | 19.05 |
| Pacific | 8.10 | 32.4 | 1,154 | 10.54 | 71 | 64.48 | 62.51 | 14.00 |
| United States | 100.00 | 43.1 | 852 | 100.00 | 57 | 65.59 | 70.94 | 12.74 |

* Reflects use of gas-engine washers in home without power

ment bulletins and publications of all kinds are, of course, excellent library sources.

Workable market data also come from private associations and trade groups that do research in the interest of their members. Among such groups are the following:

American Association of Advertising Agencies
National Automobile Chamber of Commerce
National Retail Dry Goods Association
Periodical Publishers' Association
National Outdoor Advertising Bureau
Outdoor Advertising Association of America

Field sources provide original data collected either by a company's research staff or by an independent market-research agency.

Having facts and knowing what to do with them are two different things. When management uses research techniques to make market analyses, the facts must be clearly interpreted. There is sometimes danger in collecting statistics on desirable markets based upon single factors, such as magazine circulation, retail sales, or automobile registrations. A far more satisfactory measure can be obtained by combining two or more factors on a weighted basis. A measure so obtained is known as a *multiple-factor index.* Three multiple-factor indexes will serve to illustrate the point: [5]

1. The Batten, Barton, Durstine & Osborn advertising agency uses a multiple-factor index made up of three factors: (1) population, (2) number of income-tax returns, and (3) number of retail outlets.

2. The McCann-Erickson Agency uses a four-point index made up of: (1) number of income-tax returns, (2) number of domestic lighting customers, (3) bank deposits, and (4) combined circulation of four most popular magazines.

3. The magazine *Sales Management* uses an index of market areas based upon a combination of (1) effective buying income, (2) retail sales, and (3) population.

*Importance of Knowing the Product.* Consumers' wants are the basic information needed for an effective marketing program. These wants were discussed in Chapter II from the consumer's angle. We should now evaluate them in terms of their importance to manage-

[5] Sandage, C. H., *Advertising Theory and Practice,* p. 186. Chicago: Richard D. Irwin, Inc., 1948.

ment. Wants are reflected in buying habits, which result in sales and afford management a chance to give service and make a profit. Full understanding of consumer wants is impossible without a thorough knowledge of the products that will satisfy them.

With this basic idea in mind, many successful sales organizations begin sales training by assigning their men to factory schools where manufacturing processes can be learned firsthand. In addition to learning how the business operates, they learn what the product is capable of doing.

Reliable facts about the operating features of a product often originate in testing laboratories. According to an authoritative source, during 1947 more than one billion dollars were spent in 3,000 industrial laboratories where both government and private personnel tested various merchandise. The U.S. Testing Company of Hoboken, New Jersey, one of the oldest and largest independent testing laboratories, reported an increase of 53 percent in its tests from 1944 to 1947, and its certificates increased 94 percent during the same period. The American Institute of Laundering reported that the use of its Certified Washable Seal on washable commodities increased 120 percent during a period of about three years.

The following check list of things to know about a product illustrates the kind of insight needed in product analyses:

1. Does the product satisfy a human need? Are there other uses for the product that are not advertised?
2. What materials are used in the product?
3. What special processes in manufacturing the product should appeal to buyers?
4. Is the product easy to guarantee?
5. What actual tests have been made of the use of the product?
6. In what ways does the product excel competitive lines?
7. Descriptive statistics about the product should be known: speed, quality, accuracy, size, weight, durability, workmanship, and appearance.
8. Is the product a luxury or a necessity?
9. How long has the product been advertised in the market?
10. Does the product appeal particularly to a special class?
11. Is the product likely to be replaced by something better?
12. How much backing does the company give in selling the product—national advertising and sales promotion?

## Procuring supplies of merchandise for resale

It has been previously pointed out that marketing presupposes a knowledge of the product and of the consumer who will ultimately use it. Before consumers can be served, however, inventories must be acquired from which orders can be filled. Specifications for purchases must be based upon knowledge of how, where, and by whom the merchandise will be consumed.

*Courtesy Armstrong Cork Company*

*Figure 16-2. Procurement of Inventory.* A lumber dealer here checks catalogue specifications for a purchase order. He and the sales representative co-operate in selecting those items that not only satisfy consumer demand but also allow a reasonable profit.

Marketing of goods takes place on several levels. At the top it involves wholesaling services to dealers and at the bottom it includes retail facilities for consumers. Wholesalers generally buy their inventories from manufacturers, retailers buy from wholesalers, and consumers buy from retailers. The procurement of goods for resale in either wholesale or retail markets involves several basic considerations.

First, the buyer must make sure he has a complete digest of consumer preferences in brand, price range, color, and performance features. These data are secured from either analyses of previous sales or market surveys. The buyer must know what goods will be needed by

the trade—that is, by the ultimate consumer, because he it is who finally decides what he wants to buy, and wholesalers and retailers simply interpret his preferences.

Added to a buyer's responsibility to consumers is the task of securing good and permanent contacts for supplies at attractive prices and terms. Wholesale buying for resale is a skill, and the extent to which one person or an organization can negotiate desirable contracts often determines how much profit will be made.

But the procurement of merchandise for resale is not simply a matter of finding the best price and terms among competitors who maintain a buyer's market for purchasing agents. There are other problems that complicate the work of a buyer. For example, funds must be available with which to take quick cash discounts, and storage facilities should be adequate for large orders so that quantity buying will not be handicapped. These and other factors make buying a difficult and responsible function.

### Risk-bearing

Profit from buying and selling does not consist simply of the difference between the cost of merchandise and the sale price. Many overhead cost items must be taken into consideration. Dealers at all levels assume risks because they are necessary in making profit. It has often been said that the extent of risk involved in a transaction governs reward or profit.

Fortunately, underwriting insurance agencies minimize these risks. Rates for insurance coverage are determined by experience tables computed mathematically to protect both insured and insurer. The subject of insurance was considered in Chapter XIII.

The following is a summary of the types of risks involved in the marketing process: [6]

A. Ownership risks:
   1. Drop in value of goods because of decline in price;
   2. Change of fashion, meaning goods must be sold at a loss;
   3. Fire—goods may be burned, or damaged by smoke or water;
   4. Theft—goods may be stolen or embezzled;
   5. Storm—goods may be damaged by flood, tornado, lightning, moisture, earthquake, hail;
   6. Decay;
   7. Vermin;

[6] Converse, P. D., *Essentials of Distribution*, p. 48. New York: Prentice-Hall, Inc., 1936.

8. Heat or drought;
9. Change in demand—goods become unsalable or must be carried in stock for long periods because of business depression, unemployment, strikes, crop failures, local catastrophes;
10. Violence—damage by mob.

B. Financial risks:
1. Accounts and notes may become uncollectible;
2. Theft and embezzlement of money;
3. Bank failures may cause loss or cut off sources of credit;

C. Liabilities for injury:
1. Trucks or salesmen's cars may injure persons or damage property;
2. Customers may be injured on premises;
3. Goods sold may be defective and injure the buyers;
4. Employees may be injured while at work.

D. Liability on contracts:
1. Coupons or tickets have to be redeemed;
2. Cost of fulfilling future contracts may increase as a result of an advance in wages or prices of materials;
3. Default of others may involve loss on joint contracts;
4. Guarantee of goods may involve loss on replacement or repairs.

E. Liability of loss of key men:
1. Important managers or skilled workers who have had expensive training may die, become sick, be injured, or resign.

F. Weather risks:
1. Sales may be lost because of bad weather.

## Standardizing and grading merchandise

Without a satisfactory system for classifying goods, it is impossible accurately to catalogue and describe merchandise to be sold. During early trading days, when "let the buyer beware" attitudes dominated, there was less need for standardization of goods offered for sale. Buyers inspected and made their own selections; descriptions were unimportant. But in modern times, when buyer and seller are far apart, sale contracts must be made in faith and confidence based upon mutually accepted standards.

Upon what should standards be based? Six bases have been used successfully.[7]

1. Quantity basis—weights and measures.
2. Numerical basis—dozen, gross, ream.

[7] Clark, F. E., *Principles of Marketing*, p. 398. New York: Macmillan Co., 1929.

3. Size and measurement basis—screws, bolts, clothing, lumber.
4. Quality basis—grain and cotton, chemical content.
5. Service basis—firms pride themselves in selling customers on their brand of fast delivery, adjustments, or improvements.
6. Price basis—"one price policy" eliminates the bargain hunter and the customer who would force reductions.

In much the same way that standardization in factory processes has resulted in economies of labor and material, standardization in marketing can save much time and greatly accelerate the buying and selling process. Economists argue that lack of standardization in marketing is our greatest waste in distribution: the figures total billions of dollars annually.

Some examples of how standardization is brought into the marketing process are given here:

1. Cotton can be divided into 10 or 12 grades depending upon length of fiber, texture, tensile strength, color, shade, and so forth.
2. Canned goods in grocery stores are listed as No. 1, No. 2, and so forth, and the quality is recognized as "ordinary," "fancy," or "extra fancy."
3. Grain is standardized on the basis of moisture content, weight per bushel, or freedom from foreign matter. The federal government has set up definite standards by which the quality and kind of wheat can be measured.
4. Mechanics buy tools, materials, and supplies by code terms.
5. Furniture is sold as "good," "better," and "best" by one leading mail-order firm.

Grading is often spoken of in connection with standardizing. The difference is simple. Standardization sets up bases for comparison and identification; grading is the application of these standards to goods prepared for markets. Grading is a process of separating goods into lots according to predetermined standards of classification.

If buyers do not recognize standardized goods or if merchants do not sell by standards, waste will inevitably result. Standardization permits a buyer to negotiate contracts in confidence, knowing that goods will be delivered as represented. No time will be lost in reorders, adjustments can be made intelligently, market prices can be accurately compared, and goodwill is stimulated. Furthermore, financing of goods-in-process in factories or finished goods in warehouses can be more effectively accomplished because loan agencies can specifically define the collateral.

*Courtesy The Quaker Oats Company*

*Figure 16-3. The Grain Market.* Minute fluctuations in price cause differences in the amount of buying and selling in the grain market, but certain recognized standards of quality are maintained regardless of price.

## Finance

Since it is obviously impossible to present here a thorough discussion of financing the marketing process, we shall select representative points that suggest the over-all meaning of the subject.

Funds are needed in business for several purposes; labor, materials, supplies, inventories, equipment, buildings, advertising, research, and promotion. Demands for capital in most marketing jobs are unusually high, because they often involve wholesale-marketing responsibilities. Retailers have some relief in matters of finance because they can resort to "hand-to-mouth" buying from wholesalers and operate on limited stocks and quick deliveries. Manufacturers and wholesalers need capital for purchases, goods-in-process, or finished inventories.

The amount needed is determined largely by the size of the business, the nature of the product being sold, dealer arrangements, and

seasonal characteristics of the business. Common sources of capital are investors (stockholders), banks, private agencies, and profits.

A fascinating bit of finance reflected in cash discounts illustrates the high cost of interest often paid directly or indirectly for the use of capital. Invoices often feature a 2 percent cash discount. If the invoice is paid when the goods are bought or within 10 days, the buyer may deduct 2 percent. If the buyer has the money at hand or can borrow it at 5 or 6 percent per annum, it will be decidedly to his advantage to take the cash discount. Invoices are usually due in full in 30 days, so the problem of finance becomes a matter of securing funds for the 20-day period from the 10th to the 30th day. For this illustration, assume that money can be borrowed at 6 percent. An invoice for $500, discounted at 2 percent, would demand only $490 from the buyer. The cash discount results in a saving of $10.00. If $490 is borrowed from the bank at the rate of 6 percent per annum, the interest for the 20 days between the 10th and the 30th would amount to only $1.63. However, if the invoice is not paid within the 10-day grace period, the buyer will be paying $10.00 for the use of $490 for the 20-day period. When cash discounts of 2 percent are taken regularly, they are equivalent to a rate more than 37 percent per annum.

### Transporting and storing merchandise

Transportation facilities will be discussed in Chapter XVIII. Storage problems will be taken up in Chapter XVII in connection with distribution facilities.

## The Commodity Approach in Marketing

In the preceding discussion the functions of marketing have been enumerated to express the purpose of marketing and the contribution it makes to the whole scheme of economic activity. A far more interesting phase of marketing is that which deals with commodities. For those whose first love is merchandising—seeing, feeling, handling, and displaying the product—there is no other approach to marketing than the commodity approach. Fortunately, no conflict with the preceding discussion of the functions of marketing is involved in shifting our attention to commodities. Commodities are marketed through the functions; functional activities facilitate the sale of commodities.

It is convenient to classify commodities in such a way as to permit their evaluation. Using the way in which goods are bought as a basis, we may classify commodities as consumer goods, industrial goods, and farm products.

## Consumer goods

Merchandise bought from retail outlets for the purpose of being used by consumers, regardless of its form, can be classified as consumer goods. Some things like flour and cloth, of course, must be processed before they can be used. The use intended by buyers of these goods makes an important analytical point. Conceivably, paint bought for the family automobile would be a consumer item, but if the same paint were used in painting other automobiles on a commercial basis, a different classification would be necessary.

The way consumers buy suggests a three-point classification: (1) convenience goods, (2) shopping goods, and (3) specialty goods.

*Convenience Goods.* Convenience goods are those bought at points of convenience for the consumer. They are usually staple items of low value, sometimes perishable, standardized, and purchased frequently. Groceries, drugs, tobacco, gasoline, newspapers, ice cream, fruits, vegetables, and cooked foods sold by restaurants are typical of this class. Many convenience goods are bought impulsively.

Consumers exert no effort to compare prices or check quality in acquiring convenience goods. Therefore, little salesmanship is required of those who sell these goods. Clerks who can intelligently wait on customers, wrap packages, and make change can effectively dispense convenience goods. But since these goods largely sell themselves through good location and attractive display, it behooves management to get maximum results from store advertising displays.

*Shopping Goods.* When consumer wants shift to a stage where kind, price, fashion, and service make a difference, they begin shopping several markets. Shopping goods are relatively large in value, bought infrequently, and sensitive to buyer preference and choice. Consumers of shopping goods are therefore willing to spend much time in going from one store to another in the hope of finding the merchandise they want. Furniture, jewelry, electrical appliances, rugs, shoes, hats, suits, and accessories are typical of shopping goods.

Managers who specialize in distributing shopping goods will do at least two things: (1) locate their stores in districts where customers habitually shop, and (2) provide competent sales personnel who can effectively present the merchandise to customers. Unlike convenience goods, shopping goods must be *sold*. Such things as good display, effective advertising, and the prestige of the store help, but contact with customers must be effectively established.

*Specialty Goods.* Goods of very high value that are bought only

after much forethought, planning, and counsel are often classified as specialty goods. They are bought infrequently because of the size of the investment and the nature of the product—e.g., a piano, television set, air conditioning system, automobile, or home. Specialty goods are usually large and therefore demand a large financial investment.

### Industrial goods

Industrial (or producer) goods are those used in making products that typically become consumer goods. Paint used commercially in painting automobiles for the public would be so classified.

Inasmuch as producer goods are used mainly by factories, naturally the number of customers for them is negligible compared with those for consumer goods. Unit sales for industrial goods are large, specifications are standardized to the point of allowing catalogue buying, and there are fewer sales compared with those to consumers.

Industrial users may be classified into nine divisions: [8]

1. Manufacturing industries
   a) Process industries
   b) Metalworking industries
   c) Textile industries
   d) Lumber industries
   e) Miscellaneous industries
2. Mines and quarries
   a) Metal and non-metallic
   b) Coal
   c) Quarries
   d) Petroleum and natural gas
3. Public utilities
   a) Electric light and power companies
   b) Gas companies
   c) Telephone companies
   d) Waterworks
4. Construction industries
   a) Engineers and architects
   b) Construction companies
   c) Sub-contractors
   d) Shipyards
5. Transportation industries
   a) Steam railroads
   b) Electrical railroads
   c) Automotive bus and freight lines
   d) Steamship lines
   e) Air transport lines
6. Specialized service industries
   a) Hotels
   b) Restaurants
   c) Theaters
   d) Laundries, dry cleaners, etc.
7. Institutions, public or private
   a) Hospitals
   b) Schools
   c) Churches
   d) Clubs and lodges, etc
8. Commercial institutions
   a) Retail stores
   b) Banks
   c) Office buildings
   d) Warehouses
9. Government institutions
   a) Federal
   b) State
   c) Local
   d) County

[8] Elder, R. F., *Fundamentals of Industrial Marketing*, p. 3. New York: McGraw-Hill Book Company, 1935.

We may classify industrial goods according to the use to which they are applied: (1) supplies for operating the plant; (2) raw materials for manufacturing the product; (3) installation accessories; and (4) equipment and machinery.

Motives for purchasing industrial goods are different from those for purchasing consumer goods. In the first place, the producer leans heavily upon rational motives in buying supplies and equipment. Lowering costs of production, improving the quality of goods, obtaining uniformity of output, and increasing salability are common buying motives.

### Farm products

Farm products are both industrial and consumer goods, depending upon the buyer's use, but the unique character of the farmer's marketing problem deserves special consideration. His problems are mostly unlike those of other producers. He produces on a small scale, his capital is limited, often he is poorly informed in matters of management, and the work that he does is intimately related to his personal and family life.

The smallness of his production alone creates a special marketing problem, because some organization must absorb his and his neighbors' output in one larger marketing agency. As Converse and Huegy point out, "This gives rise to a large group of middlemen, constituting the general class of 'assemblers of farm products.' In this class are grain elevators, live stock buyers, cream stations, farmers' coöperative associations, fruit and vegetable buyers, milk dealers, tobacco and other country auctions, and some types of brokers and commission merchants." [9]

The farmer produces the indispensable supplies of raw materials from which other productive processes generate. Nearly all production and marketing begin and end with the soil. Figure 16-4 [10] shows the total volume of agricultural production from 1919 to 1946. Two supplementary lines show the volume of livestock and products and of crops.

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[9] Converse, P. D., and Huegy, H. W., *The Elements of Marketing*, 3rd rev. ed., p. 174. New York: Prentice-Hall, Inc., 1946.

[10] As used in Railroad Committee for the Study of Transportation, *Transportation in America*, p. 80. Washington: Association of American Railroads, 1947.

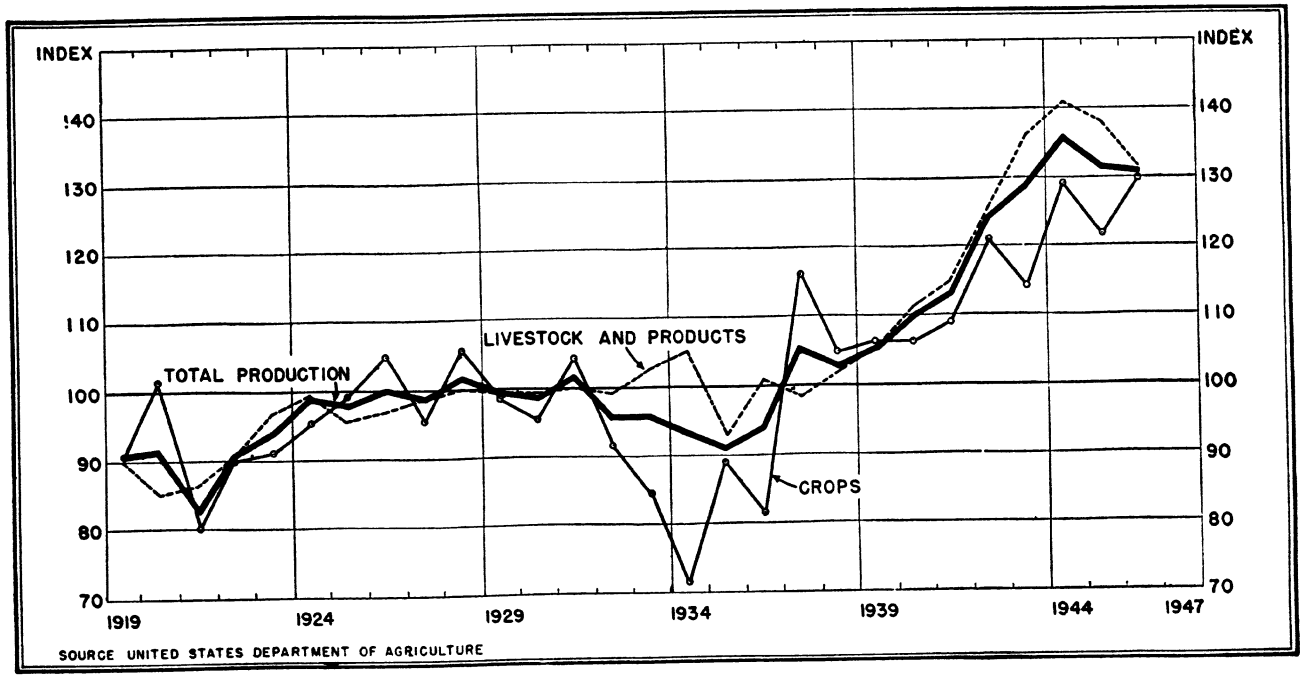



*Figure 16-4. Volume of Agricultural Production in the United States, 1919-1946.* (The period 1935-1939 equals 100.)

## Co-operative Agencies

Co-operative organizations are usually composed of people who find some dissatisfaction with the usual profit system of producing, distributing, or consuming goods and services. By definition, a co-operative agency (often known as a co-op) is an organization of people designed for some mutual gain in price, service, or both through a type of management that returns savings (profits) to its members in dividends, properties, or both. These organizations of co-operative effort are not limited to consumers. They extend into virtually every phase of economic activity. In broad classification, there are consumers', retail, wholesale, and farmers' co-operatives.

### Consumers' co-operatives

The most common form of co-operative is the consumers' co-operative. There are consumers' co-operatives in or near almost all American communities; therefore, most people are somewhat familiar with their

*Courtesy Consumers Cooperative Association, Kansas City, Mo.*

*Figure 16-5.* Co-op members throughout the Midwest buy their groceries, meats, and fresh fruits and vegetables at stores like this one. By producing many of their own goods and marketing them through the co-op they are enabled to make a saving.

operations. Table XVI-5 [11] reviews the number of associations, membership, and volume of business in 1944.

[11] Duddy, Edward A., and Revzan, David A., *Marketing, An Institutional Approach*, p. 240. New York: McGraw-Hill Book Company, 1947.

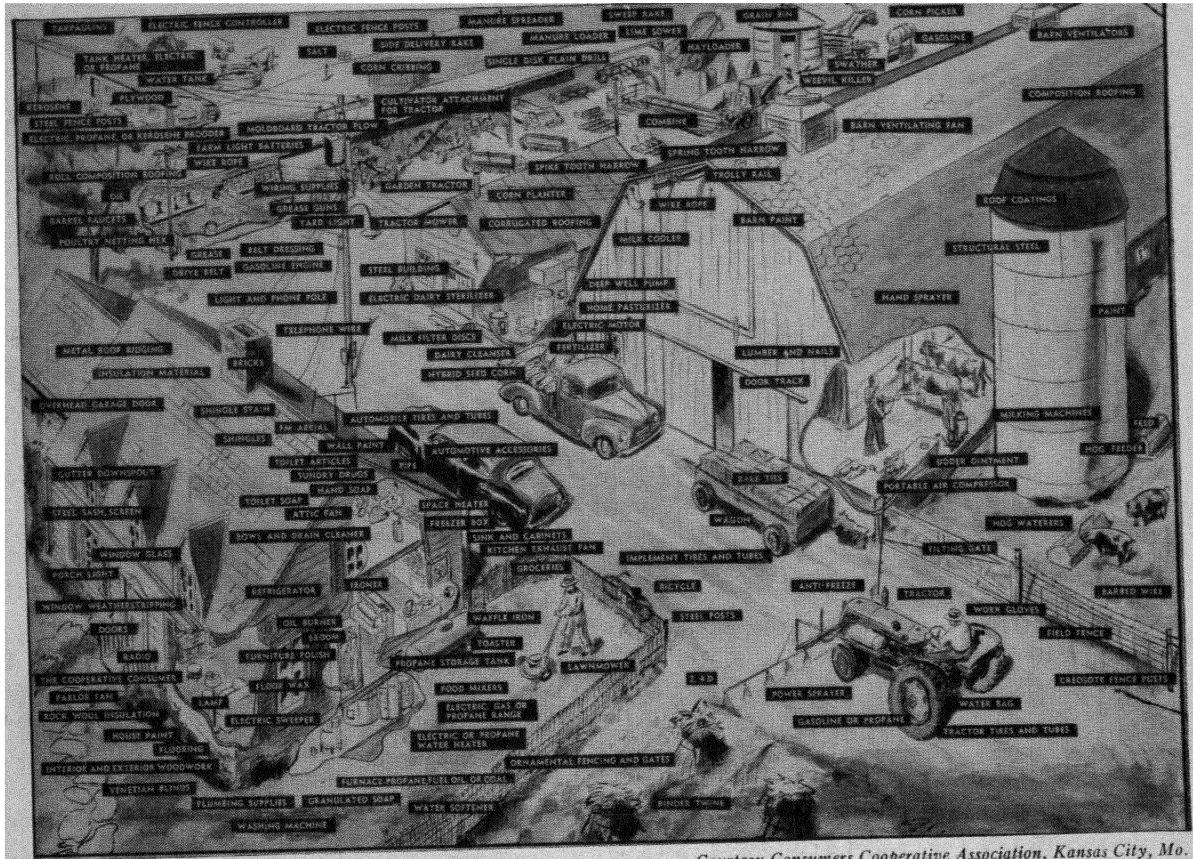
The consumer co-operative began in this country much before the Civil War and has enjoyed rapid growth in those communities where the people had the co-operative spirit and were willing to apply themselves to this form of organized buying and selling. In sections of Massachusetts, Michigan, Wisconsin, and Minnesota the movement has been notably successful, because the people in these parts were unusually sympathetic toward the movement. The Finnish people have been particularly enthusiastic about the co-operative program.

TABLE XVI-5. MEMBERSHIP AND BUSINESS OF CONSUMERS' CO-OPERATIVES IN 1944, BY TYPE OF ASSOCIATION.

| *Type of association* | *Total number of associations* | *Number of members* | *Amount of business* |
|---|---|---|---|
| Local associations: | | | |
| Retail distribution | 4,285 | 1,524,500 | $557,000 |
| Stores and buying clubs | 2,810 | 690,000 | 280,000 |
| Petroleum associations | 1,425 | 810,000 | 270,000 |
| Other distribution | 50 | 24,500 | 7,000 |
| Service Associations: | 577 | 318,500 | 11,055 |
| Rooms and/or meals | 175 | 18,000 | 2,600 |
| Housing | 59 | 2,100 | 1,575 |
| Medical and/or hospital | 68 | 140,000 | 3,400 |
| Burial | 40 | 36,400 | 280 |
| Other | 235 | 122,000 | 3,200 |
| Electricity | 850 | 1,149,700 | 60,960 |
| Telephone | 5,000 | 330,000 | 5,485 |
| Credit unions | 9,099 | 3,027,694 | 212,305 |
| Insurance | 2,000 | 10,510,000 | 190,000 |
| Federation: | | *Association members* | |
| Wholesales | | | |
| Interregional | 2 | 26 | 11,775 |
| Regional | 25 | 3,790 | 140,498 |
| District | 10 | 152 | 113,178 |
| Service | 21 | 1,500 | 7,820 |
| Production | 12 | 140 | 14,895 |

## Retail co-operatives

In much the same way that consumers' co-operatives are designed to benefit their members by making investments, buying and selling goods, and providing services, retail (or merchant) co-operatives are organized for mutual benefit or gain. The members of retail co-operatives are retail-store dealers. One common advantage of retail co-operatives is consolidated buying power and the greater efficiency that comes from less expensive overhead required in the procurement of mer-




*Courtesy Consumers Cooperative Association, Kansas City, Mo.*

*Figure 16-6.* Co-op members boast of more than 1,000 labels owned by themselves and recognized as their guarantee of quality. Their own agents set rigid standards for products given the co-op's seal of approval.

chandise. Retail co-operatives also profit from consolidating research facilities for market surveys and scientific tests and from pooling transportation facilities.

It is reported that in 1944 there were 4,285 retail distributive associations in the United States serving an estimated 1,524,500 members and doing about $557 million in business.[12]

### Wholesale co-operatives

Co-operatives developed in wholesale organizations for much the same reasons as those in the retail area. The co-operative organization offered wholesalers something their business needed and could not procure so economically elsewhere, in buying power, contacts with manufacturers, transportation, or distribution.

Most wholesale co-operatives are sectional or regional in coverage and operate chiefly in the states within their territory. Recent studies have shown that about one-half of all retail co-operatives are in some way related to wholesale co-operatives (buying associations).

### Farmers' co-operatives

The co-operative movement has been notably successful in the marketing of agricultural products. One of the most important things accomplished by farm co-operatives was the organization of a plan for marketing farm products instead of permitting a vicious system of dumping on the market. The farmer's bargaining power was increased under the co-op system; he had better resources, was better protected against trade abuses, and usually made more money than when operating as an individual.

Fruitgrowers have formed marketing co-ops on quite a large scale for the purpose of getting higher prices, more efficient marketing methods, and better management. The California Fruit Growers Association is a world-famous illustration of this type of co-op.

From a statistical point of view, marketing co-operatives for farm products involve large memberships and often sell large volumes of merchandise. Table XVI-6 shows an analysis of six kinds of marketing co-ops.[13]

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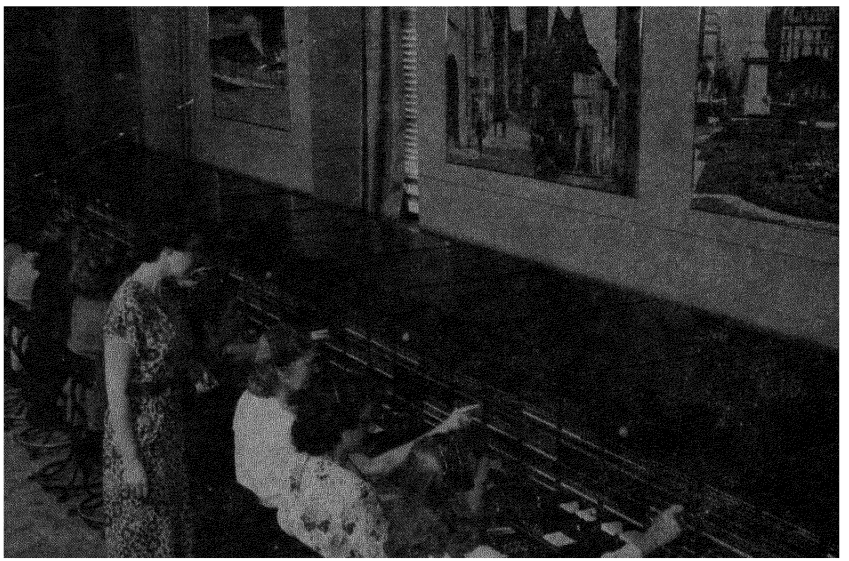
[12] Waite, Warren C., and Cassady, Ralph, *The Consumer and the Economic Order*, 2nd ed., p. 381. New York: McGraw-Hill Book Company, 1949.

[13] Shilt, B. A., and Wilson, W. H., *Business Principles and Management*, 2nd ed., p. 67. Cincinnati: South-Western Publishing Company, 1947.

TABLE XVI-6. MARKETING CO-OPERATIVES—1942.

| *Type* | *Number of Organizations* | *Number of Members* | *Approximate Annual Sales* |
|---|---|---|---|
| Fruit and vegetable growers | 1,250 | 165,000 | $300,000,000 |
| Egg and poultry producers | 300 | 120,000 | 125,000,000 |
| Dairies | 2,500 | 600,000 | 815,000,000 |
| Livestock marketing | 1,000 | 600,000 | 320,000,000 |
| Grain marketing | 2,600 | 380,000 | 500,000,000 |
| Cotton (gins, oil mills, and large-scale selling associations) | 400 | 350,000 | 140,000,000 |

Although marketing co-operatives give the farmers a better system of selling, grading, and standardizing their products, there are some inherent weaknesses in the co-operative system. Some of these are: inadequate capital to promote organizations, poor educational programs for members, lack of interest, lack of volume at times, and irregular crops, which make planning difficult.



*Courtesy American Telephone and Telegraph Company*

*Figure 16-7. Business Abroad.* This overseas switchboard symbolizes the nearness of markets in Europe, South America, the West Indies, and other places throughout the world.

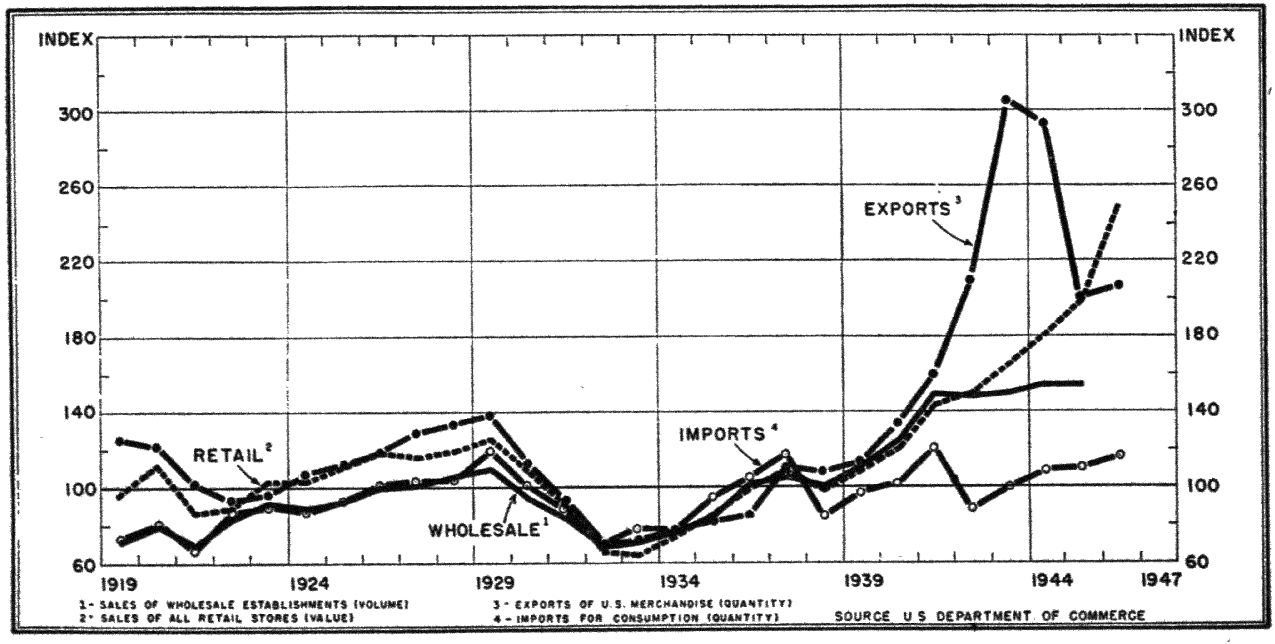



*Figure 16-8. Trends in Domestic and Foreign Trade of the United States, 1919-1946.* (The period 1935-1939 equals 100.)

## Foreign Trade

### Reluctance to develop foreign markets

A large number of producers of consumer and industrial goods are reluctant to develop foreign markets because their imagination does not carry them beyond their immediate domestic trade channels. Furthermore, since it has not been customary to export their lines, many producers are slow to initiate changes. However, many of our attitudes toward foreign markets are deeply rooted in our history of conflict and misunderstandings with other peoples, and these are not easy to change. Language differences and problems of currency, transportation, and credit systems have served as stumbling blocks to world markets, too.

The mechanics of exchange between different countries represents a complicated problem. For a long time gold was almost universally accepted as a basis for exchange, but now that almost every country is off the gold standard, the problem of changing currency is a very difficult one. Furthermore, the fact that many currency systems are subject to constant fluctuation gives rise to additional problems

The trend of domestic and foreign trade in the United States during the 27 years following 1919 is seen in Figure 16-8,[14] which analyzes imports and exports as well as wholesale and retail sales The high point in exports during this period was reached in early 1943 At the same time wholesale volume was holding its own and the volume of retail sales was rising here at home.

The flow of this country's foreign trade is shown graphically in Figure 16-9.[15]

### Advantages of foreign markets

Foreign markets are often more advantageous than domestic ones for a number of reasons. First, they offer less competition; modern communication and transportation systems have opened new worlds unexplored for trade purposes. Secondly, the peoples of other countries have sometimes become quite intent upon duplicating the patterns of Western civilization.

By way of illustration, Africa buys one million dollars' worth of

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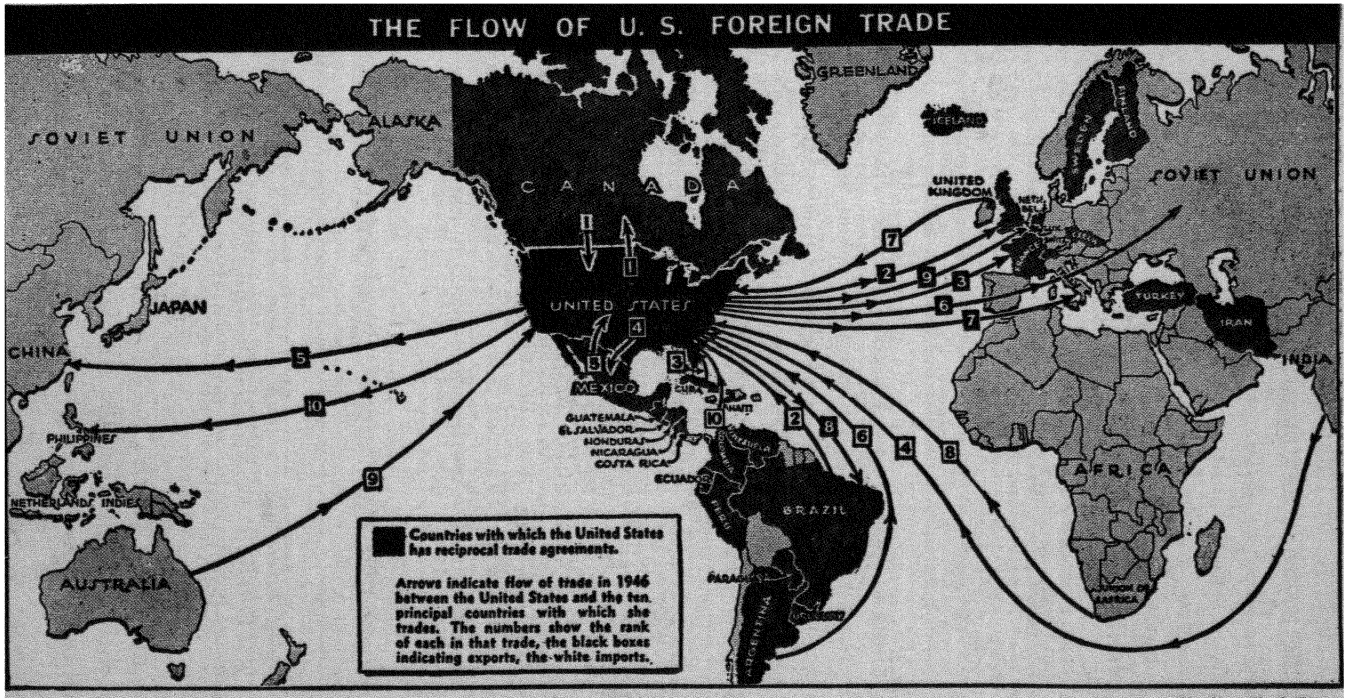
[14] As used in Railroad Committee for the Study of Transportation, *Transportation in America*, p. 85. Washington: Association of American Railroads, 1947.

[15] *The New York Times*, January 26, 1947, Vol. XCVI, No. 32,509, Section 4, p. E5.




Courtesy The New York Times

*Figure 16-9.*

American goods a day—everything from textiles to railroad cars. The white population of the Union of South Africa has the highest per-capita buying power of any people in the world except those of the United States. American goods—machinery, airplanes, automobiles, office equipment, household things, clothing, and drugs—are to be found almost everywhere in the Union of South Africa. The dollar volume of leading exports from the United States to the Union of South Africa in 1947 was: [16]

| | |
|---|---|
| Machinery and Vehicles | $155,736,000 |
| Textile Fibers | 114,071,000 |
| Metals (Bars, Rods, Plates) | 35,762,000 |
| Non-metallic Minerals | 20,165,000 |
| Wood and Paper | 19,884,000 |
| Vegetables and Food Products | 10,041,000 |

Natural climatic conditions that make it winter elsewhere when it is summer in the United States and summer when we have winter present ideal market conditions to level seasonal fluctuations in American business. Argentina, Chile, South Africa, New Zealand, and Australia, for example, have their coldest weather in July and August. Christmas comes during their summer weather.

From a political point of view, desirable trade relations with other countries afford one practical solution to world problems. Every nation wants employment for its people. Employment cannot come without production; production cannot originate without raw materials, machinery, and equipment; and surely all productive processes are dependent upon markets. Without buying power there are no markets at home, and financially worth-while foreign markets might be the answer.

## Employment and Promotional Opportunities in Marketing

In no other field is one's compensation more nearly in proportion to his ability to produce than in marketing. In selling work it is possible, through a combination of salary and commission, to earn in direct ratio to one's ability to earn profits for his company. Many salesmen who have been in the field for years and have built up contacts with many customers earn salaries comparable to those paid to minor executives of their company. Because salesmen have fewer responsibilities than the officers of the company, some salesmen decline executive positions.

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[16] *African Resources.* New York: Farrell Lines, Inc., 1949.

### Advantages

1. There are always marketing jobs.
2. Promotional opportunities are good.
3. One can choose between working for someone else and owning one's own business.
4. Of vocations requiring the same amount of formal training, selling is one of the most highly paid.

### Disadvantages

1. By its very nature marketing requires work indoors, in busy, noisy, and crowded centers.
2. Many selling positions require long hours on one's feet.
3. Periods of pressure and dullness alternate.
4. Eating periods are irregular.
5. Overtime work is required during busy seasons.
6. Some selling positions require traveling and spending considerable time away from home.

### General Manager of the Marketing Division

The extent to which the marketing function is developed in a business organization is determined by the size of the organization, the products manufactured and distributed, and the administrative policies. In a small business the marketing function would surely be consolidated with many other functions. In a large business the marketing function can be seen in full-scale operation by analyzing the marketing division. For this reason, a section from a management guide designed for a large oil company is here quoted: [17]

GENERAL MANAGER, MARKETING DIVISION

I. FUNCTION

As a line member of management, the General Manager of the Marketing Division is charged with advising the President, with conducting the sales, pricing, market research, product acceptance, and advertising activities of the Company, and with operating warehouses.

II. RESPONSIBILITIES AND AUTHORITY

Within the limits of his approved program and Company policies and control procedures, the General Manager of the Marketing Division is responsible for, and has commensurate authority to accomplish, the fulfillment of the duties set forth below. He may delegate to members of his Division

[17] Hall, George Lawrence, *The Management Guide*, p. 53. San Francisco: Standard Oil Company of California, 1948. Reproduced by the permission of the Standard Oil Company of California.

appropriate portions of his responsibilities together with proportionate authority for their fulfillment, but he may not delegate or relinquish his over-all responsibility for results nor any portion of his accountability.

A. Operations and Activities
   1. He will formulate, or receive and recommend for approval, proposals for policies on sales, pricing, market research, product acceptance and advertising, will administer such policies when approved, and will conduct such activities for the Company.
   2. He will establish and administer procedures pertaining to sales, pricing, market research, product acceptance, and advertising.
   3. Based upon his studies of product acceptance, he will recommend new or altered products and the discontinuance of products.
   4. He will solicit special accounts, will supervise sales involving deliveries in two or more Sales Districts, and will sign sales agreements covering such transactions.
   5. He will recommend selection of firms or individuals as advertising representatives.
   6. He will lease or purchase and operate such warehouses as are necessary to the accomplishment of his function.
   7. He will conduct necessary buying activities.
   8. He will approve adjustment of complaints involving amounts over $500 but not over $1,000, and will recommend approval of adjustments involving sums in excess of the latter amount.

B. Organization of His Division
   1. He will recommend changes in the basic structure and complement of his Division.

C. Personnel of His Division
   1. Having ascertained the availability of qualified talent from within the Company, he will hire personnel for, or appoint employees to, positions other than in management within the limits of his approved basic organization.
   2. He will approve salary changes for personnel not subject to the provisions of the Fair Labor Standards Act who receive not over $350 per month, and will recommend salary changes for such personnel receiving in excess of that amount.
   3. He will approve wage changes for personnel subject to the provisions of the Fair Labor Standards Act.
   4. He will recommend promotion, demotion, and release of personnel not subject to the provision of the Fair Labor Standards Act.
   5. He will approve promotion, demotion, and release of personnel subject to the provisions of the Fair Labor Standards Act.
   6. He will approve vacations and personal leaves, except his own.
   7. He will prepare necessary job and position descriptions.

D. Finance of His Division
   1. He will prepare the annual budget.
   2. He will administer funds allotted under the approved annual budget, or any approved extraordinary or capital expenditure program, or any appropriation.
   3. He will approve payment from allotted funds of operating expenses and capital expenditures not in excess of $1,000, which are not covered by the approved budget, any approved expenditure program, or an appropriation.
   4. He will recommend extraordinary or capital expenditure programs and appropriations.
   5. He will administer fiscal procedures.
   6. He will receive for review and recommendation the items of the annual budgets of other staff departments and the field divisions coming within his province.

## Terms for Study

Auction
Bailee
Brokerage house
Cargo
Commission merchant
Confirmation
Consumer goods
Conventions
Current price
Direct selling
Elastic demand
Forecasting
Foreign exchange
Gross profit
Industrial goods
Jobber
Market analysis
Market value
Mart
Middlemen
Monopoly
Per capita
Population shift
Price discrimination
Price war
Priorities
Primary market
Sales promotion
Seasonal demand
Shopping goods
Specialty goods

## Questions

1. In what general ways is marketing related to other aspects of business?
2. Name four areas of business that are dependent upon the functions of marketing. Explain.
3. What are the functions of marketing?
4. How is the marketing function related to the production function? (Consider, among other things, price, style, color, and form.)
5. How do you account for the fact that with all our efficiency in production management we are apparently wasteful in our distribution systems?
6. Name some commodities that do not require a complicated system of distribution.
7. Why do wholesalers usually make a smaller percentage of profit on their sales than retailers?
8. Name five marketing problems of retailers that would be the same as those of wholesalers.

9. What are the limitations of yesterday's sales in predicting tomorrow's markets?

10. How do fashions influence markets? Do you think it would be economically desirable to eliminate fashion goods from our markets?

11. What suggestions could you offer for making market analyses suitable for small-scale merchandising programs?

12. What is the difference between standardization and grading? How do these figure in the marketing process?

13. If our system of mass production and distribution were modified, would consumers pay more for their goods and services? Does this question suggest a defense for high costs of marketing? Explain.

14. What are the most important government and private sources for market information?

15. How can risks in marketing be eliminated or minimized?

16. Why are foreign markets often neglected? Could and should this situation be improved? How?

17. Defend the commodity approach to marketing.

## Problems and Projects

1. Such information as that presented in Table XVI-2 has often been classified as "secret" by the management of a business, and customers have not been informed about how much profit the business made. Can you set up good arguments to defend such profit percentages and to stimulate more respect on the part of customers for the services of management? For example, Table XVI-2 shows a retailer making 24.6 percent on a pound of butter. Can you prove this amount is too much or too little in terms of a fair net profit and operating expenses of the business?

2. Make a list of all the pertinent marketing information you can collect about your community. Show statistically in your own style how this information could be used in developing a new market for a patented water-softening device that operates on kitchen-sink faucets.

3. List the five most important changes in the market characteristics of your own community during the last ten years. (You may need to consult local sources of information, people, or library references.)

4. In what ways can the Chamber of Commerce provide data that will supplement library sources of market data? List your ideas.

5. What type of market statistics about college students would be useful to a clothing merchant?

6. Select ten consumer goods. Classify each as a convenience, shopping, or specialty good. Tabulate these ten items in one column. In columns to the right, evaluate each in terms of the following:

Column 1. Required selling time
Column 2. Value expected

Column 3. Frequency of purchase
Column 4. Price
Column 5. Anticipated guarantee
Column 6. Dealer service
Column 7. Type of person usually making purchase

7. Tabulate some weaknesses of the co-operative system of marketing merchandise. If possible, get the reaction of a local member of a co-operative to its service, prices, and general adaptability to his way of life.

8. Construct a plan you believe would immediately accelerate local interest in export trade.

9. From previous self-analyses of your personal qualifications to pursue a business career, evaluate yourself in terms of fitness for a marketing career. Consider such characteristics as personality, experience, temperament, interest, imagination, and sociability.

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CHAPTER XVII

# DISTRIBUTION PROCESSES

## The Importance of Middlemen

Seven functions of marketing were outlined in the preceding chapter, but these alone stand meaningless unless they are applied to a broad area of service between producers and consumers. We now amplify the seven marketing functions by showing them in operation in modern distribution systems.

The characteristics of any economic group determine in large measure its systems of production and distribution. An extremely conservative group of people, relatively few in number and closely grouped geographically, choose a simple and inexpensive system of distribution. On the other hand, a large, rich, progressive, industrious, and style-conscious country, geared to the tempo of modern living, uses a complicated and expensive system of distribution.

The size and geographical characteristics of our country seem to count most in dictating the vastness of our distribution system. Yet with approximately 150 million people scattered as far as 3,500 miles apart we have simplified our pattern of life with the world's finest transportation and communication systems. These make the population closely knit. We think much the same, do the same things, and appear the same. Our occupations are largely standardized and per-capita income ranges do not vary greatly throughout the country.

In analyzing our distribution system it is important to remember that some goods can and do move directly from producer to consumer without the services of middlemen. Such sales are accomplished either through the company's own retail outlets or by using catalogues, booklets, folders, circulars, letters, and house-to-house salesmanship.

There are at least four reasons why manufacturers prefer to by-pass middlemen:

1. Their products demand stronger and more aggressive specialty selling techniques than are afforded through the usual middleman setup.

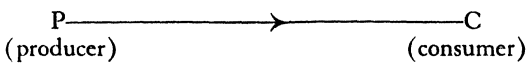
2. Local competition among middlemen reduces sales for the manufacturer's product.

3. Sometimes manufacturers are dissatisfied with the general type of services provided by middlemen—small selling organizations, weak credit arrangements for buyers, limited coverage, and non-co-operative management.

4. Direct selling to consumers often affords lower competitive prices to buyers.

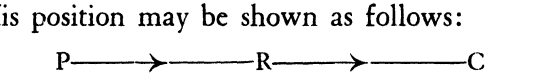
Some manufacturers who make simple products sell direct to consumers because of the smallness of their business. Specialty furniture manufacturers and weavers often sell direct to users, too. Real Silk hosiery, Fuller brushes, Stanley household products, and New Process shirts are well-known names in the direct-to-user specialty field.

The simplicity of the producer-consumer relationship is seen in the following diagram. Goods move directly from producer to consumer.

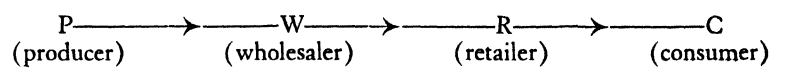



However, if the nature of the products and the marketing process are complicated, middlemen are needed. Why? Middlemen service consumers in definite ways. Markets must be evaluated, desires created, and supplies and inventories secured. Goods must be protected, standardized, graded, financed, and finally delivered. One or several of these added to the other work of producers would ordinarily be too much responsibility. Middlemen are not only better equipped, trained, and organized to perform these essential services, but also can handle them more economically than most producers. As long as markets were small, goods were produced in limited numbers, and wants were simple, there was little need for middlemen. But the size of our modern society prevents marketing without the service of middlemen.

The retailer is a popular middleman working between producer and consumer. His position may be shown as follows:




If the wholesaler enters the picture as an additional middleman, there will be a four-point scheme of distribution like this:




Actually, there are nine combinations involving middlemen that can be worked out in the distribution of goods from producer to con-

sumer. The three presented, however, will serve as a working pattern for commonly used distribution plans.

## Wholesalers

The two most commonly recognized classes of middlemen who work between producer and consumer are wholesalers and retailers. Although the retailer is sometimes not classified as a middleman, he does perform a middleman's service. Retailing will be discussed in Chapter XIX.

The wholesaler is the best known of middlemen. His position is halfway between producer and consumer; he is not a producer or consumer himself, nor does he usually sell to consumers. His primary function is to buy large quantities of merchandise to sell to retailers or other distributors. Other functions of the wholesaler have been discussed in the preceding chapter on marketing.

Wholesalers can be accurately classified in several different ways. A common analysis groups them according to kinds of merchandise they sell. For example, there are wholesalers of food, grain, cotton, clothing, electrical appliances, furniture, and office supplies and equipment.

Another analysis groups wholesalers according to the size of their organization. They may be independent units or chains. They may be local, state, national, or international in scope. Ownership plans enter into classification systems, too. A wholesaler may be organized as a proprietorship, partnership, corporation, or co-operative.

The advantages of distributing through wholesalers are: [1]

| *Field Operations* | *Management Benefits* |
|---|---|
| 1. Close coverage of all outlets, including those with limited potential. | 1. Reduction in sales and supervisory personnel. |
| 2. Increased number of dealer contacts, supplemented by | 2. Less sales, office and shipping overhead through larger and fewer orders. |
| 3. Daily telephone calls, as in drug and other fields. | 3. Credit risks reduced, collection turnover increased and bad debt loss minimized. |
| 4. Fill-in or trial orders not limited to factory unit packing. | 4. Ideal distribution for short lines, small packed deals, limited to one or two quick-turn items. |
| 5. Quick, free delivery to prevent dealer substitutions on consumer inquiries. | 5. Key jobbers' counsel to supplement market research on new items or restyled merchandise. |

[1] Dorr, W. C., "Direct vs. Jobber Distribution, An Appraisal of the Pros and Cons." *Sales Management,* February 15, 1949, Vol. 62, No. 4, p. 56.

*Field Operations* (cont.)

6. Distribution of new products enhanced by jobbing salesman's knowledge of dealer purchases of similar and related items.
7. Reliance of dealer upon wholesaler's man for counsel in buying.

*Management Benefits* (cont.)

6. Expert local market knowledge of wholesaler helpful on sales budgets.
7. In times of stress, jobbers can offer special concentrated help to move frozen inventory.

TABLE XVII-1. FUNCTIONS PERFORMED BY VARIOUS TYPES OF WHOLESALERS.

X—Function fully or usually performed
L—Limited performance
O—Optional performance (sometimes performed)
N—Not performed (seldom or never performed)

| *Function* | TYPE OF WHOLESALER | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | *Service* | *Specialty* | *Cash-Carry* | *Retail Owned and Mutual* | *Manufacturers' Branch Houses* | *Manufacturers' Sales Office* | *Chain Store Warehouse** | *Chain Store Buying Office** |
| Buying: | | | | | | | | |
| Determine needs | X | X | X | X | L | N | X | X |
| Find seller | L | L | L | L | N | N | X | X |
| Negotiate | X | X | X | X | N | N | X | X |
| Transfer title | X | X | X | X | O | N | X | X |
| Selling: | | | | | | | | |
| Stimulate demand | L | O | L | N | X | X | N | N |
| Find buyer | X | X | L | N | X | X | N | N |
| Advise buyer | X | O | L | X | O | L | N* | N* |
| Negotiate | X | X | X | L | X | X | N | N |
| Transfer title | X | X | X | X | X | O | O | O |
| Transporting: | | | | | | | | |
| (Delivery) | X-O | O | N | O | O | N | X | N |
| Storing | X | X | X | L | X | N | X | N |
| Grading† | N | O | N | N | O-L | N | O | O |
| Dividing | X | X | X | X | X | N | X | N |
| Packing | X | X | L | X | X | N | X | N |
| Financing: | | | | | | | | |
| Stock (inventory) | X | X | X | X | X | N | X | N |
| Customers | X | L | N | L | X | O | N | N |
| Risking: | | | | | | | | |
| Stock | X | X | X | X | X | N | X | N |
| Credit | X | L | N | L | X | O | N | N |
| Recording | X | X | L | X | X | L | X | X |

* Chain-store organizations do supervise and manage their stores, but here we consider this a function separate from warehousing and buying.

† Aside from inspection.

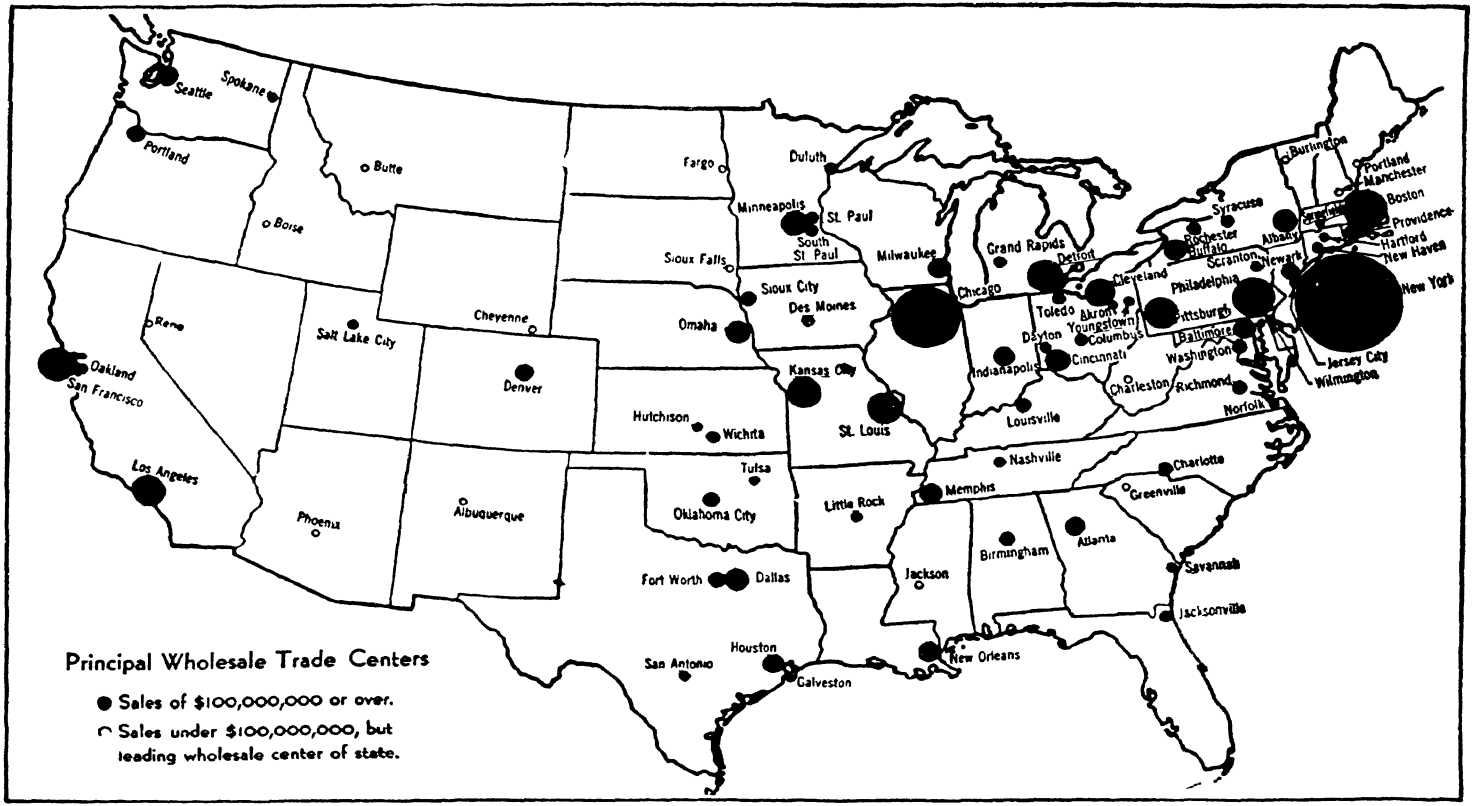
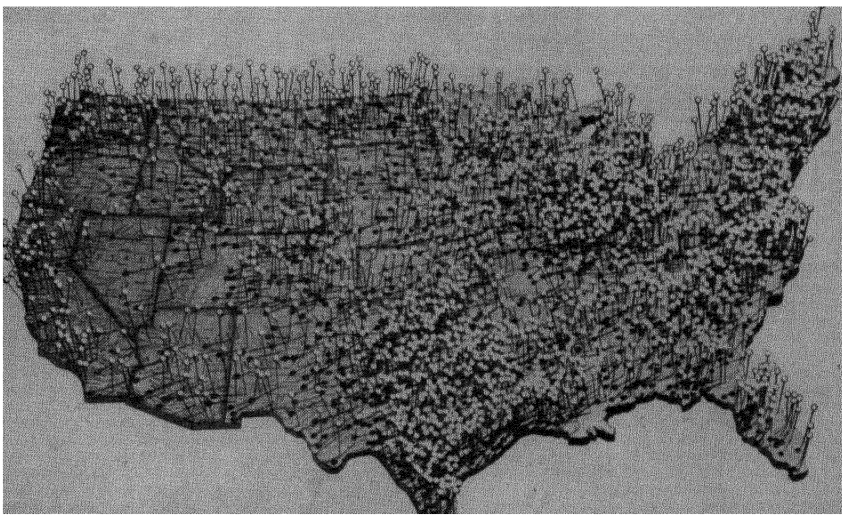



*Figure 17-1. Principal Wholesale Centers*

The magnitude of the wholesaler's coverage of the thickly populated areas in the United States is shown graphically in Figure 17-1. Wholesale trade centers with sales of more than $100 million are marked by black circles; those with sales of less than that amount are shown with small circles.[2]

The functions of wholesalers are generally the same as those in any other marketing situation, but various types of wholesalers have different degrees of responsibility in performing their functions. Table XVII-1 [3] summarizes these for eight types of wholesalers.



*Courtesy The Texas Company*

*Figure 17-2. Wholesale Distribution.* This pin-up map showing the location of more than 2,000 wholesale distributing plants of The Texas Company indicates the wholesaling problem of just one company in one major industry.

## Wholesalers serve retailers in special ways

Much the same relationship exists between wholesaler and retailer as between retailer and consumer. Selling to retailers is a major responsibility of the wholesaler, and his success in this is largely determined by two factors: first, his ability to analyze intelligently the retailer's needs, and second, his enthusiasm and ability to promote trade among the retailers.

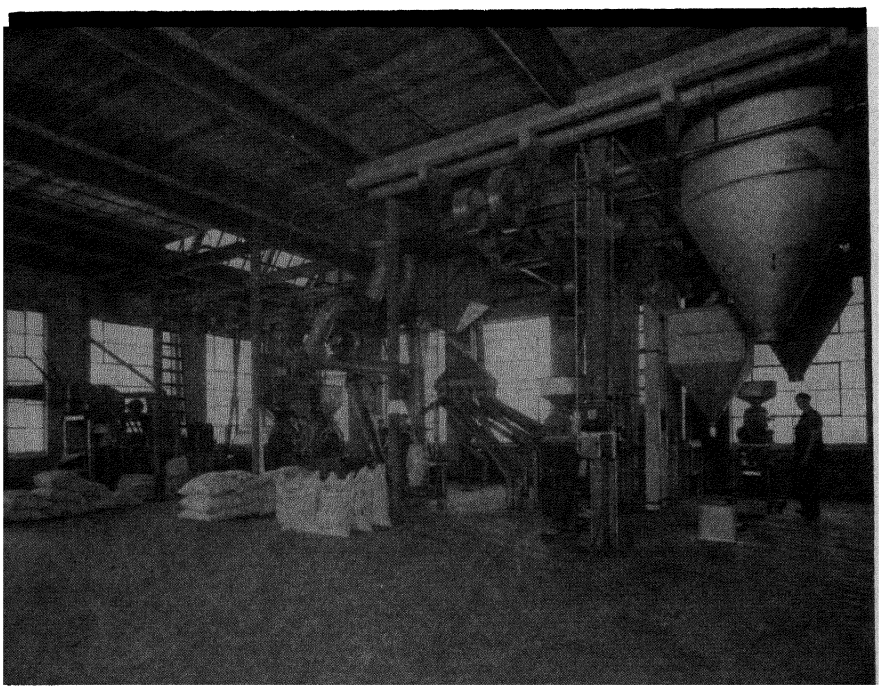
[2] Shilt, B. A., and Wilson, W. H., *Business Principles and Management,* p. 96. Cincinnati: South-Western Publishing Company, 1947.

[3] Converse, P. D., and Huegy, H. W., *The Elements of Marketing,* 3rd rev. ed., p. 281. New York: Prentice-Hall, Inc., 1946.

One common denominator in selling to retailers and to consumers is the importance of the consumer's willingness and ability to accept what is ultimately offered for sale in the stores. Wholesalers as well as manufacturers are therefore ever-vigilant in observing trends in consumer buying.

*Selling to Retailers Is Different.* Selling to retailers is quite a different process from selling to consumers. Most retailers are realistic buyers. They look for profit, or gain, in their buying and selling. They seek styles, price ranges, and merchandising features that will appeal to their buyers—that is, to consumers, who buy to use rather than resell. Sales to retailers are usually in larger units than sales to consumers because retailers consolidate their wholesale orders.

*Assembly Services.* Wholesalers sometimes perform assembly services of sacking, weighing, classifying, or grading merchandise for the retailer. This service is particularly important in sacking sugar, flour, and other bulk items in convenient package sizes.

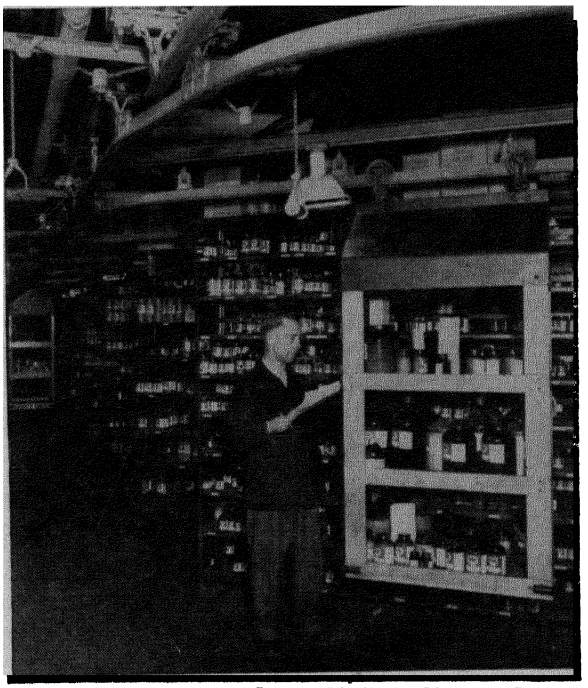


*Courtesy Waples-Platter Company*

*Figure 17-3. Packaging, a Wholesale Function.* Like this food company, many wholesalers package their products from bulk in suitable sizes, often under their own brand name, for retailers and, ultimately, consumers.

Also, dividing and classifying merchandise often gives the wholesaler a good opportunity to introduce the retailer to the wholesaler's own brand names. This promotion plan builds sales and often results in substantial savings to retailers through competitive practices.

In other types of assembly service, wholesalers assemble machine parts or "knocked-down" wooden parts in order to save the retailer time and money in getting merchandise ready to sell to consumers. As an illustration, wholesale appliance dealers do major or minor assembly jobs on cookstoves, washing machines, and furniture for their retail customers.



*Courtesy The Louden Machinery Company*

*Figure 17-4. Warehouse Interior Service.* Efficient storage depends upon many internal economies. This carrier, which operates on a monorail system, saves time and labor. Longer and fewer lines are made possible by not arranging the shelving and track at right angles.

*Catalogue Service.* Wholesalers catalogue thousands of products from many factories and thus retailers may conveniently select their merchandise in small or large quantities in one order through the distributor. Convenience, lower transportation costs, credit terms, and many special dealer aids, such as setting up displays, arranging demonstrations, and calling on customers, make good wholesale connections

almost indispensable to retailers. These services partially explain the strong bond of friendship that exists between most retailers and wholesalers.

There are more than 50,000 American manufacturers of food and related products, and an energetic food wholesaler carries as many as 20,000 different items in stock at one time. A wholesale drug company may stock more than 50,000 different drug and sundry items. It would be impracticable for a retailer who bought merchandise by making individual contacts with many of the 50,000 manufacturers of food to resell to consumers. Furthermore, it is easy to imagine what would be the bewilderment of a retailer in selecting from a stock of 20,000 food items or 50,000 drug items without the aid and counsel of a wholesaler.

The vastness of modern wholesale organizations is vividly illustrated by the wholesale hardware business of Hibbard, Spencer, Bartlett & Company of Evanston, Illinois.[4] This company has recently built a $4,000,000, 20-acre warehouse, employs 600 people, and does a $25,000,000 business annually with 9,000 regular retail customers. Nineteen thousand base trays known as pallets, together with powerful fork trucks, facilitate stacking, unstacking, and moving their 30,000 different hardware items bought from 3,000 different manufacturers.

*Financial Services.* The wholesaler's service in giving credit to retailers is strong justification for his position in the distribution system. Some wholesalers customarily give retail customers sixty days' credit, which permits them to sell to consumers on a shorter credit contract. Thirty days' credit is the usual arrangement retailers offer their customers. Through normal turnover of consumer accounts, retailers try to sell their goods, collect the money, and pay their wholesale obligations within the sixty-day contract period. With a minimum of capital and a maximum of credit, a retailer can thus satisfactorily finance his inventory.

### Wholesalers serve manufacturers

The most important service wholesalers perform for manufacturers is selling their products. Wholesalers are sales agents who maintain contact with thousands of buyers. Therefore, the wholesale channel is the logical distribution channel. Manufacturers sell to only a few wholesalers at most, whereas if they sold direct to retailers they would be absorbed in a multiplicity of expensive and undesirable detail. Indeed, if a manufacturer maintained a sales organization large enough

[4] The following data have been verified by Mr. V. M. Bowers of Hibbard, Spencer, Bartlett & Company.

to call on several thousand retailers direct, he might spend most of his time in selling instead of producing.

An ideal arrangement between manufacturer and wholesaler is that by which a wholesaler or a small group of wholesalers contract with the manufacturer to buy his entire output for one season, one year, or some other contract time. This arrangement encourages volume planning and results not only in lower manufacturing costs but also in similar economies in the distribution process.

Wholesalers are capable of handling large volumes of goods at a lower unit cost than would probably be possible under other systems of distribution. Manufacturers prefer wholesale outlets also because of the economy they make possible in packing, handling, moving, and accounting for large shipments. Carload lots and even smaller case lots can be packed, sealed, and delivered to wholesalers at a much lower transportation and handling cost than would be possible under a unit-purchase system.

The relationships between wholesaler and manufacturer are usually quite cordial and profitable for both parties. Indeed, the manufacturer is eager to make the most of his contacts with wholesalers, because they afford the volume sales that sustain large-scale production. In this capacity, the Joint Policy Committee of the Armstrong Cork Company of Lancaster, Pa., is particularly significant.[5]

This committee was established in 1926 by the Board of Directors for the purpose of giving the Floor Division firsthand views and opinions from wholesalers in various parts of the country. These opinions were to be consolidated in managerial policies and operations with a maximum of timeliness and a minimum of effort. One wholesaler from each of four representative sections of the country is selected by other wholesalers as a member of the committee. Each serves for a period of one year. The other four members of the Joint Policy Committee are top executives of the Floor Division of the company. This committee is charged with the responsibility of working with five areas: (1) manufacturing policies; (2) inspection and grading; (3) shipping and traffic; (4) new patterns and grades; and (5) advertising and merchandising policies. Proof of the company's intention of continuing this work is seen in the resolution guaranteeing that the committee will not be discontinued or its powers curtailed without one year's prior notice to all jobbers.

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[5] Mimeographed description of Armstrong Cork Company's operations to the authors, August, 1949, p. 3.

## Other Important Middlemen

There are many agents and special representatives who operate as middlemen but who are not usually classified as wholesalers.

### Brokers

A broker is one who brings buyer and seller together. He may represent either party to the transaction. The justification for his service lies in his specialized knowledge and personal contacts in the field he represents. He is also useful as a co-ordinator of information about sources of raw materials, supply, or finished merchandise. Since he works strictly as a contact agent, he vigorously develops all sources of information about the lines he represents. Brokers profit by charging either a commission or a flat sum for units sold. They do not generally attain title to their merchandise. Many small producers would be helpless without the aid of brokers who keep them in touch with markets. Notwithstanding the fees brokers charge, they often make possible substantial savings by obtaining economical handling and low transportation rates on large contracts.

### Commission merchants

Unlike a broker, a commission merchant attains possession of merchandise on a consignment basis, although he does not attain title to it either. His services include storing, dividing, selling, billing, delivering, and collecting from accounts.

Commission merchants are prominent in the marketing of many different commodities, such as livestock, grain, dairy products, fruits, vegetables, and manufactured products. Manufacturers in particular have used commission selling plans to encourage dealers to carry larger stocks than they might otherwise carry.

Several factors have recently contributed to a decline in the importance of commission merchants. Producers have often been able to get higher prices through other marketing channels. Wholesalers have absorbed some of their services, and in some states federal regulations of commission men who handle perishable agricultural products have discouraged this plan of selling. State laws also bear upon the commission business. In New York, for example, commission dealers who handle farm products are required to procure licenses and post bonds.[6]

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[6] Converse, P. D., and Huegy, H. W., *The Elements of Marketing*, p. 228. New York: Prentice-Hall, Inc., 1946.

### Manufacturer's agent

One who represents a small group of noncompetitive manufacturers is usually classified as a manufacturer's agent. Such representatives seldom maintain inventories and they assume little or no credit risk. They sell from samples on a commission basis or collect a flat sum for the units they sell.

The efficiency of the sales organization maintained by a manufacturer's agent can make distribution of a manufacturer's product cheaper than if the manufacturer maintained his own sales organization. A manufacturer's agent can catalogue thousands of items carried by hundreds of manufacturers and represent them as a group at one time to their wholesale or retail customers. Some manufacturer's agents take "exclusives" under highly remunerative contract arrangements and concentrate on special sales promotion for the market.

### Sales agent

A sales agent is a manufacturer's broker who usually contracts to sell the manufacturer's entire output. The relationship between the manufacturer and the sales agent is very close, and their contractual agreements are more or less continuous. Sales agents are strategically located in the distribution cycle. They often finance sales, name selling prices, select dealerships, and regulate the plans for distributing all or a part of a producer's output in the markets. Sales agents are paid a higher commission than other brokers in return for assuming these special responsibilities.

## Warehousing Services

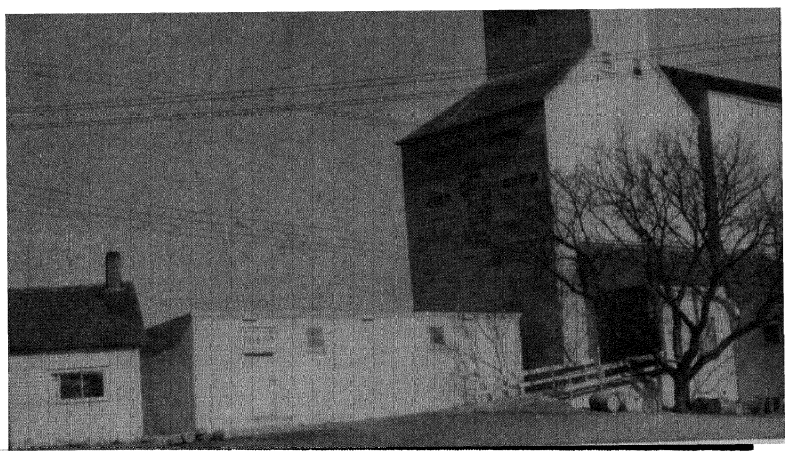
### Significance of storage in the distribution process

The cost of unavoidable delay in conveying goods from producer to consumer never ceases to be a major problem of business management. Although modern systems for controlling, handling, and transporting goods have made our distribution system rapid and thorough, there are distribution problems yet unsolved. These may be related to goods in any of three forms: (1) raw materials, (2) goods in the process of being manufactured, and (3) goods finished and ready for distribution to consumer outlets.

The responsibility of storing goods in either private or public warehouses is a marketing function. Storage creates time utility. In other chapters of this book it must be taken for granted that goods are *avail-*

*able* to consumers and that the major problem of management is salesmanship. Actually, behind-the-counter schemes that facilitate distributing goods seem so complicated that one wonders how merchandise ever gets through to retailers.

Consumer goods are not all produced at the points where they are consumed. Therefore, they must be stored, classified, sold, and shipped to customers. Storage facilities minimize the problem of delays in this process by allowing *time* for handling and moving goods. To a certain extent transportation facilities contribute to time utility and compete



*Courtesy Beech Aircraft Corporation*

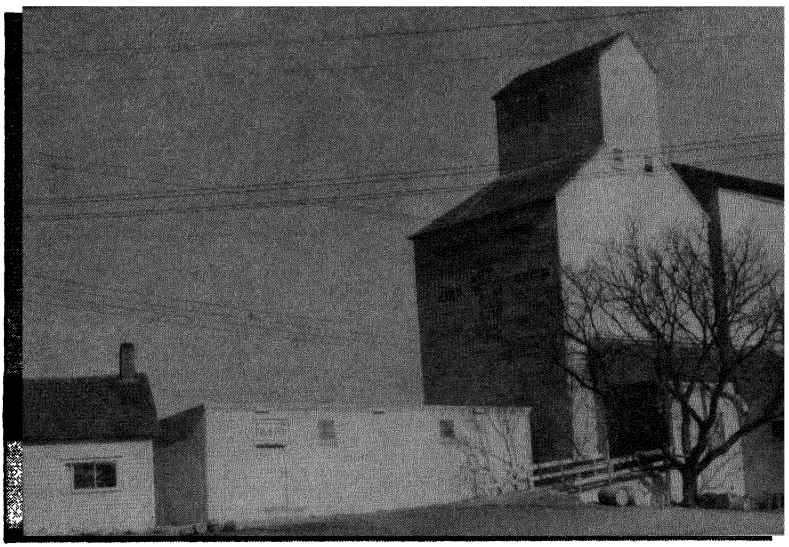
*Figure 17-5. Design Facilitates Storage.* Scientific engineering of shipping crates not only insures protection of the product in transit, but also accelerates the filling of orders and reduces storage costs.

Many storage problems in the marketing process are related to seasonal factors. Consumer wants vary from one season to another. Demands for holiday goods, vacation equipment, and merchandise affected by climate are good examples. Good storage facilities aid in distributing toys for Christmas shoppers, bathing suits for California vacationers, and antifreeze for winter drivers.

Either private or public warehouses can effect sizeable savings in transportation of merchandise by handling carload lots. Transportation rates are much higher for less-than-carload lots than for carload lots. Assume that the freight rate for shipping a commodity from Chicago to Houston is $2.45 per 100 pounds for less-than-carload lots (l.c.l.). The corresponding rate for carload lots (c.l.) might be $2.15. A saving

of 30 cents on every 100 pounds would amount to $120 on a shipment of 40,000 pounds.

Since many commodities, such as cotton, tobacco, grains, and wool, are produced seasonally, storage facilities are needed to carry supplies over to nonproductive seasons. Also, there are seasons during the year in which demand exceeds supply even though production is not entirely seasonal. For example, poultry and dairy commodities are more or less regular in production throughout the year, but they are more in demand in some months than in others.



*Courtesy The Quaker Oats Company*

*Figure 17-6. Country Grain Warehouses.* Grain is often stored near the source of supply in warehouses like this grain elevator.

Storage sometimes improves quality. Lumber, tobacco, and many kinds of meats, for example, are so improved. Other goods deteriorate during storage by loss of flavor, color, size, weight, or usefulness.

### Private warehouses

Aside from the basic functional responsibilities of wholesalers in the marketing process, there are obvious physical problems of providing space and facilities for storing merchandise. The location of these facilities must be chosen in terms of accessibility to retail outlets. Finding strategic market areas as well as desirable terminal connections for transportation lines is very important. These problems are affected, of course, by the amount of space required. The nature of the market, the

characteristics of the products, and the size of the retail outlets all bear upon the arrangement of storage space for goods handled by middlemen.

The problem of storage is closely related to the wholesaler's problems of selling. This is where private warehouses help out. A private warehouse is a storage area secured for the exclusive use of the selling agent. The area may be a part of the same building in which the wholesaler's administrative offices and service equipment are located, or it may be located in one or several other places. On the other hand, public warehouses are storage areas provided for public use on a rental basis.

One strong argument for private warehouses is that large wholesalers often build their merchandising policies around dealer service. They feel that wholesaling involves more than filling a retailer's order: they must follow through and guarantee consumer satisfaction with the merchandise bought from retailers.

These two quotations of remarks made by manufacturers illustrate the idea:[7]

"If possible, we always prefer to use the private warehouse of our agents as they are familiar with our equipment and would give better service on replacement parts than would be possible from a public warehouse. A public warehouse is all right for handling complete units of equipment but is not so good for handling repair part business."

"Our equipment does not lend itself to public warehouse storage, as most of it is used by contractors on a rental basis. It is necessary to maintain shops and machinery to overhaul and repair our equipment after it comes in off rental jobs, and also the manufactured parts to replace breakages. You will readily realize that this could not be done in public warehouses as they are not equipped for this maintenance work."

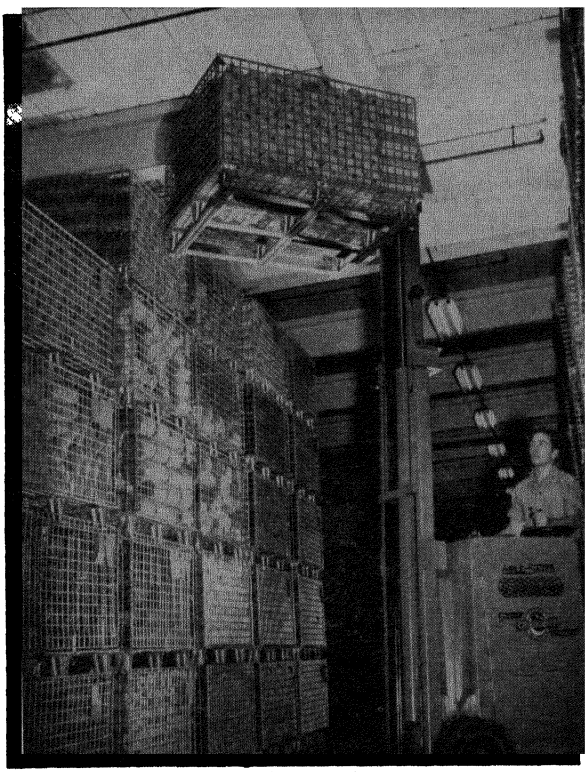
Maximum utilization of plans and modern storage equipment can work effectively in building up fast delivery service for wholesalers who maintain their own storage facilities. One large wholesale hardware dealer customarily ships orders within six hours after arrival. As an illustration of the speed and efficiency with which this company moves stock, review these three cases of freight shipments.[8]

A freight car containing 956 packages of roofing paper and shingles, weighing 64,970 pounds was unloaded and checked for $9.45, and the thirty-two-ton

[7] Phillips, Charles F., *Marketing by Manufacturers,* p. 452. Chicago: Richard D. Irwin, Inc., 1947.

[8] "Handlers of Hardware." *Fortune,* Vol. XXXIX, No. 3, March, 1949, p. 129.

load was transported to the storage area and stored for 78 cents. Breaking this down, two men working in the car by hand palletized and checked 806 rolls of roofing paper and 150 bundles of shingles in 4.40 hours, for a cost of $9.45, while a man with a fork lift transported and stored the whole load in .71 hours, for 78 cents.



*Courtesy The Beattie Manufacturing Co. and* Factory Management and Maintenance

*Figure 17-7.* Special wire baskets afford control of small units that must be stored in large quantities. These baskets are built with special base frames that accommodate stacking.

Similarly, a car containing 2,700 cartons of mailboxes, weighing 21,600 pounds, was palletized and checked by two men by hand in 3.46 hours, for $7.44. The load was then transported and stored by one man with a fork lift in the same amount of time for $3.85.

And a car containing 676 cartons of paper towels and 105 cartons of toilet tissue, weighing 37,770 pounds, was palletized and checked by hand by two men in 3.48 hours for $7.47, and the load transported and stored by two men in 5.54 man-hours for $6.09.

With older or less efficient methods the company estimates that the unloading and storing of similar amounts of merchandise would have cost one-third more than the present method.

*Courtesy Hibbard, Spencer, Bartlett & Co*

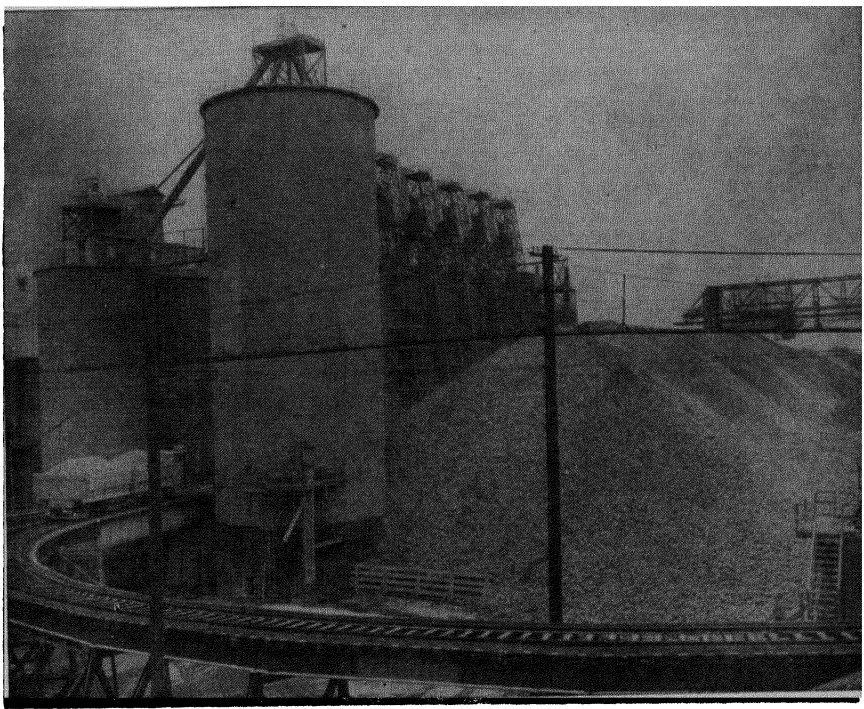
*Figure 17-8. Private Warehousing Facilities.* Here is a view of one of the largest hardware warehouses in America. Note the unit control, the stacking arrangement, and the system for classifying stock.

Furthermore, some manufacturers and wholesalers alike prefer private warehouses because of the advertising value of having their names on the buildings. Producers and distributors feel that the more they can keep their names before their customers, the better their sales will be. In addition, private warehouses can give personalized service to retailers. When a wholesaler works closely with orders, stock, customer complaints, credit, and returns and allowances, he learns the individual characteristics of his customers. Some argue that public warehouses never assume the same personal responsibilities as private warehouses.

Distributors also argue that when they handle their own warehousing problems in private storage they make fewer mistakes than when the same merchandise is handled by public warehouses.

One of the most potent reasons for private warehouses is that some products require special handling and care. The wholesaler is naturally best qualified and has the most responsibility for this service. The phrase *Special handling and care* has broad implications. A product

may require such treatment because of its size, fragility, tendency to deteriorate, or service and maintenance features. Usually the term means that wholesalers are required to maintain and sell goods to retailers in denominations that are unattractive to public warehouses. For example, retail dealers often make unreasonable demands of wholesalers by ordering broken lots and unprofitable mixed orders. A broken lot is an amount less than that customarily packaged and sold as a unit and is usually smaller than a case lot. Wholesalers, through their private warehouses, are glad and willing to serve retailers in these special ways because doing so increases their chances for larger orders later. Public warehouses, however, are less suited to serving wholesalers in this way.



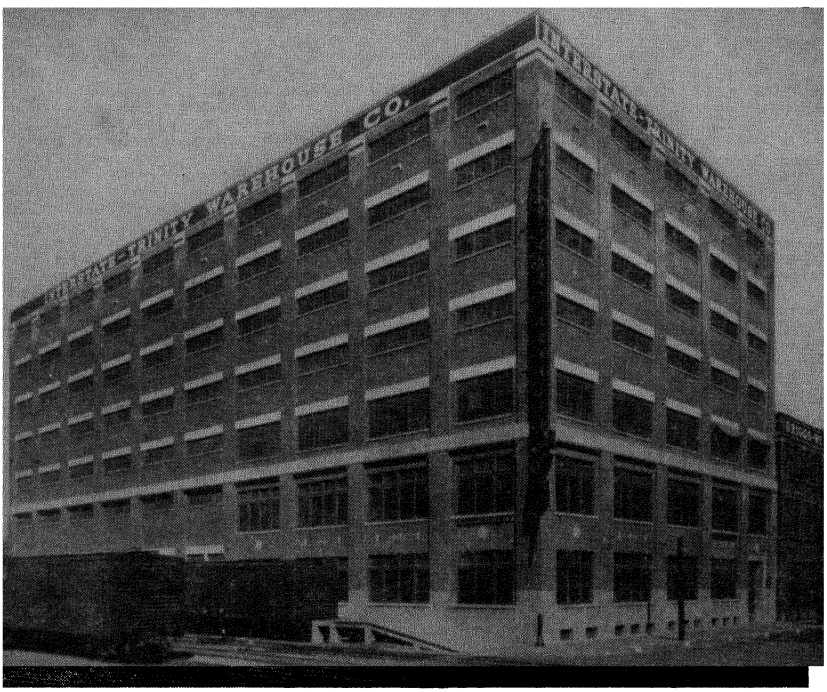
*Courtesy Pittsburgh Plate Glass Company*

*Figure 17-9. Outdoor Storage.* Some products, such as limestone for chemical production, require huge outside storage space.

The following words of a wholesaler express the private warehousing point of view: [9]

[9] Phillips, Charles F., *Marketing by Manufacturers,* p. 452. Chicago: Richard D. Irwin, Inc., 1947.

"All of our shipments of goods are sent to our own warehouses from the factory in uniform quantities. We have approximately 4,000 representatives ordering goods from these different warehouses weekly. Their orders for the most part are very light in weight, averaging about twenty pounds. They do not order in case lots, and the average order has as many as twenty-five items with probably not more than three or four of each item. It would practically be impossible for a public warehouse to give our account the attention that it requires."




*Courtesy Interstate-Trinity Warehouse Co*

*Figure 17-10. The Public Warehouse.* This seven-story structure typifies the advantages offered by public warehouses—accessibility, nearness to markets, and efficient storage.

Finally, for some kinds of wholesaling service, private warehouses may be less expensive to maintain than public warehousing service. No hard and fast rule can be established on this point, but it is always worth investigating to see whether distributing a product through private warehouses is more or less expensive than distributing it through public warehouses. Private warehouses are particularly well adapted to small shipments, mixed orders, light freight, nonseasonal selling, personalized service, and flexible credit terms.

In many cases a private warehouse is a single building and is op-

erated by one management. Many private warehouses, however, operate through what are known as field warehouses, or substations, located at key points geographically in terms of sources and outlets. Table XVII-2 classifies almost 1,800 products that are warehoused in field locations.[10] The table also gives the percentage of total products stored represented by each kind of product.

TABLE XVII-2. FIELD WAREHOUSES OPERATED BY FIVE LEADING COMPANIES AT MID-1941, BY PRINCIPAL TYPE OF PRODUCT WAREHOUSED.

| *Principal type of product warehoused* | *Number* | *Percent of total* |
|---|---|---|
| Canned food products | 304 | 17.1 |
| Miscellaneous groceries | 236 | 13.2 |
| Lumber, timber, building supplies | 180 | 10.1 |
| Coal, coke | 117 | 6.6 |
| Seeds, feed, grain, flour | 113 | 6.3 |
| Fuel oil, gasoline, petroleum products | 91 | 5.1 |
| Wines, liquors, beers | 80 | 4.5 |
| Textile products, wearing apparel | 76 | 4.3 |
| Iron, steel, and products | 66 | 3.7 |
| Household machinery and equipment | 54 | 3.0 |
| Miscellaneous agricultural products | 51 | 2.9 |
| Paints, chemicals, drugs | 45 | 2.5 |
| Industrial and commercial machinery and eqpt. | 37 | 2.1 |
| Paper, wood pulp | 38 | 2.1 |
| Cotton, wood | 37 | 2.1 |
| Miscellaneous hardware | 34 | 1.9 |
| Furniture, finished wood products | 31 | 1.7 |
| Cheese, milk powders | 20 | 1.1 |
| Nonferrous metals and products | 19 | 1.1 |
| Rubber tires, rubber products | 16 | 0.9 |
| Stone, clay, glass, and products | 15 | 0.8 |
| Sugar, syrups | 12 | 0.7 |
| Bags, bagging | 11 | 0.6 |
| Shoes, slippers | 11 | 0.6 |
| Books, paper products | 11 | 0.6 |
| Meat and meat packing | 10 | 0.6 |
| Nonferrous ores | 10 | 0.6 |
| Tobacco | 8 | 0.4 |
| Hides, leather, leather products | 8 | 0.4 |
| Iron ore | 4 | 0.2 |
| Not classified * | 39 | 2.2 |
| Total | 1,784 | 100.0 |

* Includes musical instruments, toys, cameras, dolls, and "not specified."

[10] Duddy, Edward A., and Revzan, David A., *Marketing: An Institutional Approach*, p. 73. New York: McGraw-Hill Book Company, 1947.

## Public warehouses

Strictly speaking, public warehouses include all legally organized facilities for storage offered to the general public on a rental basis. Warehousemen differ from landlords who simply rent space in that they are bailees of goods. A bailee is a person who assumes responsibility for the security of value entrusted to his care. There are four kinds of public warehouses: (1) those that provide accommodations for household goods and personal belongings, (2) those that store general merchandise, (3) those that provide cold storage, and (4) those that specialize in such commodities as cotton, grain, tobacco, or wool.

Public warehouses may be used as reservoirs for surplus goods or as distribution centers in the marketing process. More particularly, they function as marketing agents and do other important miscellaneous services. Public warehouses differ radically from private warehouses in that they isolate goods from their wholesaling or distributing agency.

With the exception of the Middle Atlantic states, the number of public merchandising warehouse buildings is fairly well divided among the geographical regions of the United States. Table XVII-3 shows the distribution of these warehouses in terms of number of buildings and total floor space available.[11]

TABLE XVII-3. PUBLIC MERCHANDISING WAREHOUSES.

| *Division* | *Number of warehouse buildings* | *Floor space sq. ft.* |
|---|---|---|
| New England | 200 | 5,188,964 |
| Middle Atlantic | 629 | 15,042,807 |
| East North Central | 367 | 10,593,585 |
| West North Central | 210 | 5,643,541 |
| South Atlantic | 143 | 3,959,768 |
| South Central | 213 | 5,987,389 |
| Mountain and Pacific | 255 | 6,342,239 |
| United States, total | 2,017 | 52,758,293 |

The major advantages of public warehousing service are:

1. Public warehouses usually have the advantage of strategic location near transportation terminals that feed quickly into limited or widely scattered markets.

[11] Duddy, Edward A., and Revzan, David A., *Marketing: An Institutional Approach*, p. 42. New York: McGraw-Hill Book Company, 1947.

2. The cost of storage in a public warehouse is usually lower if the distributor needs a great deal of space and if his needs are seasonal. Only the space used must be bought. Under erratic market conditions, which put emergency pressure on distributors who need extra storage space for reserves or supplies to be shipped immediately, the flexibility of public warehouses simplifies the problem.

3. Public warehouses afford a distributor ample storage facilities without requiring him to own buildings and equipment.

4. The use of public warehouses also encourages dispersion of stocks and inventories in several locations. Distribution through many field warehouses not only expedites the handling of customers' orders but also assures more safety against total destruction of stock through fire or natural causes.

5. Insurance rates are usually lower in public warehouses than in private warehouses because they afford the safest possible storage service, with fireproof buildings, automatic sprinkler systems, patented alarm devices, sectional cut-out doors for blocking fire regions, and a 24-hour patrol service. Although these minimize losses, no system has yet completely eliminated the risk factor in storage.

6. Public warehouses are well equipped physically to render good storage service. They not only have highly trained personnel who work with storage problems year in, year out, but also have good railway sidings, elevators, power trucks, belt conveyors, lift trucks, and hoisting and tiering machines.

7. Public warehousing has financial advantages. For example, when goods are deposited in public warehouses, negotiable or nonnegotiable receipts are issued. Negotiable receipts have definite financial value. Inasmuch as goods for which negotiable receipts are issued cannot be removed from public warehouses without presentation of such receipts, the claims of other creditors are blocked and the goods evidenced by the receipts can be used as collateral for bank loans.

8. Finally, public warehouses perform many important miscellaneous services. They sometimes function as manufacturer's agents; they may act as selling agents for distributors by honoring order requisitions sent in by dealers or other distributors. If necessary, they will aid in collections by arranging C.O.D. shipments and draft forms.

Public warehouses also repack or re-sort goods, repair broken packages, and give delivery service to regular or special customers who have proper credit authorization.

## Warehouse receipts

Under the Uniform Warehouse Receipts Acts, warehouse receipts are largely standardized in two forms, negotiable and nonnegotiable. The negotiable form provides that goods will be delivered to the bearer or to any person named on the receipt. The nonnegotiable form specifies that goods will be delivered to the depositors or to any other specified person. Both kinds of forms are required by law to include these specific points: [12]

1. The location of the warehouse where the goods are stored.
2. The date of issue of the receipt.
3. The consecutive number on the receipt.
4. Whether the goods received will be delivered to the bearer or to a specified person on his order.
5. The rate of storage charges.
6. The description of the goods or of the packages containing them.
7. The signature of the warehouseman, which may be made by his authorized agent.
8. If the receipt is issued for the goods, of which the warehouseman is owner, either solely or jointly or in common with others, the fact of such ownership.
9. The amount of advances made and of the liabilities incurred for which the warehouseman claims a lien. If the amount of such advances made or of such liabilities incurred is, at the time of issue of the receipt, unknown to the warehouseman or his agent who issues it, a statement of the fact that advances had been made or liabilities incurred and the purpose thereof is sufficient.

## American Warehousemen's Association

The American Warehousemen's Association is one of the oldest national trade associations in existence, having been organized in October, 1891. This organization has a great deal to do with the establishment of operating standards for public merchandising warehouses in this country. Here are only a few of the great names in American business that are served by the members of the Association: [13]

| | |
|---|---|
| American Home Products Corp. | Frigidaire |
| American Radiator | General Electric Co. |
| American Sugar | General Foods Corp. |
| American Tobacco Co. | General Mills |

[12] Nystrom, P. P., *Marketing Handbook*, p. 1002. New York: Ronald Press Company, 1948.

[13] Little, Wilson V., *The Public Merchandise Warehouse in Distribution*, p. 16. Chicago: American Warehousemen's Association, 1947.

Best Foods
Borden Company
Bristol-Myers Co.
Campbell's Soups
Carnation Milk
Chase & Sanborn
Coca-Cola
Colgate-Palmolive-Peet
Congoleum-Nairn Co.
Corn Products Refining Co.
Cudahy Packing Co.
Del Monte Foods
Diamond Match Co.
Diversey Corp.
Du Pont
Florence Stove Co.
Gerber Products Co.
Hershey
Hoover
International Paper
Jell-O
Kellogg's
Lady Esther
Lever Brothers Co.
Pillsbury Flour
Procter and Gamble
Radio Corporation of America
Ralston-Purina Co.
R. J. Reynolds Tobacco Co.
E. R. Squibb & Sons
Standard Brands, Inc.
Standard Sanitary Corp.
Swift & Co.

## Terms for Study

Advertised brand
Branded merchandise
Brand names
Broken lots
Consignment
Consumer trend
Dealership
Field warehouse
Gross margin (profit)
Inventory
"Knocked-down"
Manufacturer's agent
Manufacturer's "exclusives"
Merchandising policy
Negotiable
Nonnegotiable
Operating profit
Outlets
Pallets
Perishables
Private warehouse
Public warehouse
Ratio
Sales agent
Stock turn
Warehouse receipt
Wholesale centers

## Questions

1. What determines the kind of distribution system needed in an economy?
2. What reasons can you advance for manufacturers' by-passing middlemen?
3. In what special ways do wholesalers serve retailers?
4. How does a commission man differ from a broker?
5. Discuss the importance of storage in the distribution process.
6. How would you go about estimating the importance of public warehouses in our distribution system?
7. What relations do you see between transportation facilities and the number, size, and composition of warehouses?
8. How is the function of storage related to the marketing of perishable goods?
9. What are the differences between private and public warehouses?

10. In what ways do public warehouses contribute to the financial responsibilities of business management?

11. How do field warehouses feature in our distribution system?

12. In what ways can storage affect the price of goods?

13. If there is profit to be made in wholesaling, why would it not be a good plan for a manufacturer to organize a subsidiary wholesale organization to handle his products?

14. Our factory system has gradually made it possible to reduce the unit cost of goods manufactured in large quantities. Why has similar progress not been made in our distribution system?

15. Explain the statement, "The producer is to the wholesaler as the wholesaler is to the retailer."

16. Explain fully how the characteristics of commodities would influence, if not completely determine, storage and warehousing arrrangements.

17. What is the warehouse receipt and in what way does it afford a financial advantage to the owner?

18. In how many other ways can the wholesaler serve the retailer besides by supplying the merchandise he orders?

## Problems and Projects

1. The Allen Wholesale Grocery Company sold one million dollars' worth of merchandise during 1949. Their gross margin (difference between net sales and cost of goods) was 10.3 percent and their expenses were 9.1 percent. How much profit in dollars and cents would the Allen financial statement show?

2. An extensive survey conducted by a large credit rating company reported the following data for a large wholesale merchandising chain:

| *When sales were:* | *Operating expenses were:* |
|---|---|
| $250,000 or less | 11.4% of net sales |
| $1,000,000 to $2,000,000 | 9.0% of net sales |
| $5,000,000 and more | 12.5% of net sales |

How would you explain the lowering of the operating-expense ratio with an increase in the volume of sales, followed by an increase in the ratio with a subsequent rise in sales?

3. The Davis Automotive Equipment Company sells its average inventory 3.8 times each year (stock turn) and makes an operating profit of 3.3 percent of net sales. Does the Davis Company make more or less profit than the Jones Dry Goods Company, which has a stock turn of 4 and an operating profit of 2.7 percent?

4. From local sources, such as the classified section of your telephone directory and industrial guides, list 10 dealers in food. Indicate whether these dealers sell wholesale, retail, or both. Explain why some food dealers have a dual system of merchandising.

5. Consult your librarian for statistics on wholesale trade in your region,

state, or city by years, beginning in 1940. Now compare the changes in your locality with similar statistics for the United States as a whole. How would you explain the increase or decrease in wholesale trade?

6. Construct a problem of your own in which you show real or imaginary costs of producing, wholesaling, and retailing some commonly used commodity. Explain with your own figures why the wholesaler's profit ratio (percentage) is less than the retailer's. Does this ratio affect the amount of profit the wholesaler makes?

7. List selling costs that are peculiar to wholesalers.

8. Construct a list of strong arguments that you think would defeat the objections raised in this chapter to public warehousing services.

9. As a means of reducing the price of automobiles, construct a plan that will reduce the cost of distribution of automobiles and at the same time not affect quality and service.

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CHAPTER XVIII

# TRANSPORTATION

## Transportation the Keystone of Distribution

### Transportation in American life

Kipling once said, "Transportation is civilization," and indeed it is *our* civilization. Statistics tabulated immediately before World War II show that we traveled 550 billion passenger-miles in one year and moved more than 600 billion ton-miles of intercity freight. Probably one-fifth of all investments and more than one-tenth of all consumer expenditures in 1940 [1] were for transportation. In one way or another, approximately one-fourth of our national income is spent for transportation. We own one-third of the world's rail mileage, one-third of its highways, and about 70 percent of its automobiles. Transportation represents American life!

All private, commercial, and industrial activities depend for their survival upon our rapid, easy, and economical transportation system. Indeed, many great cities trace their origin to the natural trade caused by transportation facilities at strategic geographical points. Handling goods at points where they were unloaded gave rise to varied activities that stimulated the growth of towns and cities.

The progress and development of transportation facilities in the United States can be summarized in five areas: [2]

a) Construction by private capital of a nationwide network of tracks, over which privately owned railroads produce the great bulk of the public service of transportation.

b) Building by governments—national, state and local—of a system of rural highways and city streets, used by individuals and by private companies in the transportation business.

c) Development, almost entirely by the national government, of inland waterways, used by private transportation companies.

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[1] National Resources Planning Board, *Transportation and National Policy,* p. 2. Washington: Government Printing Office, 1942.

[2] Railroad Committee for the Study of Transportation, *Transportation in America,* p. 66. Washington: Association of American Railroads, 1947.

d) Construction and operation at government expense of a system of airways and airports, used by private companies in the business of air transportation.

e) Construction and operation, chiefly by private capital, of an extensive pipe-line system, used principally for the transportation of petroleum and its products.

## The role of transportation in distribution

Procurement and transportation are so closely related that oftentimes the procurement section of a marketing division owns and operates its own transportation system. Transportation creates place utility by getting goods to the correct location. If the businessman captures the consumer's interest and enthusiasm for his product, goods must be made available for consumption at the right time and place.

In the marketing of seasonal goods it is easy to see how effective transportation makes the most of time utility. Merchandise for Easter, Christmas, other holidays, and special events must arrive in time to be sold before—not after—the days celebrated. Effective transportation lines deliver goods in time to reach markets.

## Transportation widens the market

Buying and selling relations work two ways: either a customer comes to a dealer, or a dealer goes to a customer. Transportation is involved in both cases. The extent to which transportation aids customers, or the extent to which dealers can deliver goods to customers, determines the volume of business. Wholesalers and retailers alike devise many ways to capitalize on the potency of transportation in making the most of markets.

Improved highways gave people incentive to own a car and "go places." State-maintained highways now cover 540,000 miles, county-maintained highways include 2,426,000 miles, and city routes cover 304,000 miles. These three classifications give more than 143 million people 3,270,000 miles of good highways. Families in both city and farm areas now either own or have access to automobile transportation.

Retailers, particularly, have educated the motorists to drive to markets where big assortments and low prices are attractive. This is done by presenting new fashions, advertised specials, bargain-day privileges, free parking, and entertainment attractions.

Department stores and some specialty shops bid for neighborhood trade within a radius of 50 or 75 miles by giving free delivery. Retail branches of mail-order houses like Montgomery Ward and Sears, Roe-

buck have made shopping in person almost as easy as shopping by mail. Out-of-town delivery service is usually scheduled on a weekly basis with company-owned trucks or through subcontracts with local transportation lines.

In the food line, a well-known Dallas bakery has extended its market for bread by making daily deliveries to distances of more than 100 miles away from the plant. A fleet of modern trucks keeps delivery schedules at all hours of the day and night to supply retailers in more than 20 nearby communities. This free service is done in competition with local bakeries, who only deliver within the city limits.

Competition in different transportation lines has helped stabilize transportation rates at a level that permits customers to buy away from home. Table XVIII-1 shows the growth and comparative importance of major transportation agencies.[3]

TABLE XVIII-1. DISTRIBUTION OF COMMERCIAL FREIGHT TRAFFIC IN THE UNITED STATES.*

| *Agency* | *Percentage Distribution* | | | | | |
|---|---|---|---|---|---|---|
| | *1939* | *1940* | *1941* | *1942* | *1943* | *1944* |
| Steam railroads, including mail and express | 63.3 | 62.3 | 64.3 | 70.9 | 72.7 | 70.0 |
| Great Lakes † | 12.9 | 14.4 | 13.9 | 12.4 | 10.3 | 10.0 |
| Rivers and canals | 3.8 | 3.7 | 3.6 | 2.9 | 2.6 | 2.8 |
| Motor trucks | 8.1 | 8.4 | 7.7 | 5.5 | 4.8 | 4.6 |
| Oil pipe lines | 11.8 | 11.1 | 10.4 | 8.2 | 9.5 | 12.5 |
| Electric railroads | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

* Includes intercity freight traffic by private, contract, and common carriers, except coastwise and intercoastal traffic.

† U. S. domestic traffic only.

Industrial engineers particularly know the value of transportation costs in establishing selling prices for products sold in a competitive market. Industry depends upon good transportation facilities because production schedules are determined by consumption statistics. Consumption is impossible without a delivery system for goods.

From another point of view, prices and market advantages may be partially determined by availability and cost of labor. Local busses and

[3] Adapted from Duddy, Edward A., and Revzan, David A., *Marketing*, p. 29. New York: McGraw-Hill Book Company, 1947.

railways by themselves can make the difference between accessible and inaccessible sources of labor supply. A large portion of the transportation revenue in this country comes directly or indirectly from carrying people to or from work.

## Areas of Transportation

### Some internal aspects

Conventional thinking on the subject of transportation includes only the external aspects, such as the movement of freight and passengers by rail, highway, water, or air. Actually, the subject of transportation is so large that it touches almost *every* phase of business activity inside as well as outside the plant, office, or store. A minimum of five areas

*Courtesy Chicago & North Western Railway Company and Association of American Railroads*

*Figure 18-1. Streamliners Serve Modern Needs.* Nearly $10,000,000 worth of streamlined trains are here being cleaned and made ready for service in various parts of the country.

of transportation cannot escape our thinking about internal aspects of transportation. Although they are discussed more fully elsewhere in this textbook, a review here will clinch the full meaning of transportation. These areas are: (1) movement of people, (2) routing of office materials, (3) transportation of merchandise, (4) transportation of factory materials and equipment, and (5) transportation of materials in storage or warehouses.

## Transportation by railways

The history of railways has paralleled the history of American business. Not only have railways become indispensable transportation units, but they have added much to the economic development of our country. Their reliability, dependability, and growth have commanded our respect in times of both peace and war.

Since World War I, the railroads have done as follows: [4]

1. About doubled the transportation performance of the average freight car per day.
2. Increased the net load of freight in the average train from less than 700 tons to more than 1,100 tons.
3. Increased the average speed of freight trains by 55 per cent.
4. Increased the transportation output of the average train from approximately 7,000 to more than 18,000 net ton-miles per hour.
5. Made railroad passenger travel nearly twice as safe.

During World War II there was convincing evidence everywhere of our dependency upon railways. Without them we would have been completely lost in our problems of moving manpower, supply, and equipment.

In recent years, highway transportation has given railways embarrassing competition. Some authorities predict that motor transportation may ultimately push many railways out of business, but there are many reasons why this may not occur. Railways have the greatest potentiality for low-cost overland transportation. Railway rates do not often seem inexpensive, yet if railways could operate at full capacity, or close to it, most of the time, low rates could be effected.

Railways are peculiarly well adapted to heavy and/or large freight shipments. On a competitive basis trucking lines could probably never compete with railways in moving heavy machinery, tools, equipment, and heavy bulk commodities like cement, gravel, and building materials. Furthermore, railways provide many useful services for shippers that other agencies cannot or at least do not provide.

*Railroad Rates.* The charges made by railroads for the movement of freight are based upon two kinds of rates—class and commodity. The rates are quoted in cents per 100 pounds (sometimes per ton) from shipping point to destination. Rates are built fundamentally around three territorial classifications: (1) Official, (2) Southern, and (3)

[4] Pamphlet from the Association of American Railroads, unnumbered pages, Washington, D. C., 1948.

Western. The Official classification includes all territory east of the Mississippi River and north of the Ohio and Potomac rivers. The Southern classification covers the territory east of the Mississippi River and south of the Ohio and Potomac rivers. The Western classification includes all areas west of the Mississippi.

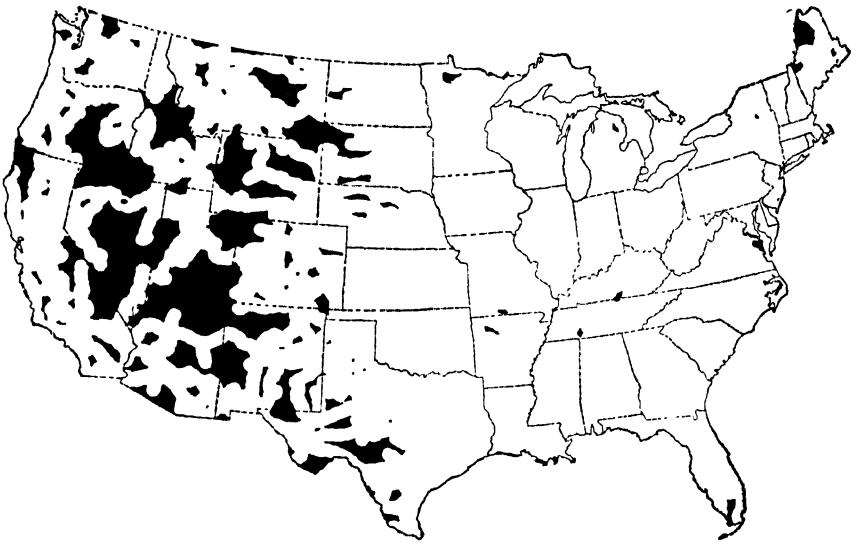

*Figure 18-2.* Here is a graphic review of how railroads serve the population of the United States. Shaded area indicates regions where the population is more than 25 miles away from a railroad. (SOURCE: Railroad Committee for the Study of Transportation, *Transportation in America.* Washington: Association of American Railroads, 1947.)

Within each of these territorial classifications are several classes, and the freight rate charged for each is quoted as a percentage of that charged for Class 1. Table XVIII-2 shows the three classifications and the percentage of the Class 1 rate charged for every class of freight.[5]

There are eight classes in the Official category, six numbered classes and two additional classes designated as Rule 25 and Rule 26. The Western classification has ten classes, five numbered and five lettered. There are twelve classes in the Southern classification.

Freight is assigned to one of these classes after careful deliberation by the three railroad freight classification committees: the Official Classification Committee with headquarters in New York, the South-

[5] Johnson, Emory R., *Transport Facilities, Services, and Policies,* p. 90. New York: Appleton-Century-Crofts, Inc., 1947.

ern Classification Committee located at Atlanta, and the Western Classification Committee in Chicago. Many factors are considered in assigning a classification for freight, such as value, weight, space occupied, quantity shipped, equipment required to handle, packing, crating, fragility, and form.

TABLE XVIII-2. FREIGHT CLASSIFICATION AND CLASS RATINGS OF THE OFFICIAL, SOUTHERN, AND WESTERN CLASSIFICATIONS.

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Official Classes | 1 | 2 | Rule 25 | 3 | Rule 26 | 4 | 5 | 6 | | | | |
| Percentages | 100 | 85 | 70 | 70 | 55 | 50 | 35 | 27.5 | | | | |
| Western Classes | 1 | 2 | 3 | 4 | A | 5 | B | C | D | E | | |
| Percentages | 100 | 85 | 70 | 55 | 45 | 37.5 | 32 5 | 30 | 22.5 | 17.5 | | |
| Southern Classes | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
| Percentages | 100 | 85 | 70 | 55 | 45 | 40 | 35 | 30 | 25 | 22.5 | 20 | 17.5 |

Commodity rates are special rates usually fixed for carload shipments of heavy commodities moved in large quantities, such as coal, coke, sand, cement, gravel, ores, lumber, grain, steel and sulphur. Commodity rates are lower than class rates, and the fact that usually only carload lots are shipped at such rates results in a second reduction.

Beginning in January, 1947, commodities were divided into 260 classifications representing 5 major groups. Previously there had only been 156.[6]

*Preferential Rates.* There are considerable differences in the prices charged by the same railroad for moving the same tonnage of freight an equal distance. Rate differentials have been severely criticized by those who felt the discrimination as well as their sympathizers. The reasons underlying rate differences are deeply fixed in many factors, such as precedent, favored markets, geographical factors, and reluctance to change.

Here are two illustrations of partiality in rates on first-class freight (manufactured goods):[7]

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[6] Railroad Committee for the Study of Transportation, *Transportation in America,* p. 103. Washington: Association of American Railroads, 1947.

[7] Payne, L. S., "Industrial Facilities of the Southwest." *Southwestern Social Science Quarterly,* March, 1947, Vol. XXVII, No. 4, pp. 341, 342.

(rates in cents per 100 pounds)

| *From* | *To* | *Miles* | *First-Class Rates* |
|---|---|---|---|
| Little Rock, Arkansas | Decatur, Ill. | 454 | 154 |
| Springfield, Ill. | Cleveland, O. | 454 | 106 |
| (difference in favor of eastern shipper) | | | 48 |
| Dallas, Texas | Chicago, Ill. | 905 | 237 |
| Chicago, Ill. | Burlington, Vt. | 909 | 154 |
| (difference in favor of eastern shipper) | | | 83 |

With commodity rates the same type of partiality is evident:

| | | | |
|---|---|---|---|
| | *Glassware* | | |
| Tulsa, Okla. | Chicago, Ill. | 670 | 71 |
| Marion, Ind. | Richmond, Va. | 685 | 46 |
| (difference in rate) | | | 25 |
| | *Cotton Fabrics* | | |
| Little Rock, Ark. | Toledo, O. | 738 | 88 |
| Rockford, Ill. | Williamsport, Pa. | 741 | 79 |
| (difference in rate) | | | 9 |

If a shipper sends as much as a carload of merchandise, he is given a carload rate (c.l.) for the class of merchandise he ships. Carload rates are, of course, much cheaper than less-than-carload rates (l.c.l.).

Railroads also deal in "local" and "through" rates. It is evident that once goods are loaded into a boxcar it costs little more to move them a thousand miles than a few hundred miles. Unloading freight at the end of a haul is an expense whether it has been a few hundred miles or thousands of miles. Therefore, railroads make lower rates for shipments that go longer distances.

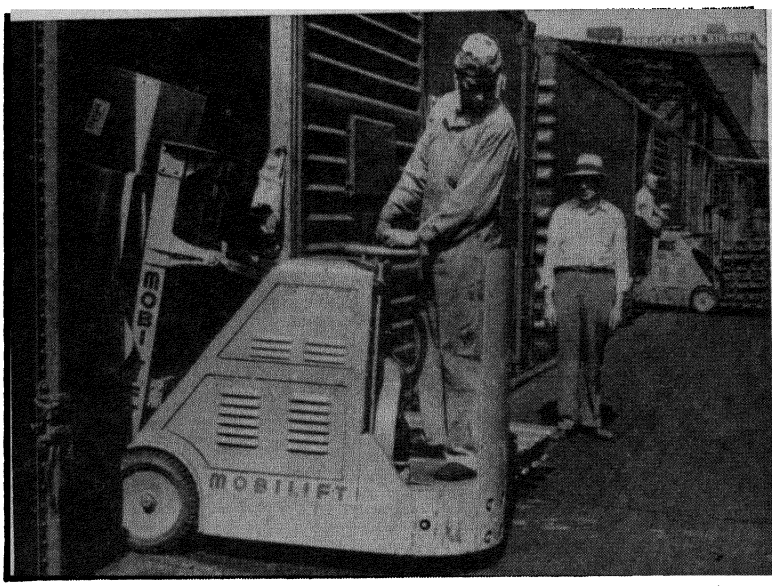
The charges made by railroads are approved by public commissions appointed to study and evaluate the problem of how much the shipper should be charged. The rates approved by the commissions are public information and are published as tariffs, which become the legal rate railroads can charge.

The most significant government control over rates and fares charged for freight and passengers comes through the Interstate Commerce Commission. Once rates have been established, they cannot be changed without filing a formal request through the Interstate Commerce Commission or its agents and waiting for hearing and approval. State, county, and city agencies regulate intrastate and intercity transportation.

*Special Service Features.* There are many special service features that make shipping by rail advantageous. Some of these services undoubtedly originated through competition with other transportation lines.

The majority of them, however, came as a result of research plus ambition to give shippers the best in specialized railroad service.

*Pick-Up, Loading, and Delivery Service.* Most railroad lines have now added door-to-door pick-up and delivery service by using trucks as feeder lines and for city delivery. However, the railroad companies give pick-up and delivery service, as well as loading service, only on less-than-carload lots.




*Courtesy Automobile Manufacturers Association*

*Figure 18-3. Platform Loading.* Specialized truck service is indispensable to the fast, efficient, and safe handling of freight in loading boxcars.

*Special Cars.* Once the goods are in the hands of the railroad, there are specialized cars available to accommodate the shipper's merchandise. Refrigerator cars are made ready for perishables like meat, fruits, and vegetables. Tank cars can be leased from the railroads for moving liquid commodities like oil, gasoline, chemicals, and some food products. Closed hopper cars are particularly useful to shippers of bulk commodities because they can be loaded from the top and unloaded through openings in the bottom. Typical commodities moved in hopper cars are cement, peanuts, soda ash, sand, and gravel. Either tank cars or hopper cars effect savings to the shipper by eliminating the need for packaging the bulk commodities being moved in special drums, cartons, or vats. In much the same way, automobile cars provide a saving to the shipper because these cars have a self-contained

loading apparatus in the ceiling as well as racks that minimize the need for special packing. Both features enable the shipper to pack more automobiles in one railroad car.

Table XVIII-3 does not give an analysis of all the specialized types of car services provided by the railroads, but it does give an excellent breakdown of eight types owned by the railroads and other companies.[8] Automobile cars, for example, are not shown in the table but are probably included among the 730,640 boxcars owned by the railroads.

TABLE XVIII-3. FREIGHT CARS CLASSIFIED BY TYPE AND OWNER, DEC. 31, 1947.

| *Types of cars* | *Owned by Railroads* | *Owned by Other Companies* | *Total* |
|---|---|---|---|
| Box | 730,640 | 1,911 | 732,551 |
| Flat | 68,336 | 179 | 68,515 |
| Stock and poultry | 51,928 | 2,160 | 54,088 |
| Gondola and hopper | 868,293 | 8,015 | 876,308 |
| Refrigerator | 8,914 | 137,486 | 146,400 |
| Tank | 20,833 | 114,397 | 135,230 |
| Cabooses | 24,758 | | 24,758 |
| Other cars | 10,814 | 1,102 | 11,916 |
| Totals | 1,784,516 | 265,250 | 2,049,766 |

*Reconsignment and Diversion Service.* Many good reasons often make it imperative for a shipper to change the destination of his goods. For example, an order of wheat might originate in Amarillo, Texas, and be consigned to Oklahoma City, but in transit or after it reached Oklahoma City the shipper might find it advantageous to ship the wheat to Little Rock, Arkansas. The railroad would reroute the wheat to the second destination at a nominal service charge.

A citrus fruitgrower in Miami, Florida, could ship a carload of oranges to a dealer, an agent, or even himself in Richmond, Virginia. While the oranges are en route he could communicate with his brokers along the way and promote the sale of the oranges. If his agent in Birmingham, Alabama, for example, wired him that the market was good there, the shipper could notify the railroad to change the route or destination of the fruit. If this notification were given before the oranges reached Jacksonville, Florida, the shipper would probably be entitled to a through rate to Birmingham plus nominal diversion charges. If the oranges had gone beyond Jacksonville, additional charges would probably be made.

Originally in transportation terminology the process of changing the

[8] Pamphlet from the Association of American Railroads, unnumbered pages, Washington, D. C., 1948.

route a shipment takes after it reaches its intended destination was called *reconsignment.* When the destination was changed before the shipment reached the original destination, that was called *diversion.* Although some writers insist on this differentiation, the terms are now used interchangeably.

*Pooling.* All freight transportation is more or less related to volume buying and selling. Actually, a dealer's advantage in a given transaction from a profit point of view, is often determined by his ability to get low transportation rates. One way this can be done is by pooling shipments of goods that are going to several destinations along the route. A Fort Worth flour mill might sell flour to one dealer in Breckenridge, one in Abilene, and one in Big Springs, Texas. Under this arrangement he would probably bill out a car of flour nonstop to Breckenridge and benefit by the carload rate. From Breckenridge the rest of the flour could be shipped to both Abilene and Big Springs at less-than-carload rates. The advantage of this arrangement would lie in the fact that all three orders would move as far as Breckenridge (about 100 miles) at a cheaper rate than each would have moved to Breckenridge, Abilene, and Big Springs if shipped separately from the Fort Worth flour mill.

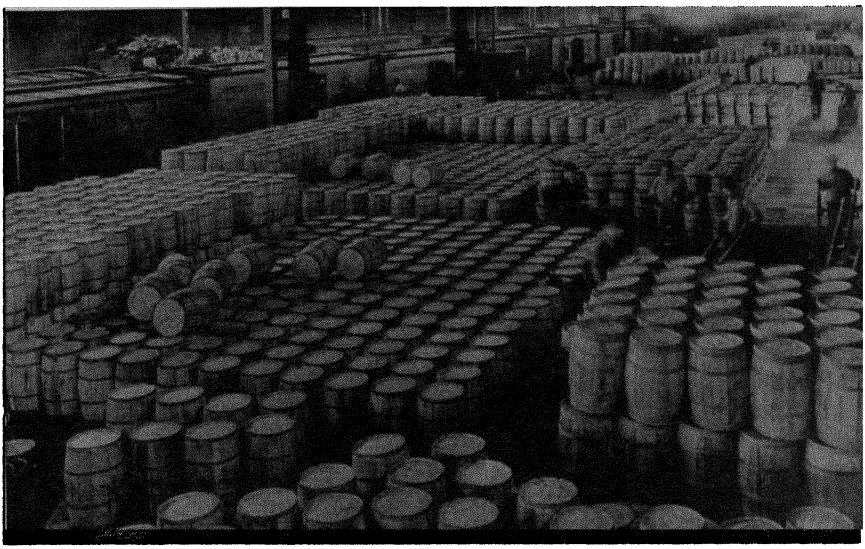
Several small dealers in the retail or wholesale field can consolidate their shipments of merchandise and gain an advantage in transportation rates by pooling their orders in one car. This type of pooling service is quite common with grocery stores and feed dealers who order flour, stock feed, and poultry mash from one or several wholesalers or manufacturers.

*In-Transit Privileges.* There are countless in-transit privileges extended by railroads to shippers. For example, the railroads will allow certain commodities to be stopped in transit for manufacturing processes, storage, milling, feeding, creosoting, fabricating, packing, cooling, grading, and concentrating. The railroad allows the shipper a through rate plus a charge for the in-transit service.

Livestock producers make use of this service when cattle are shipped long distances. The cattle are sometimes taken off the train, fed, watered, and rested while on the way to their destination.

*Terminal Services.* The railroads make unloading easy for shippers by providing elaborate terminal facilities. Temporary storage facilities are often provided, specialized trucking facilities are available for unloading, and larger shippers are serviced with special tracks or spurs that bring the railroad cars to the customer's own warehouse or loading dock.

After a freight shipment has been "spotted," located officially in the yard by track number, and so forth, the person to whom the shipment is addressed (the consignee) is notified and 48 hours are usually allowed as free time in which the freight car can be unloaded. In order to discourage delay, the railroad makes a demurrage charge of approximately $2.00 for each of the first four days after 48 hours and $5.00 per day thereafter.



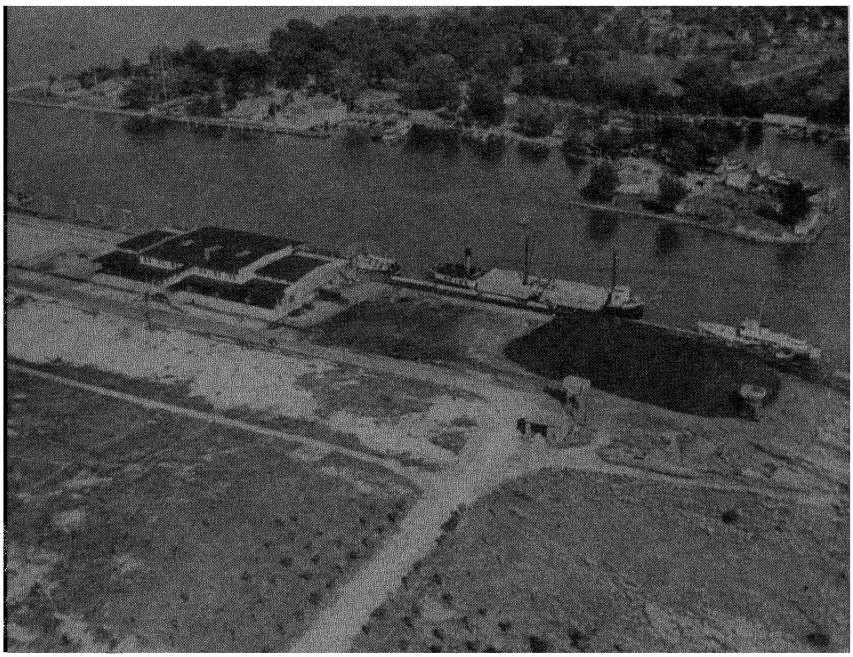
*Courtesy Norfolk & Western Railway and Association of American Railroads*

*Figure 18-4. Warehousing Facilities.* These are apples waiting to be loaded from the warehouse of a large Eastern railroad terminal. Such warehousing is a good example of the special services railroads can give the shipper.

Although demurrage charges may seem high, if not unfair, actually they are quite reasonable and can encourage a dealer to use track service as temporary storage for his product while he completes local sales contracts. Under most circumstances, demurrage costs would be much less than the cost of moving heavy freight to a warehouse and then on to a point of consumption or sale.

Lumber dealers often buy a car of lumber and sell it from the track to large contractors rather than move it to their lumber bins and deliver it to the contractors from there. The same plan is often employed in selling large quantities of other bulk commodities, such as cement, lime, Sheetrock and plywood building products.

This type of track storage should not be confused with the temporary terminal warehouse service provided by railroads in large cities.



*Courtesy Rochester, N. Y., Chamber of Commerce*

*Figure 18-5. Wharf and Warehouse Facilities for Waterways.* Strategically located terminal facilities are necessary if waterways are to be fully utilized.

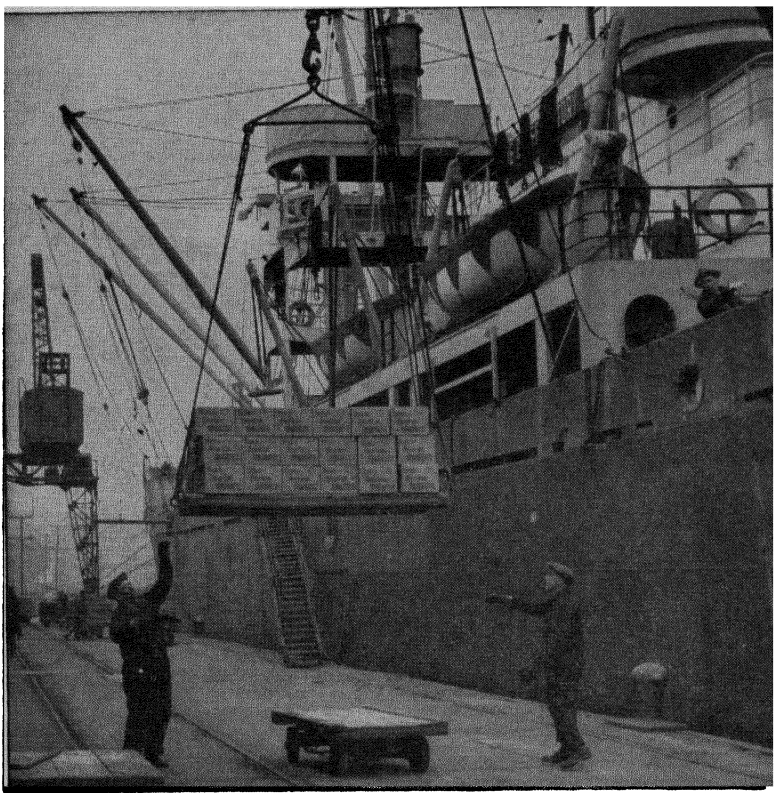
## Transportation by waterways

Waterways have significantly developed world trade and commerce chiefly because of their accessibility and economy. They provide the cheapest of all means of transportation. Shipping by water is ideal for bulk cargo, heavy merchandise, and long routes. The term *waterways* includes lakes, rivers, and channels as well as oceans.

Although the cost of water transportation has proved to be a great enticement, there are definite limitations to the use of waterways. For one thing, shipping by water is slow. The modern tempo of distribution being what it is, the time element alone is enough to eliminate much shipping by water, because styles become outdated, markets are seasonal, and losses are incurred through spoilage.

The export merchant and local dealers who use waterways are also handicapped at times because of the inflexibility in routes caused by poor docking facilities and ports. Furthermore, if ports are not strategically located near overland feeder routes, distribution is bottlenecked.

Domestic shipping by waterways is normally along the Atlantic, Pacific, and Gulf Coasts; and intercoastally through the Panama Canal between the Atlantic and Gulf Coasts on the one side and the Pacific Coast on the other. Furthermore, the Great Lakes, various inland waterways such as the Mississippi River and its tributaries, and a large number of local barge canals offer limitless possibilities for the transportation of goods by water.

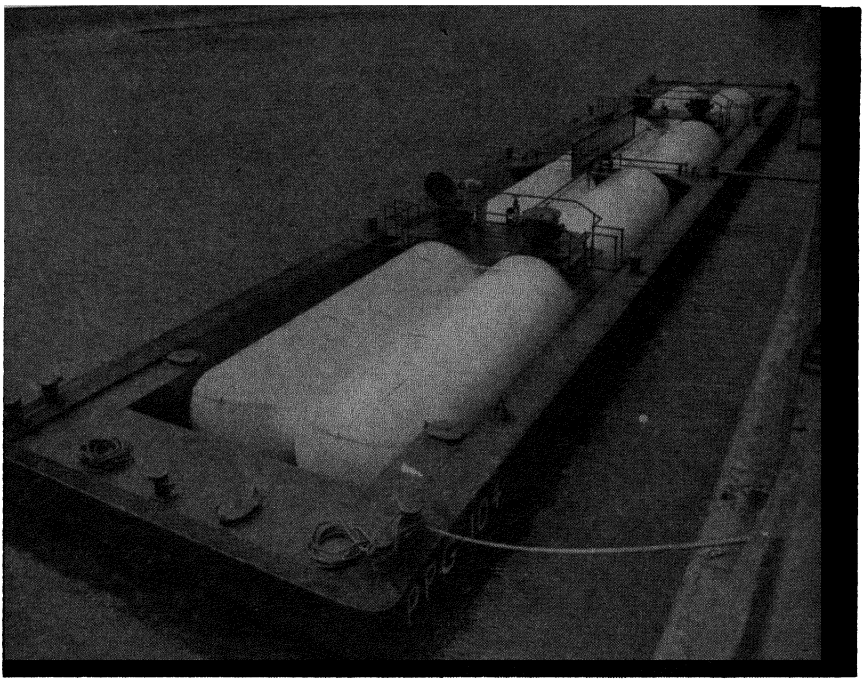


*Courtesy Campbell Soup Company*

*Figure 18-6. Loading Freight.* Freight transportation by waterways involves various means of hoisting cargo and requires specialized labor for handling.

In 1940, 8,000 vessels of all kinds, with a total capacity of 15 million tons, were available for public hire in domestic trade. Furthermore, 2,700 vessels, with a possible capacity of nearly 2.5 million tons, were engaged in private shipping service.[9]

[9] Railroad Committee for the Study of Transportation, *Transportation in America,* p. 50. Washington: Association of American Railroads, 1947.



*Courtesy Pittsburgh Plate Glass Company*

*Figure 18-7. Specialized River Barges.* Efficient, economical transportation of chemicals used by a large glass company is made possible by river barges.

## Motor transportation

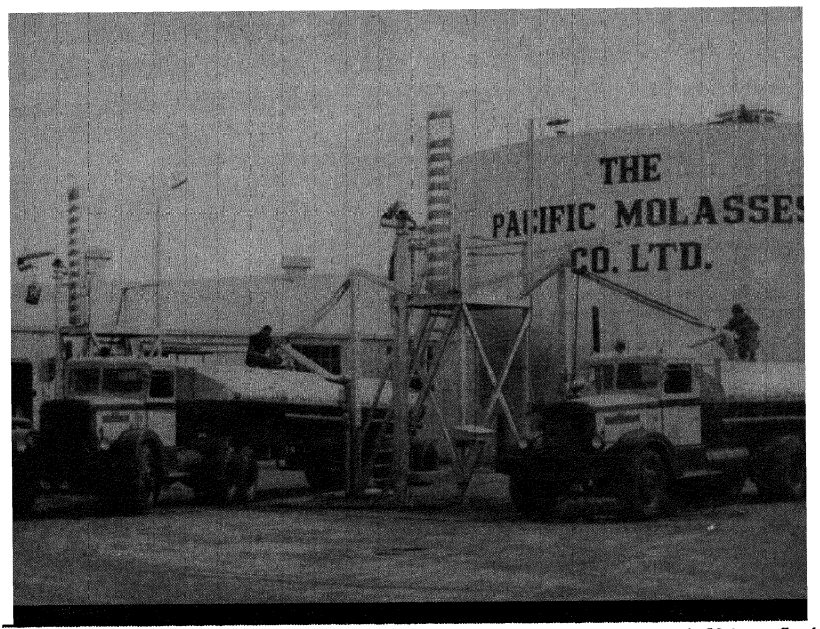
Motor transportation in this country actually began in 1892 in Springfield, Massachusetts, when the first automobile was put in motion by a gasoline engine. The invention of the automobile inevitably led to its commercialization. The motor truck was the result. From the beginning, truck lines capitalized on the inherent advantages of their flexibility for serving individual needs. This feature led to a complete reorganization in our modern distribution system.

"Why on earth do you need to study what's changing this country?" said a life-long resident and shrewd observer of the Middle West. "I can tell you what's happening in just four letters—A U T O!" [10]

Today there are more than 6½ million trucks operating in the United States, and they serve more than 25,000 communities that have neither rail nor air connections. The size of the trucking industry is

[10] Lynd, Robert S., and Lynd, Helen Merrell, *Middletown,* p. 251. New York: Harcourt, Brace and Co., 1932.

partially indicated by the fact that it employs 5½ million workers. More than $15 million are spent annually for the maintenance of motor vehicles.




*Courtesy Pacific Molasses Co. Ltd*

*Figure 18-8. Molasses by Truck.* Trucks have many diversified uses, including the bulk movement of molasses and by-products.

There are many reasons why highway transportation has grown so rapidly.

1. Flexible routes over state, county, and local highways connect most buyers and sellers throughout the United States. Furthermore, the truckers' door-to-door delivery eliminates extra local handling of merchandise between terminal points and users' locations.
2. Accessibility to local warehouses and wholesalers makes it possible for retailers to buy in smaller quantities, maintain smaller inventories, and minimize their capital investments.
3. Highway transportation minimizes the handling of goods in transit. Many deliveries are through shipments and are not repacked with other freight to accommodate car shipments in rail terminals.
4. Good roads have encouraged the development of larger transpor-

tation systems, and at the same time transportation vehicles have developed good roads. Good highways encourage people to own and drive a car, and modern automobiles require the construction of a special type of highway.

Vehicles without highways are of no value. Therefore, good highways have been built for both private and commercial vehicles. Although highway construction, maintenance, and improvement are now on the upward trend, improvements in our highway system have not kept pace with automobile registrations.

*Courtesy Socony-Vacuum Oil Company, Inc.*

*Figure 18-9. Delivery by Tank-Wagon.* This tank-wagon loading rack dispenses an average of 18,000,000 gallons per month of gasoline, oil, and other petroleum products. This is probably the largest oil-distributing center in the East.

*City Motor Transportation.* Not the least important phase of motor transportation is city delivery service. Retail stores rely heavily upon free city deliveries to stimulate buying and have found the added expense of delivery justifiable. Most retail stores that offer free delivery service maintain their own fleet of trucks, but some stores hire the services of local delivery companies that specialize in consolidating deliveries for several stores in the city.

Delivery service from wholesalers to retailers must not be overlooked. The efficiency of wholesale delivery service makes it possible for many retailers to maintain smaller inventories, because they can get almost hourly delivery service from their wholesalers. Where wholesalers or distributors do not deliver, retailers often have their own pick-up trucks or larger vehicles for the purpose of maintaining their stocks by picking up orders at the wholesaler's warehouse frequently.

### Transportation by airways

The development of air transportation is one of the most spectacular chapters in the history of American transportation. The story of man's ability to overcome the force of gravity and move tons of weight at

*Courtesy Chicago and Southern Air Lines, Inc.*

*Figure 18-10. Modern Airways.* The entire family chooses the air route for speed, safety, economy, and pleasure.

hundreds of miles per hour thousands of feet above the ground is nothing short of amazing! The romance of flying is often interpreted in terms of speed, but our concern now is with the freight aspect of air transportation.

The first commercial use of aircraft was in flying the mails. Daytime flights for mail service began in 1918 and night flights started in

1925. Although commercial passenger service began in the late twenties, 80 percent of the air carriers' total revenue was from mail service even as late as 1932. In 1946 the revenue sources were almost reversed: 87 percent of the total revenue came from passenger service, and less than 7 percent originated from mail service. In 1946 seven hundred domestic airplanes flew nearly 310 million revenue miles and received a total of $316.3 million. Of this revenue, 87 percent ($275.6 million) was from passengers.[11]

The Railway Express Agency, which is wholly owned by the railroads, pioneered the development of cargo carriage in air transportation. Since 1937 the Railway Express Agency has handled the express business for all the domestic airlines.

Air-express shipments totaled about 27,000 tons in 1946, which represented approximately 23¾ million ton-miles. Gross revenue per ton-mile from air express was about 62 cents, of which the airlines retained about 40 cents.[12] Principal commodities shipped by air express are: motion-picture films, flowers, luxury fruits and vegetables, and machine parts for emergency repair or replacement.

Today, there are no regularly scheduled exclusive air-freight lines operating between specified terminals, but most regular airlines carry air freight, and numerous companies maintain nonscheduled air-freight service and do contract flying.

*Advantages and Disadvantages of Transportation by Airways.* The most obvious advantage of air transportation is speed, which makes possible several other advantages: saving of time, lower cost of maintenance of goods in transit, and lower cost of preserving goods that are perishable.

The speed of air transport becomes less of an advantage when short distances are to be covered. Often the air terminals are located five or ten miles from cities and much time is required not only in using overland transportation methods to deliver goods to airports but also in transferring and weighing the cargo. Furthermore, time is often lost in transferring cargo from one airline to another. More than 40 percent of air-express shipments, yielding 30 percent of air-express revenues, move over more than one airline.[13]

In conclusion, it might be pointed out that older freight carriers are not particularly worried about competition from airlines because of the physics involved.

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[11] Railroad Committee for the Study of Transportation, *Transportation in America,* p. 57. Washington: Association of American Railroads, 1947.

[12] *Ibid.,* p. 58.

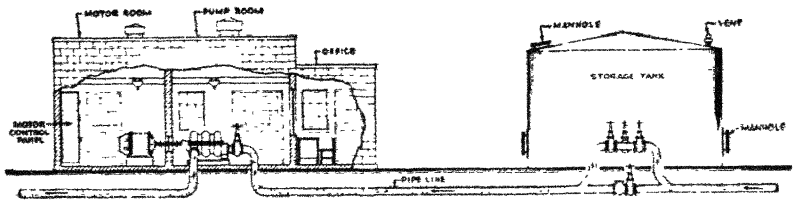
[13] *Ibid.,* p. 59.

Avoiding technicalities, a simple fact is that an airplane carries its load on its back, so to speak, while the railroad locomotive pulls its load on wheels along a smooth surface. So long as it holds good that one can pull on wheels a heavier load than he can carry, the railroad will be much the cheaper medium for moving a given quantity of freight. This is aside from the additional—and most important—fact that the airplane must utilize a considerable portion of its power simply to maintain itself and its load in the air, while the entire energy of the locomotive can be devoted to forward movement, thus creating an additional factor of substantial economy in favor of ground transportation.[14]

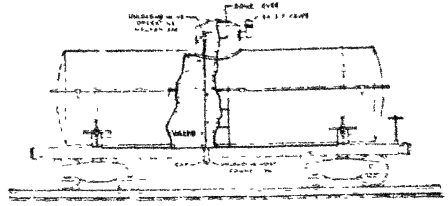
*Courtesy Chicago and Southern Air Lines, Inc.*

*Figure 18-11. Commercial Air Transportation.* Experience, engineering, and safety control have helped to make the airways a basic part of American transportation.

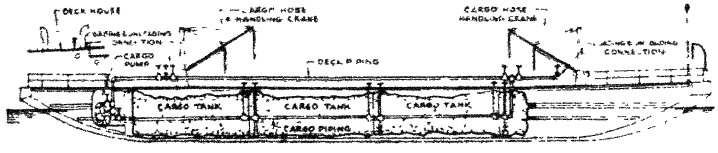
[14] *Ibid.*



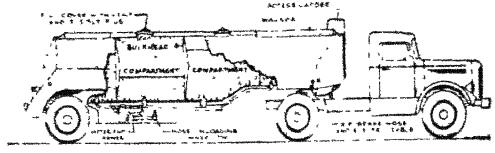

**THE PIPELINE** is the principal carrier of oil overland The United States has a network of petroleum pipelines that range from small three inch gathering lines of the oilfields to huge twenty four inch arteries of steel. These carry millions of barrels of oil daily over mountains, under rivers, and through field and forest. Heart of the pipeline is the pump station where powerful pumps drive the oil through the miles of steel conduit to the next station.



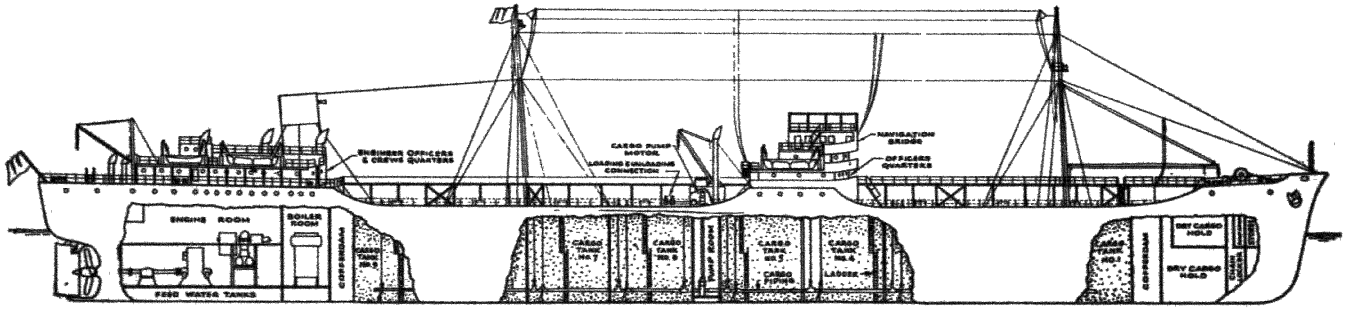
**THE RAILROAD TANK CAR** is used chiefly in the transportation of petroleum products. More than 100,000 of these tank cars holding as much as 12,000 gallons each are in service, carrying oil wherever the steel rails go.




**THE STEEL OIL BARGE** is used for coastwise, river, lake, canal and harbor transportation. Some oil barges are towed singly and others, for ease in handling on rivers and canals, are made up in flotillas and pushed or towed by powerful towboats.



**THE TANK TRUCK** has become a familiar sight on American highways It is used principally as the last link of petroleum transportation that reaches from the distant oil well to the service station on the corner, or to the fuel oil tank in your basement.




**TANKERS** by the hundreds, sail the seas, carrying oil from areas of production to refining and consuming centers. The modern tanker carries nearly ten million gallons of oil which can be quickly loaded and discharged.

*Courtesy American Petroleum Institute*

*Figure 18-12. Petroleum Transportation.*

### Pipe-line transportation

Crude petroleum, petroleum products, and natural gas are moved today in large quantities by pipe lines. Limited quantities of powdered coal and wood pulp are now being transported in this way, too, either on an experimental basis or in local areas. In two ways, pipe lines compete with railways and other transportation facilities: (1) Petroleum products move through pipe lines and thus avoid standard facilities, and (2) natural gas is brought into regions where otherwise fuel that required the employment of other means of transportation would be used.

Prior to the war, pipe lines as well as railways were distinguished as being built and operated entirely by private capital. Recently, however, much expansion in the service and mileage of pipe-line transportation, including construction of the Big Inch and Little Big Inch lines, has been made possible by government funds.

For the five-year period ending in 1941, the railroads handled only about 3 percent of all the crude oil received at refineries; about 75 percent of the oil was handled by pipe lines, and tankers carried the rest. Petroleum pipe lines in this country totaled 128,000 miles in 1941. Of these, 119,000 miles were used for carrying crude oil and 9,000 miles were used for carrying refined products. In the same year these lines carried more than 970 million barrels of crude oil and 82 million barrels of refined oil.[15]

In 1941 more than 2.8 billion cubic feet of natural gas were marketed, and 816 million cubic feet were shipped out of the states where they were produced. In the same year more than 88,000 miles of pipe lines were used to transport natural gas to the areas where it was to be consumed.[16]

Figure 18-12 shows the various types of transportation used by the petroleum industry.

## The Traffic Manager

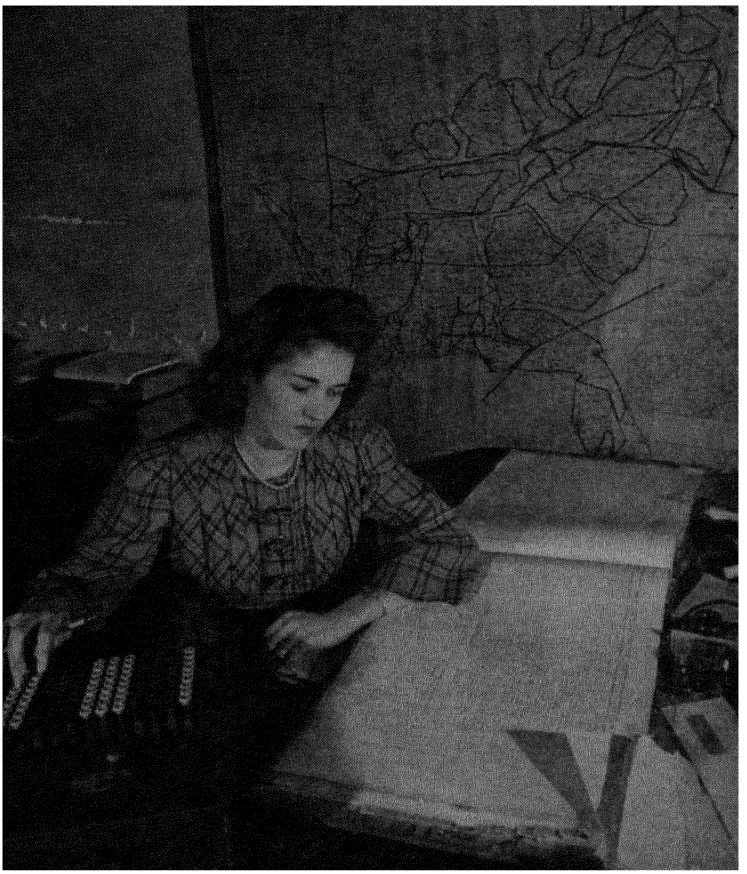
### Traffic department

Every business organization, whether large or small, has traffic problems. The nature of the departmental organization set up to handle these problems is governed by the size and nature of the business. In

[15] *Ibid.*, p. 41.

[16] *Ibid.*, p. 42. Circular from the American Petroleum Institute, 50 West 50th Street, New York, N. Y.

a retail store traffic problems center about procuring goods through the most advantageous shipping routes. Doing this requires complete knowledge of the market as well as of the various transportation facilities that serve it.



*Courtesy Standard Oil Co (N. J.)*

*Figure 18-13. Traffic Records.* Control in the traffic department is dependent upon countless records involving rates, zones, weights, and classifications.

The wholesale distributor has essentially the same problem. The manufacturer has the problem, too, in terms of choosing the transportation routes and arranging commodity rates and possibly return-haul contracts with smaller transportation lines or private overland contractors.

*Courtesy Standard Oil Co. (N. J.)*

*Figure 18-14. Delivery Control.* Here is a specialized phase of transportation. These clerks are preparing the next day's delivery cards in their heating-oil "Degree Day" delivery system.

*Functions of Traffic Department.* A good way to show something of the work of a traffic manager is to review the operations of his department. For convenience, we shall classify the work of a traffic department as (1) routine and (2) special. As part of its routine functions, it should:

1. Collect accurate rate information.
2. Audit freight bills.
3. Prepare claims of overcharge, damage, or loss.
4. Trace lost shipments.
5. Select common carriers to be used in transporting goods.
6. Expedite emergency orders.
7. Arrange schedules of back orders and reserves for adequate inventory controls.
8. Prepare the shipping documents.
9. Supervise the actual handling of the freight.
10. Verify car facilities.

As part of its special functions, the traffic department should:

1. Consolidate small orders into carload shipments.
2. Select most advantageous or strategic destination points for shipments.
3. Arrange systematic warehouse distribution points for less-than-carload lots.
4. Seek adjustments on overcharges due to discriminatory rates (prepare cases and represent them before commissions and government bodies).
5. Aid in selecting plant and warehouse sites in terms of most desirable transportation service.
6. Study and perfect ways of reducing loss in shipments due to improper packaging and handling of merchandise.

### The traffic manager

It is probably inaccurate to single out one person and call him the traffic manager, because seldom, particularly in a small organization, is the work assigned to one person as a specialist with this title. Actually, the work of the traffic manager is combined with other jobs. How much jobs are to be combined is determined by the type of business, its size, its administrative leadership, and so forth.

For example, even in a large oil company (Standard Oil of California) transportation functions are combined with supply. The person in charge is called the Manager of the Supply and Transportation Department and he "is charged with advising the President and furnishing functional guidance to the heads of the organizational components of the Company on supply co-ordination, transportation, traffic, inventory and stock control, buying and warehousing, with allocating stocks, and with conducting purchasing activities." [17]

### Terms for Study

| | | |
|---|---|---|
| Air express | Destination point | Hopper cars |
| Allocate | Diversion | Industrial engineer |
| Boxcar | Document | Intercity freight |
| Carload | Expedite | Intercoastal |
| Commodity rate | Flexible routes | In-transit privileges |
| Consolidate | Gondola cars | Local rate |
| Demurrage | Haul | Overcharge |

[17] Hall, George Lawrence, *The Management Guide,* p. 46. San Francisco: Standard Oil Company of California, 1948. Reproduced by the permission of the Standard Oil Company of California.

| | | |
|---|---|---|
| Pooling | Reconcile | Stabilize |
| Preferential rate | Reconsignment | Tariff |
| Public carrier | Refrigerator cars | Terminal services |
| Public commissions | "Spotting" | Through rate |

## Questions

1. Compare the several means of transportation by showing expenditures for each.
2. Explain how transportation facilities widen the market.
3. How would you explain the rapid growth in highway transportation?
4. How does suburban delivery service from downtown department stores increase sales?
5. Explain how transportation helps create both time and place utility.
6. Has the transportation aspect of our system of marketing and distribution affected our standard of living? How?
7. How have improved transportation facilities contributed to lower prices for consumer goods?
8. In what ways can highway transportation facilities effectively compete with railways?
9. What share of the expense of maintaining our public highways do you think should be carried by the truck lines?
10. Comment on the importance of inland waterways in rendering transportation service in the United States.
11. List the handicaps of air transportation for freight.
12. What is the difference between diversion and reconsignment?
13. In what ways have railroads met the competition of motor transports?
14. In what ways could preferential freight rates affect the competitive position of a business?
15. Why can railroads afford to make commodity rates attractive to shippers?
16. Would railroad regulations about packing, crating, and classification of freight affect the manufacturing and processing of products? Explain.
17. Why is so little attention paid by management to the subject of internal aspects of transportation?
18. Explain fully the role of transportation in the development of modern civilization.

## Problems and Projects

1. In addition to their Detroit warehouse, the Detroit Stove Manufacturing Company has three large wholesale distribution centers in Atlanta, Dallas, and San Francisco. List the transportation and storage problems the Company will confront when introducing a new model throughout their four areas simultaneously on November 1 of the present year.

2. In one column list ten commonly used consumer goods. Above Columns 2, 3, 4, and 5 use the headings Railroad, Motor, Airway, and Waterway, respectively. Now check the transportation facilities used to deliver each commodity from manufacturer to middleman, retailer, and consumer. What factors contributed to the popularity of the most commonly used transportation service?

3. Make a list of personality and service factors that seem important in gaining competitive advantages in local transportation service.

4. List five specific ideas showing the relationship between consumer wants in the market and services demanded of transportation lines by producers and distributors.

5. In what ways has transportation served to lower consumer prices or maintain them at a reasonable level?

6. Statisticians show the population distribution in the Wilmington, Delaware, market as follows:

| *Radius of Wilmington* | *Population* |
|---|---|
| 60 miles | 4,417,183 |
| 120 miles | 20,855,939 |
| 18b miles | 24,774,126 |
| 240 miles | 29,603,101 |
| 300 miles | 40,171,539 |

Market experts say transportation facilities widen the market. Explain how transportation facilities widen this one. (Keep in mind other cities that are bidding for the same market.)

7. Set up a problem of your own in which you show with facts how improved transportation facilities inside a factory or business would lower the cost of operation. You may use a problem relating to the transportation of people, office materials, supplies, equipment, or merchandise.

8. Although the freight rates of two lines may be essentially the same, there may be good reasons why you as a wholesaler would choose one transportation line over another. Enumerate these factors.

9. Consult two or three local merchants who ship a great deal of freight by railroad. Make notes and report how they have reduced transportation costs by taking advantage of the many services provided by railroads. Wouldn't you think that such savings would stimulate recognition of the need in most businesses for accurate knowledge about traffic problems? Discuss.

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CHAPTER XIX

# RETAILING OUTLETS

## Retailing an Integral Part of Marketing

The basic functional characteristics of marketing were presented in Chapter XVI as a part of our general economic system of doing business. Now we turn to retail channels, which are an integral part of the general field of marketing and which are, incidentally, particularly well known to most people because retailers handle most consumer goods and services.

### Definitions

How shall we define a retailer? Are some businessmen classified as retailers although they do not maintain retail stores? Are some wholesalers also classified as retailers because they sell to both dealers and consumers?

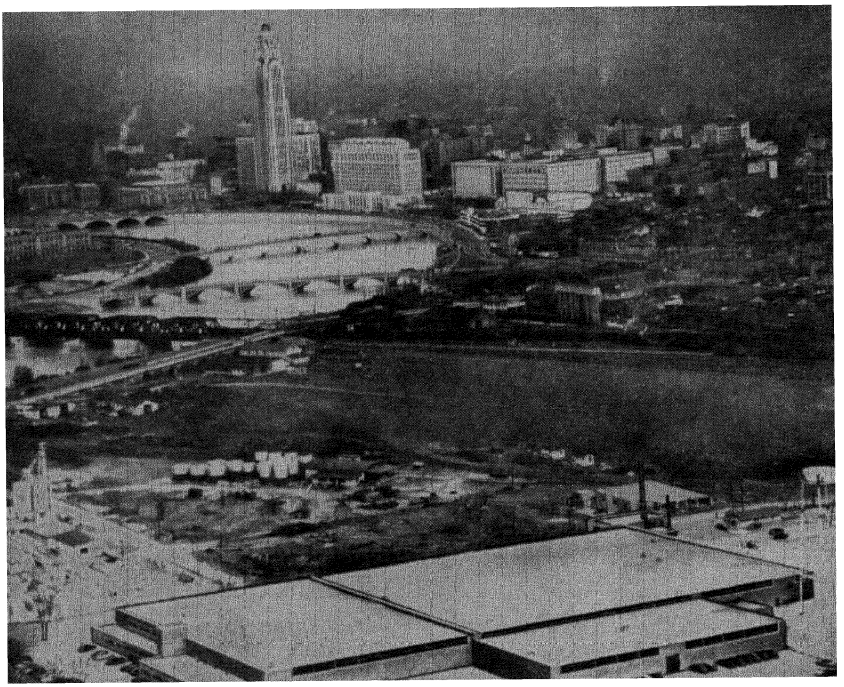
A retailer is one who buys relatively large quantities of goods, or has immediate access to them, and sells them for profit to those who want them for either personal or household use. The word *retail* implies dividing, separating, parceling, or distributing in small quantities, such as by the yard, pound, or gallon. Of course, the varieties of goods and services sold by retailers include virtually all consumer commodities: food, clothing, shelter, recreation, and entertainment. Because retailers provide so many goods and services that are obtained and used directly by consumers, the number of retailers in business is naturally very large.

### Importance of retailing

By way of illustrating the importance of retailing in business, we may say that more than half (58 percent) of all business establishments (three million plus) listed by the United States Bureau of the Census in 1939 were retail and service establishments. This included *all* retailing establishments that were in business to sell to the public.

Prior to 1940, 16 of every 100 employed people were engaged in retail occupations. This represented seven and a half million people, and

in addition there were nearly one million more who dealt in the stocks, bonds, securities, and credit functions of retail stores. These figures, then, represent a combined total of more than eight million people engaged in retail occupations.



*Courtesy The F. & R. Lazarus & Co.*

*Figure 19-1. Bulk-Service Building for Downtown Retailer.* Retail service in this city has been greatly accelerated by means of a unique system of distribution to customers through a bulk-service building located a short distance from the store.

From an investment point of view, retail stores had approximately $16.8 billion invested in land and buildings, $8.4 billion invested in fixtures and equipment, $7.0 billion plus invested in merchandise and supplies, and $9.2 billion invested in charge and installment accounts. The capital investment required to keep each worker employed amounted to $5,500.[1]

The growing importance of retailing is emphasized by the fact that retail sales leaped from $42 billion in 1939 to nearly $130 billion in

[1] The data presented in the preceding paragraph are from Robinson, O. Preston, and Haas, Kenneth B., *How to Establish and Operate a Retail Store,* pp. 3-4. New York: Prentice-Hall, Inc., 1946.

1948. Table XIX-1 gives the amounts of sales during 1948 in various retail classifications.[2]

TABLE XIX-1. SALES OF RETAIL STORES.
(in millions of dollars)

| *Kind of Business* | *1948* |
|---|---|
| Automotive | $ 17,563 |
| Building Material and Hardware | 10,834 |
| Home Furnishings | 6,676 |
| Jewelry | 1,203 |
| Apparel | 9,867 |
| Drug | 3,687 |
| Eat and Drink | 12,612 |
| Food | 31,857 |
| Filling Station | 6,325 |
| General Merchandise | 16,992 |
| Other Retail Stores | 12,307 |
| Total | $129,923 |

Statistics on department-store sales are compiled by the Board of Governors of the Federal Reserve System and each of the twelve federal reserve banks for their respective districts. These in turn are published monthly in the *Federal Reserve Bulletin* and in the *Survey of Current Business*. It is easy for the business student to observe growth in the retail field by consulting these and similar sources from time to time.

## Functions of Retail Stores

Since retail stores are small links in the marketing chain, their functions are much like those of marketing in general. In particular, retailing functions may be stated as follows: (1) purchasing merchandise for resale; (2) dividing, packaging, and attaching price tags; (3) storing merchandise; (4) selling merchandise; (5) providing capital; (6) assuming risks; and (7) transporting merchandise.

### Purchasing merchandise for resale

Purchasing merchandise for resale to consumers is not the same as purchasing merchandise for resale to retailers. Wholesalers buy in much larger quantities sometimes further in advance of the market, assume different responsibilities for their customers, and generally operate on a much larger scale than do retailers. Buying for a retail store, however, carries many of the same earmarks as wholesale buying.

[2] Adapted from *Survey of Current Business*, February, 1949, Vol. 29, No. 2, p. 27.

Successful buying depends upon a number of factors. Among them are: (1) how much the buyer knows about the customers—who they are, where they are, how much they have to spend, and how they want to spend it; (2) the buyer's ability to interpret the market, and (3) the buyer's ability to locate a desirable market.

Records of previous sales serve as a guide for intelligent buying. Also, want lists made up from customers' inquiries about merchandise are helpful. Efficiency in buying comes through careful, thoughtful, and meticulous planning. The mechanics of buying involve contacting a salesman or ordering from a catalogue. Both sources give accurate information about merchandise concerning price, size, quality, weight, and color. Placing an order is usually a simple matter of filling out standard order forms approved and used by the business.

### Dividing, packaging, and attaching price tags

Merchandise shipped from wholesalers cannot be displayed for sale without being processed in the stockroom. Because customers buy in small quantities, case lots, cartons, boxes, and other large units must be opened and divided up. This process may involve simply opening a pasteboard box and removing one unit, or it may involve weighing, sacking, wrapping, labeling, and testing the units to be sold.

Attaching price tags serves the dual purpose of showing retail prices to customers and recording cost figures that aid in keeping inventories. Although smaller merchants fix price tags by hand, larger stores use machines and other laborsaving devices.

### Storing merchandise

Storage is often regarded as a warehousing subject, but actually the problem can become as important for a retail store as for a warehouse. Different kinds of retail stores use different systems of storing merchandise. Where space is ample, the back section of the sales floor may be partitioned off for storage purposes. In other stores reserves of stock are loaded heavily on the retail floor, on counters, underneath counters, on shelves, and within dummy areas concealed by wall paneling in different parts of the building.

Any good storage system should include several definite features:

1. Accessibility to the retail floor.
2. Accurate filing and classification according to departments within the store.
3. Protection against breakage, depreciation, theft, or shrinkage.

Larger department stores have separate warehouses, or if their main building is large enough, entire floors are reserved for storage. The May Company of Denver, Colorado, at one time used two entire floors of their retail store for storage.

The F. & R. Lazarus & Co. of Columbus, Ohio, has attracted national interest by its "bulk service building." This storage and processing building is probably unlike any other retail distribution structure in the world. Here are some of the building's unique features, as set forth in a descriptive brochure made up by the company (adapted):

It replaces four buildings formerly used in downtown Columbus for storage and processing.

It is located one mile from the Lazarus main store.

It provides 265,000 square feet, including 100,000 square feet on what is called the mezzanine deck. Through the use of the mezzanine deck and adjustable shelves, merchandise need not be lifted higher than six feet.

It receives merchandise from either boxcar or truck.

It maintains 22 docks for loading customer deliveries.

It provides parking space for 150 cars.

It has an extraordinary system of shelving that stores merchandise above the floor level, thus creating almost no walls or partitions and at the same time making the floor space accessible by platform lift.

### Selling merchandise

This topic will be taken up at some length in Chapter XX, "The Selling Function."

### Providing capital

In retailing as in other businesses, capital is essential. Although funds are usually provided for when a business is organized, often plans do not work out to take care of all the demands for funds. Furthermore, the capital requirements are not the same for different types of retail stores. For example, Figure 19-2 reviews the capital structure for seven retail lines. The largest initial investment in inventories is in the furniture and house furnishings line, and the least amount is required for eating and drinking places. Apparel lines have the smallest proportional investment in plant, and eating and drinking places have the largest. Other comparisons can be made similarly by interpreting Figure 19-2.

In addition to the initial investment in inventories, funds must be available from time to time for quantity buying to take advantage of desirable discounts. Funds must also be available for operating ex-

penses—wages, advertising, rent, utilities, and incidentals. Finally, they are needed to finance customers' accounts. Probably more than half of American retail stores extend to their customers some form of charge-account service. Indeed, sales volume often depends heavily upon charge-account customers.

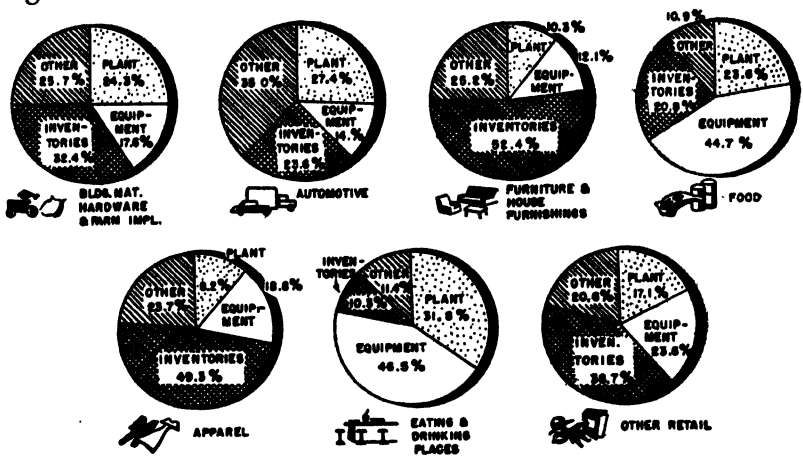



*Figure 19-2.* Here is how initial investment was used in specific retail lines. (SOURCE: *The Financing of New Trade Enterprises.* New York: Dun & Bradstreet, Inc.)

## Assuming risks

Many of the usual risks in a retail business can be covered with insurance, as we have seen in Chapter XIII. Although insurance does not eliminate the risk, it does shift the loss under a protective plan offered through underwriting agencies—insurance companies. Fire, hail, windstorm, cyclone, theft, and other risks are included.

Many other risks taken by retailers, however, cannot be economically underwritten. These are losses from price changes, conversions of fashion, merchandising duds (white elephants), and unpredictable losses on customers' accounts or public liability.

Risks involved in maintaining the proper balance in inventory are a considerable cost item assumed by the retailer. Take the illustration of a clothing merchant. In order to keep just one suit of clothes for each of the customary sizes and styles would require single- and double-breasted suits in 11 standard sizes in each of 5 types (regular, short, long, stout, and portly) and in 3 basic styles (conservative, semi-drape, and drape). Thus, 330 suits would be required in all. If the clothing merchant averaged 3 suits of each size and each model, he would need to stock 990 suits. If these cost him $50 apiece wholesale,

a capital outlay of $49,500 would be needed. And these calculations, of course, take into account only a single fabric pattern.[3]

If customers do not buy suits in proportion to stocks that are maintained, retailers must reduce their stocks or salvage their values in some other way. In any event the risk involved is considerable and this problem represents a cost of selling the product.

### Transporting merchandise

Although transportation has been separately discussed in Chapter XVIII, some specific retail applications should be considered here. Fast, efficient, courteous delivery service is an effective bid for customer goodwill, but consumers should realize that *free* delivery service is impossible. In theory, at least, each buyer pays more if merchandise is delivered than he would pay if it were not.

Another kind of transportation that may be even more important to retailers than delivery service to customers is the procurement of merchandise from wholesalers for resale purposes, or the procurement of supplies and equipment for store use. Since some wholesalers operate on a cash-and-carry basis, and since many special close-out purchases at factory sites and in distant warehouses are made "f.o.b. warehouse" (free on board at the warehouse), the retailer must provide his own transportation service. Often the difference between profit and loss depends upon close buying at the sale site where company trucks can be made available for transporting the purchases.

## Types of Retail Stores

Where may we find the functions of retailing at work? What types of retail stores do we have today? How may they be classified for analytical purposes? Customers automatically classify stores according to the need they have for the services of retailers. When a customer wants clothing, he chooses a clothing store. He looks for flowers at a florist's, drugs in a drugstore, and gasoline in a filling station.

However, the consumer's commodity classification of retail stores is not necessarily adequate because of the *number* of commodities dealt with; also, there is much overlapping among stores in the kinds of commodities sold. For example, drugs and sundries are sold not only in drugstores but also in food establishments, general-merchandise stores, some filling stations, and many cigar stands. Portable radios and electrical appliances are now distributed in almost every type of retail

[3] See the illustration of the PhotoMetric process, on page 35, for one means of circumventing this problem.

establishment except those handling food and liquor. The same is also true of yard tools and household wares.

A more satisfactory but not all-inclusive classification divides retail stores as follows: (1) the general-merchandise store; (2) the specialty store; (3) the supermarket; (4) the variety store; (5) the department store; (6) the mail-order house; and (7) the house-to-house dealer.

### The general-merchandise store

The history of early American life is the history of the general-merchandise store. Wherever there were consumer needs in community centers or at crossroads, the general-merchandise store usually came into being. The geography of our country and the early systems of transportation and communication stimulated the special type of service offered by these stores. Everything needed for living was a potential stock item—groceries, clothing, farm implements, feed, drugs, notions, seed, and burial equipment, among others. The scarcity of customers, their uneducated buying habits, and limited storage facilities made specialization in merchandising impossible. Today, the inventions of science have brought our population closer together and only a few isolated communities still retain the general-merchandise store that was characteristic of pioneer days.

### The specialty store

A specialty store is a small retail store that sells limited kinds of merchandise. It specializes in food, hardware, drugs, accessories, automobile service, or machinery. The aggressiveness of modern merchandising plans have caused some specialty stores to lose some of their uniqueness by selling not only their specialty but also related or mixed lines. The specialty store is often located in the downtown area where pedestrian traffic is heavy.

The specialty store is easily identified by its smallness, limited stock, few employees, and the fact that it has an owner-manager. Their lack of room for storage can be effectively overcome with good wholesale and warehouse connections located nearby in basements, lofts, or cheaper rental areas.

### The supermarket

Food merchants have now perfected larger merchandising plants called supermarkets. These represent the most outstanding recent development in the field of retailing. The term *supermarket* is correctly applied to any large food store, especially of the warehouse type, or

to any large cash-and-carry self-service system handling groceries, meats, and vegetables.

Important characteristics of the supermarket are its enormous size and huge stocks, its striking color displays, its self-service plans, its countless varieties of brands and sizes of merchandise, and its cash-and-carry policy. Supermarkets are always strategically located in thickly populated areas where sales volume can bring low prices through fast merchandise turnover.

In October, 1944, there were more than 8,700 supermarkets. Most supermarkets are located in the larger cities. For example, Table XIX-2 [4] shows that only about one-fifth of the supermarkets are located in cities with populations of 10,000 or fewer. Fifteen percent of the supermarkets are in cities with populations of from 10,000 to 25,000. The remaining 63.7 percent are located in population centers of more than 25,000. These figures indicate the need these stores have for the volume sales available in densely populated areas.

TABLE XIX-2. NUMBER OF SUPERMARKETS, BY SIZE OF CITY, JANUARY, 1942, AND OCTOBER, 1944.

| *Size of city* | *January, 1942* | | *October, 1944* | |
|---|---|---|---|---|
| | *Number* | *Percentage of total* | *Number* | *Percentage of total* |
| 500,000 or over | 2,176 | 24.5 | 1,887 | 21.6 |
| 100,000—500,000 | 1,857 | 20.9 | 1,724 | 19.7 |
| 25,000—100,000 | 2,006 | 22.5 | 1,960 | 22.4 |
| 10,000— 25,000 | 1,242 | 14.0 | 1,311 | 15.0 |
| 5,000— 10,000 | 811 | 9.1 | 895 | 10.2 |
| 2,500— 5,000 | 480 | 5.4 | 550 | 6.3 |
| Under 2,500 | 322 | 3.6 | 419 | 4.8 |
| Total | 8,894 | 100.0 | 8,746 | 100.0 |

## The variety store

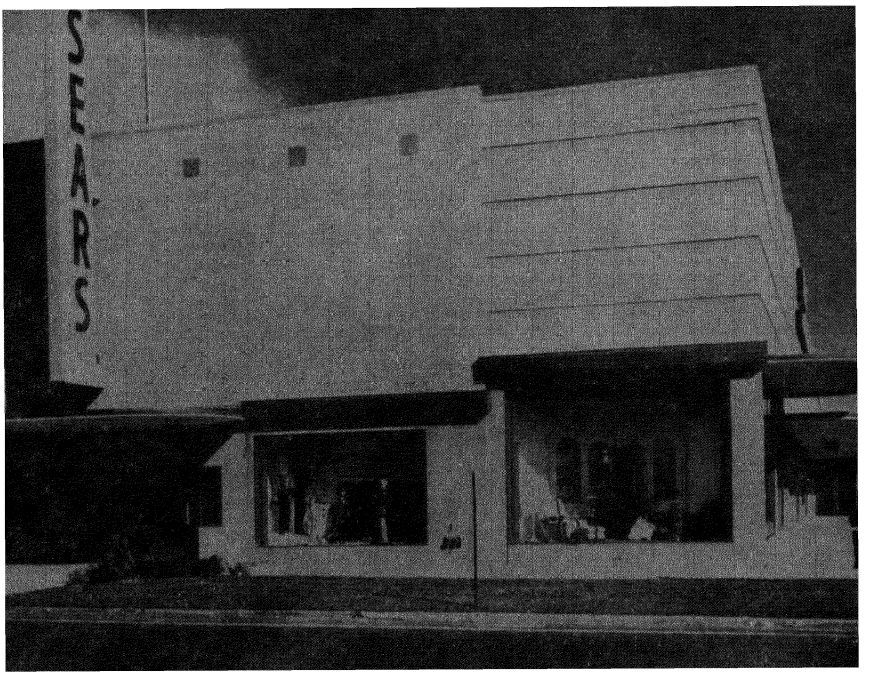
The variety store differs from other retail outlets in its methods of doing business. It exists primarily for the sale of convenience goods and thrives best in heavy traffic centers or near suburban shopping areas close to supermarkets and specialty stores.

The variety store specializes in handling many kinds of household necessities, appliances, hardware, notions, candy, stationery, toiletries, and toys. Store services are held to the minimum—that is, charge ac-

[4] Duddy, Edward A., and Revzan, David A., *Marketing: An Institutional Approach*, p. 230. New York: McGraw-Hill Book Company, 1947.

counts are not used, delivery service is not provided, and adjustments and exchanges are sometimes slower than at other stores. Since variety stores depend a great deal on volume, competitive prices are afforded and customers usually look for lower-priced goods in these stores.

Although most people regard all variety stores as chain stores, possibly 10 percent of them are independently owned and operated. The independent owner finds it easy to duplicate the standardization and




*Courtesy Sears, Roebuck and Co.*

*Figure 19-3. Retail Store Maintained by Mail-Order House.* Compare the architectural style of this store with that of the one illustrated in Figure 19-6.

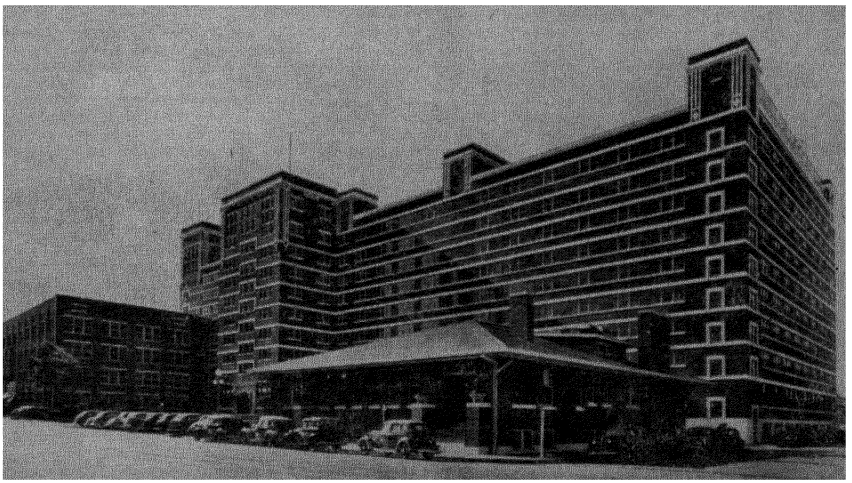
general merchandising pattern of chains, but it is more difficult to compete with their large buying power. Chain stores often buy direct from producers. As a rule, independent variety stores do not have the sales volume to justify direct buying, and consequently they buy through wholesalers.

## The department store

As the name implies, a department store is made up of many different departments. In one sense it may be said that a department store

groups many different specialty stores under one roof and one management. A department store generally has good buying power, ample capital resources, and well-planned management. Although limited amounts of convenience goods are usually stocked by stores of this kind, a department store specializes in shopping goods and some specialties.

A department store is built around customer service. A wide range of merchandise, including clothing, household furnishings, hardware, floor coverings, home appliances, millinery, toys, notions, cosmetics,



*Courtesy Sears, Roebuck and Co.*

*Figure 19-4. A Large Mail-Order Plant.* This plant not only serves thousands of customers in the Southwest, but also aids in supplying the retail stores maintained by Sears, Roebuck and Co.

and accessories, is carried in stock for easy, convenient shopping. Most department stores offer liberal credit policies and free delivery service. They also provide postal service, wrapping accommodations, restrooms, style shows, and eating facilities. Many department stores feature short courses and lectures in how to use appliances, how to cook, or how to enjoy good books.

### The mail-order house

The unique characteristic of mail-order stores is that customers select goods from a catalogue.[5] Mail-order houses specialize in selling to widely scattered customers. Since mail-order stores contact customers

[5] Of course, some mail-order houses also maintain regular retail stores.

entirely by mail, a great deal depends upon the advertising appeal of catalogue descriptions.[6]

All retail stores can and usually do engage in mail-order selling, but only a few like Montgomery Ward and Company, Sears, Roebuck and Co., Spiegel, Inc., and Alden, Inc., have become prominent.

*Courtesy Sears, Roebuck and Co.*

*Figure 19-5. Shipping Room of a Large Mail-Order Plant.* The problem of classifying and routing the mail in such an organization is so large that the work resembles that of a large post office.

The merchandising plan and the size of mail-order organizations led into chain stores. After the mail-order plan was used successfully in one part of the country, it was expanded into other parts. Chain organizations therefore are quite common with mail-order stores. The largest of these are Montgomery Ward and Sears, Roebuck. The importance of mail-order and chain-store sales is emphasized in a consolidated report issued by the United States Department of Commerce. Table XIX-3 [7] shows sales volume for various kinds of businesses.

[6] See Chapter XXI for further discussion of direct-mail advertising.

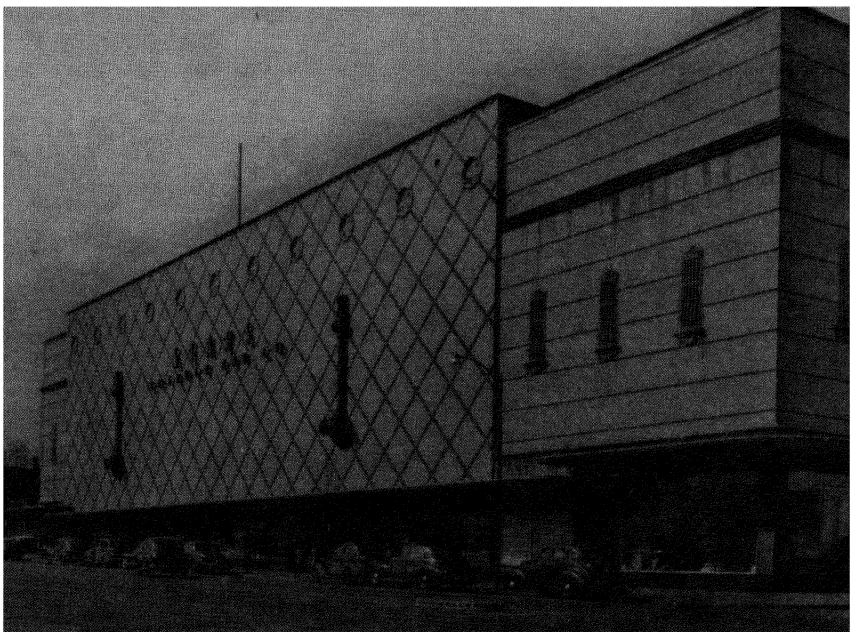
[7] Adapted from *Statistical Abstracts of the United States,* 69th ed., p. 974. Washington: U. S. Department of Commerce, 1948.

TABLE XIX-3. RETAIL SALES OF CHAIN STORES AND MAIL-ORDER HOUSES BY KINDS OF BUSINESS.
(In millions of dollars)

| *Kind of Business* | *1947* * |
|---|---|
| Automotive | $ 699 |
| Building Materials and Hardware | 1,179 |
| Home Furnishings | 728 |
| Jewelry | 154 |
| Apparel † | 2,754 |
| Drugstores | 833 |
| Eating and Drinking Places | 618 |
| Food | 9,681 |
| Filling Stations | 373 |
| General Merchandise †* | 6,756 |
| Other Retail Stores | 1,443 |
| Total | $25,218 |

* Preliminary group.

† Apparel group total for all year. General merchandise group total includes other related businesses not shown.

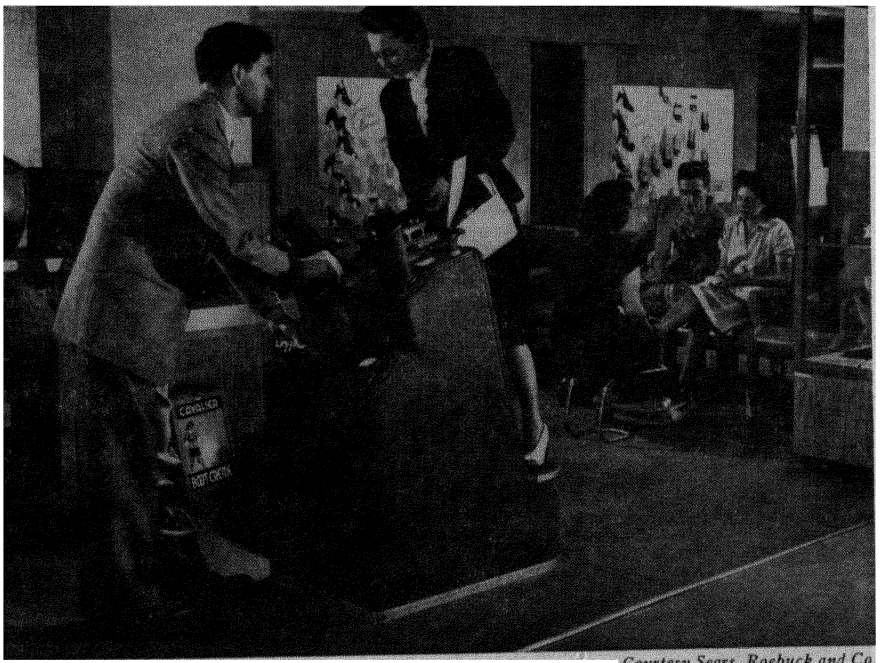


*Courtesy Sears, Roebuck and Co.*

*Figure 19-6.* Large mail-order houses often maintain retail stores where customers can see the merchandise, examine it, and buy it from clerks, much as in any other kind of store.

In the future, mail-order selling as a plan for retailing merchandise may not be so attractive as it has been in the past, because improved transportation facilities and communication systems have changed consumers' buying habits. Authorities believe that mail-order stores will be largely replaced by department stores and specialty shops.

The fact that both Montgomery Ward and Sears, Roebuck have rapidly expanded their retail outlets during the last 10 or 15 years is evidence of the trend toward store merchandising.



Courtesy Sears, Roebuck and Co.

*Figure 19-7.* Mail-order houses have modern merchandising methods and equipment in their retail stores. This machine is designed to aid in fitting shoes.

## The house-to-house dealer

There are many good reasons why house-to-house salesmen are not wholeheartedly welcomed by consumers. These explain the high turnover in sales personnel and the expensiveness of this system of distribution.

Most people prefer to take the initiative in deciding when they want to buy. There is resentment in being approached at home, where personal matters come before business. Consumers like to see what they buy, and possession gives high personal satisfaction. Since most house-

to-house representatives cannot deliver the article, the customer is expected to wait several weeks before delivery, even though a down payment is required to consummate the sale.

There is a place, however, for specialty selling in the marketing process, and house-to-house contacts provide an opportunity for developing it. It is possible for a company to build up a great deal of prestige for a product sold in this way and not distributed through other market channels. The Fuller Brush Company and the Real Silk Hosiery Mills have done a creditable job of making this type of selling a high-class merchandising service.

Hucksters are house-to-house salesmen who carry their stock of goods with them and sell from truck, car, or cart, calling regularly upon customers in their territory.

*Courtesy Automobile Manufacturers Association*

*Figure 19-8. Market on Wheels.* The grocery store comes to the housewife in this modern "Mobil Market—Store at Your Door."

## Organization Plans

Retail functions can be better understood by reviewing how stores are organized. Organization plans here cover the size of the business, internal operations, and physical properties.

### Independent stores

The most common organization plan for a retail store is that composed of one unit—the independent store. This is the usual number

notwithstanding the fact that the United States Bureau of the Census defines an independent store to include as many as three separate stores under one management. Independent retail stores are typically small; they buy from wholesalers rather than manufacturers; they have modest sales, limited finances, often mediocre management, and limited credit.

The ownership plan for independent retail stores may be either a proprietorship, partnership, or corporation. The over-all merchandising plan for all of these is essentially the same.

### Chain stores

Several units may be consolidated in one organization as a chain store. Chains seem ideal for accommodating large fields of retail service, and their management is usually quite efficient.

Although they seem comparatively new as a form of organization, chain stores are actually quite old in origin. The Great Atlantic & Pacific Tea Company, which is better known as the A&P, was founded in 1858, and the Mitsui chain in Japan is said to have originated in 1643.

Chain stores depend heavily upon standardization of managerial policies, centralized buying power, and volume distribution. Most large chain department stores buy direct from producers or manufacturers' agents rather than from wholesalers because they are, in a sense, dealers in wholesale quantities for themselves. Because chain stores are usually financially strong, they can afford to buy in large quantities and thus take advantage of attractive trade and cash discounts.

A good way to evaluate the importance of chain stores is to look at the portion of retail sales of durable and nondurable goods they handle. Table XIX-4 [8] not only gives this information but also shows the growth of chain-stores from 1929 to 1943. The growth in sales of durable goods was erratic, but over the 14-year period (1929-1943) the percent of total retail sales of this kind handled by chain stores moved up from 11.9 to 13.7 percent. The percent of total retail sales of nondurable goods moved up slightly, held its own for a period of 13 years, and then in 1943 dropped from 26.9 to 24.3. The percent of all retail sales handled by chain stores increased from 21.5 in 1929 to 22.8 in 1943.

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[8] Duddy, Edward A., and Revzan, David A., *Marketing: An Institutional Approach*, p. 203. New York: McGraw-Hill Book Company, 1947.

TABLE XIX-4. RELATIVE IMPORTANCE OF CHAIN-STORE SALES, BY KINDS OF BUSINESS, 1929–1943.

| *Kinds of business* | *1929* | *1933* | *1935* | *1936* | *1937* | *1938* | *1939* | *1940* | *1941* | *1942* | *1943* |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Durable goods | | | | | | | | | | | |
| Auto parts and accessories | 20 4 | 33 6 | 50.0 | 45 5 | 45 3 | 48 4 | 45.0 | 42 5 | 40 4 | 37.1 | 37.4 |
| Building materials | 18 6 | 19 0 | 23.2 | 22 6 | 20 5 | 22 2 | 19 9 | 19 5 | 20 2 | 21 5 | 23.7 |
| Household appliances | 16 7 | 19 2 | 14 8 | 15 0 | 15 7 | 16.2 | 16 5 | 16 3 | 16.5 | 16.5 | 15.6 |
| Household furniture | 13 0 | 13 3 | 11 4 | 11.8 | 12.0 | 12.4 | 12.6 | 12 1 | 11.4 | 10.7 | 12.5 |
| Jewelry | 6.7 | 6 3 | 9 4 | 9 8 | 9 8 | 10 0 | 10 5 | 10.8 | 11.1 | 11.3 | 11.9 |
| Farm implements | 1 2 | 1 1 | 5.1 | 5.4 | 6.2 | 6 7 | 7.2 | 6.8 | 6 7 | 6.3 | 4.7 |
| Hardware | 3 0 | 5 8 | 3.9 | 3 6 | 3 7 | 4 1 | 4 0 | 4.1 | 4.2 | 4.5 | 4 5 |
| Motor vehicles | 9 7 | 5 4 | 4 3 | 3 7 | 3.3 | 2 9 | 2 7 | 2.5 | 2 4 | 2 2 | 1 8 |
| Total. | 11 9 | 10 9 | 10 9 | 10 2 | 9 9 | 11 1 | 10.1 | 9 4 | 9 3 | 12 8 | 13 7 |
| Nondurable goods. | | | | | | | | | | | |
| Variety . | 82 9 | 91 2 | 90 8 | 89 7 | 88 4 | 87 6 | 86 8 | 86 5 | 86 5 | 86 4 | 86 5 |
| Shoes | 45 7 | 52 0 | 54 6 | 55 1 | 55 2 | 56 2 | 55 9 | 56 2 | 56 1 | 54 2 | 48 7 |
| Groceries and comb | 38 5 | 44 1 | 38 8 | 38 1 | 36 4 | 36.4 | 36 7 | 37 4 | 39.0 | 37 5 | 32.8 |
| Dept. stores and mail order | 18 8 | 22 6 | 27 8 | 29 2 | 29 9 | 30 5 | 32 6 | 34 0 | 36.3 | 34 3 | 30 4 |
| Drugs | 18 5 | 25 0 | 25 7 | 25 0 | 24 8 | 25 6 | 25 6 | 26.5 | 25 5 | 25 0 | 24 1 |
| Women's apparel | 19 9 | 22 3 | 18 3 | 19 6 | 20 5 | 21.3 | 21 9 | 22 9 | 23.1 | 24 8 | 24 5 |
| Other food stores | 17 8 | 21 7 | 22.4 | 22 0 | 21.6 | 21 2 | 20.8 | 20 5 | 20.4 | 20 3 | 20.3 |
| Men's clothing | 20 0 | 20 7 | 19.4 | 20 4 | 20 2 | 20 4 | 20 6 | 21 1 | 22 1 | 19 9 | 17 9 |
| Filling stations | 33 9 | 35.5 | 21 5 | 17.4 | 14.2 | 11.7 | 10 2 | 9 5 | 8.9 | 8.3 | 7 7 |
| Eating and drinking | 14 1 | 12 7 | 10 4 | 9 8 | 8 8 | 9.1 | 8 6 | 8 4 | 7.5 | 6.7 | 6 1 |
| All other stores | 12.6 | 16 5 | 15 1 | 14 4 | 13 8 | 13 5 | 13 1 | 12.9 | 12 9 | 12.4 | 12.4 |
| Total | 25 4 | 30 9 | 28 7 | 27 9 | 26 8 | 26 9 | 26.9 | 27.2 | 27.5 | 26 9 | 24.3 |
| Total—all stores | 21 5 | 27 0 | 24 5 | 23.4 | 22 4 | 23.3 | 22 8 | 22 4 | 22 4 | 24 4 | 22 8 |

(Percentages of total retail sales for each kind of business, respectively )

## Operational divisions

The interior organization of a large retail store—particularly a department store—includes four major divisions: (1) merchandising; (2) selling; (3) operations; and (4) control.

*Merchandising.* The merchandising division is supervised by a merchandising manager, who works through assistants and departmental buyers. Each department has its own buyer or buyers, who are responsible for both selecting and selling items in their department. The number of buyers who work under the merchandising manager is determined by the size of the store, its merchandising policies, and the kinds of merchandise handled. It is not uncommon to find as few as 25 or 30 buyers in a small department store or as many as 200 in a large one. Much buying is also done through affiliated buying offices maintained in large market centers by the store.

*Selling.* The selling division is the promotion division. Most department stores rely heavily upon advertising by newspaper, direct mail,

and radio, because such advertising can be localized and directed to immediate trade groups. The advertising or sales promotion manager is in charge of this department.

More information about selling will be presented in the following chapters.

*Operations.* The operations division of a large retail store is responsible for physical problems of building, handling merchandise, employment and maintenance of personnel, and over-all supervision. The store manager is usually in charge of operations.

*Control.* The controller, who is in charge of the control division, is responsible for all records of operations. He sees to paying for merchandise bought by the store, paying employees, borrowing money, making collections, and auditing accounting records.

## Physical properties

The planning of every successful retail store involves housing facilities for personnel, merchandise, fixtures, and equipment. The extent to which these are satisfactorily maintained determines in large measure the success of the business. The fact that only about one-half of the people in retail stores are engaged in sales jobs indicates that an almost equal amount of work is going on behind the scenes in moving goods from the wholesaler to the customer.

Good merchandising methods dictate that only the best light, heat, and air conditioning be provided for retail stores. Although the building itself may not be owned by the management, renovations, remodeling, and modern architectural designs may be brought in at management's expense. Long-term leases with options for renewals make it possible to retire these heavy expenses painlessly over a period of 10, 20, or 25 years.

In addition to the selling area, each retailer must have adequate stockrooms, receiving docks, and shipping facilities. Investments in office space, restrooms, recreational areas, and elevators and escalators must be made, too.

*Parking Facilities.* Since the automobile has become so integral a part of American life, it has affected retail merchandising methods. Shoppers now choose suburban locations for the sake of convenience. Many downtown retailers are losing desirable business to shopping centers farther out for reasons other than parking convenience, too. For example, neighborhood retailers encourage the informality of wearing housedresses, slacks, shorts, and play suits.

For many good reasons, therefore, successful promoters of suburban

or neighborhood retailing establishments have arranged parking facilities, by purchasing land, taking out leases, or making other agreements.

## Retailing as a Career

The broadest field of employment in the marketing area is undoubtedly the field of retailing. Of those gainfully employed in marketing, approximately one-half are in retail occupations.

These retail occupations may be in small stores or in large department stores, but the basic principles of merchandising that underlie them are fundamentally the same—buying and selling. In the large organizations, of course, there are greater opportunities for specialists.

What type of work is done in a retail store? This can probably best be answered by examining the pattern of work in a retail department store. There the work is normally divided into two main divisions: (1) store operations, and (2) merchandising management.

Store operations include supervision of the buildings and offices, accounting and finance, markups, mail orders, wrapping, and alterations. Merchandising management covers the marketing functions of buying, selling, and sales promotion. Within the several departments, often departmental managers are held responsible for both buying and selling in their departments and are accountable to the merchandising manager. Sales clerks in turn are responsible to the departmental manager or his assistant.

Several years ago a detailed study was made of all retail-store jobs and the results were published in three volumes entitled *Job Descriptions for the Retail Trade.*[9] This publication not only listed the titles for retail jobs but also gave information about departmental organizations and individual job descriptions. Here are some of the job titles listed in this study:

| | |
|---|---|
| Adjustment Clerk | Outside Shopper |
| Bookkeeper | Personal Shopper |
| Buyer | Salesclerk |
| Cashier | Salesperson |
| Copywriter | Secretary (clerical) |
| Commercial Artist | Shipping Clerk |
| Correspondence Clerk | Show Card Writer |
| Credit Interviewer | Statistical Clerk |
| Display Manager | Stock Clerk |
| Interior Decorator | Tearoom Hostess |
| Model | Window Trimmer |

[9] United States Employment Service, *Job Descriptions for the Retail Trade.* Washington: Government Printing Office, 1938.

From these titles it is possible to get a general idea of the types of work done in a retail store.

Undoubtedly many business students expect to own a retail store. Table XIX-5 [10] is designed to show what qualifications are desirable. This analysis will be valuable for those considering employment at lower levels as well.

In addition to employment opportunities in small independent retail stores and large department stores, there are good opportunities in chain stores and mail-order houses. For example, the J. C. Penney Company has hundreds of stores that constantly need retail personnel. Such mail-order houses as Sears, Roebuck and Montgomery Ward not only have large regional mail-order units but also maintain large department stores in most of the major cities.

## Terms for Study

Bulk-service storage
Buying "f.o.b. warehouse"
Cash-and-carry basis
Consummate
Denomination
Dividing
Erratic
"Free" delivery
House-to-house salesman
Labeling
Merchandising duds
Packaging
Parceling
Physical properties
Repercussions
Self-service
Specialty store
Stockroom
Supermarket
Tangible sales
Variety store

## Questions

1. How does the field of retailing fit into the marketing picture?
2. What purpose is served in classifying retail stores?
3. There is a tendency for variety stores to group themselves together. How do you explain this situation?
4. Is the problem of store location as important to the small business as to the larger one? Explain.
5. Chain stores seem to spend more time and money than independent stores in doing research. How do you explain this fact?
6. Stores of different kinds sometimes try to locate near each other. Explain.
7. How can the importance of retailing be emphasized with statistical information?
8. What agencies contribute current statistical reports on the operations of department stores?

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[10] Shosteck, Robert, *Careers in Retail Business Ownership*, p. 47. Washington: B'nai B'rith Vocational Service Bureau, 1946.

## Table XIX-5. Qualifications for Entry into Retail Business Ownership.

| QUALIFICATIONS | Food and Drug | | | | | | | | | Lumber—Hardware | | | | Automotive | | | | Furniture—Household | | Apparel and Gen. Mdse. | | | | Other Fields | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Drug | Bakery | Fruit—Vegetable | Delicatessen | Ice Cream—Dairy | Confectionery | Dairy Products | Meats | Grocery | Hardware | Farm Equipment | Paint—Glass—Wallpaper | Heating—Plumb Equip | Lumber—Bldg Materials | Service Stations | Auto Accessory—Tires | Used Car Sales | New Auto Sales | Furniture (used) | Home Appliance—Radio | Furniture (new) | Dry Goods—Variety | Shoes | Millinery | Women's Clothing | Men's Clothing | News Stands | Gift—Novelty—Souvenir | Florist | Tobacco | Office Appliance—Stat'ery | Bookshop | Jewelry | Hay—Grain—Feed | Liquor | Fuel and Ice |
| **Minimum Experience in the *Specific* or a Closely Allied Retail Field:** | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Less than 1 year | | | x | | x | | | | x | x | | | | | x | | | | x | x | x | | | | | x | x | | | | | | | x |
| 1 to 2 years | x | x | | | [1] | | [2] | | | | x | | | | | x | | | | | | x | x | | x | | | x | | | | | | |
| Over 2 years | | | | x | | | | x | | | | x | x | x | | | x | x | | | | | | x | | | | | | x | x | x | | x | x |
| **Helpful Education and Training** | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| a. In a skilled trade | | x | | | | | | | x | x | x | | x | | x | | | x | x | x | x | | | | | | | | | | | | | | |
| b. College | [5] | | | | | | | x | | | | x | | x | | | x | | | | | | | | | | | | | | | | | | |
| **Capital** | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| $ 1,000 or more | | | x | | | x | x | | | | | | | | x | | | | x | x | x | | x | | | | | | | | | | | | |
| $ 2,000 or more | | | | x | x | | | | | | | | | | | x | | | | | | | | x | x | | | | | | | | | | |
| $ 5,000 or more | x | x | | | [1] | | [1] | | x | x | x | x | x | | | | x | [4] | x | x | | x | x | | | x | | | | | | | | | |
| $10,000 or more | | | | | | | | | | | | | | x | | | | x | | | x | | | | | | | | | | | | | | |
| **Desirable Aptitudes** | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Manual | | x | | | | | | | | x | x | | | | x | x | | | | x | | | | | | | | | | | | | | | |
| Mechanical | | | | | | | | | | x | x | | x | | x | x | x | x | x | x | | | | | | | | | | | | | | | |
| Scientific or Engineering | x | | | | | | | | | | | x | | x | | | | | | | | | | | | | | | | | | | | | |
| Artistic | | | | | x | x | | | | | | | | | | | | | | | x | | x | x | x | | | | | | | | | | |
| Literary | | | | | | | | | | | x | | | | | | | | | | | [7] | | | | | | | | | | | | | | |
| **Rural Background Desirable** | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| **Women: Very active in field** | | | | | x | x | x | | | | | x | | | | | | | | | | | x | x | | | | x | | | | | | | |
| **Special License Needed** | x | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| **Franchise Needed** | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| **Physical Requirements** | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| a. Heavy lifting or carrying | | x | x | | | | | x | | x | | x | x | x | x | x | | | x | x | x | | | | | x | x | | | | x | | x | | x |
| b. Outdoor work | | | x | | | | | | | | x | | | x | x | x | x | | | | | | | | | | x | | | | | | | | x |
| c. Cleanliness | x | x | x | x | x | x | x | x | x | | | | | x | x | x | | | | | | | | | | | | | | | | | | | x |

[1] With fountain and/or ice cream manufacturing equipment.
[2] Ice cream or candy making requires up to 2 years experience.
[3] Under $500 required.
[4] May suffice in small town or rura larea with limited sales.
[5] College degree in pharmacy required.
[6] Only for office appliances.
[7] Women's and children's shoes

9. What are the seven functions of retailing?
10. How do market evaluations contribute to successful retailing?
11. What is the difference between a specialty store and a variety store? How do their merchandising systems differ?
12. What four divisions are recognized in analyzing the operational characteristics of a large retail store?
13. What physical properties contribute to successful retailing?
14. Name the fundamental factors that make a good consumers' market.

## Problems and Projects

1. The following questions might well be answered by any merchant considering a location for a retail store. Study each, thinking in terms of a store-location problem of your own. Select a type of business that appeals to you—drugstore, variety store, or department store, for example—and check these 10 questions against your choice.

Type of business _____

Location _____

(city) (street)

_____ _____

(part of block) (side of street)

* * *

(1) What is the size of the community? _____
(2) Are the spending habits of the people favorable to your type of business? _____
(3) Is the location considered a good trade center? _____
(4) Is the community growing? _____
(5) Are parking facilities adequate? _____
(6) How many transportation lines serve the community from the outside? _____
How many from the inside? _____
(7) Are the local service clubs active in promoting the welfare of the people? _____
(8) Is the community a desirable one in which to live? _____
(9) What is the local tax rate and percentage valuation? _____
(10) Is public opinion favorable to your type of business? _____

2. Set up a list of specific ways in which a small country merchant can use market-research techniques in planning his merchandising program.
3. Do the functional operations of a retail store suggest types of employ-

ment you would like to prepare for? Enumerate those functions that appeal to you and list your personal qualifications for them.

4. Recall the most effective retail salesman you have seen recently. Why did he impress you? Can you analyze his salesmanship objectively?

5. Set up your own problem to show how an expensive location in terms of dollars and cents can actually become inexpensive to the management.

6. A retail shoe store had the following expenses:

| | |
|---|---|
| Salaries and wages | 16% of net sales |
| Rent | 5 |
| Advertising | 3 |
| Interest | 2 |
| Taxes | 1 |
| Utilities | 1 |
| Supplies | 2 |
| Other | 2 |
| Total | 32% |
| Profit | 6% |

If the amount spent for supplies was $1,200, how much were the net sales?

7. Chain-store prices are often lower than the prices of other retail stores. Explain this situation. How can independent stores make up for this disadvantage?

8. Refer to Table XIX-1. How would you go about interpreting these data in terms of choosing a retail occupation?

9. Make a list of duplicate services offered by wholesalers and retailers in handling goods. (For example, both frequently offer credit and both sometimes give delivery service.)

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CHAPTER XX

# THE SELLING FUNCTION

IT HAS BEEN PREVIOUSLY POINTED OUT that marketing is a process of getting tangible goods to consumers. A fundamental part of this process is creating *demand* for goods. No other marketing function seems quite so important and indispensable in the distribution process. Other marketing processes depend upon consumer demand, the governor of business activity!

The purpose of this chapter is to enlarge upon the importance of the selling function and show how saleswork is related to the operations of a business.

## Selling Processes

Economists and business-management experts are not in complete agreement upon the eminence of the selling process. It is generally agreed, however, that most business activity hinges upon fundamentals that make people buy, provide a market, move the goods, and keep factories busy. It is abundantly evident that most businesses prosper because of the volume of business created by their selling forces. In fact, the productivity of a prosperous sales organization often seems to minimize many other shortcomings that may exist in the management of a business.

Selling processes do not operate independently in a sales organization. Many processes are constantly at work in creating consumer wants and in directing consumers toward a specific product. A friendly word from a satisfied customer, a bit of unusual advertising copy, a service guarantee fulfilled, well-lighted displays, and newspaper advertising may all work toward convincing the customer that *he should buy*. Thus, no attempt is made here to show selling processes as complete within themselves. Saleswork is divided into separate areas only for analytical purposes.

### Selling through advertising

Advertising's contribution to selling will be discussed in the next chapter.

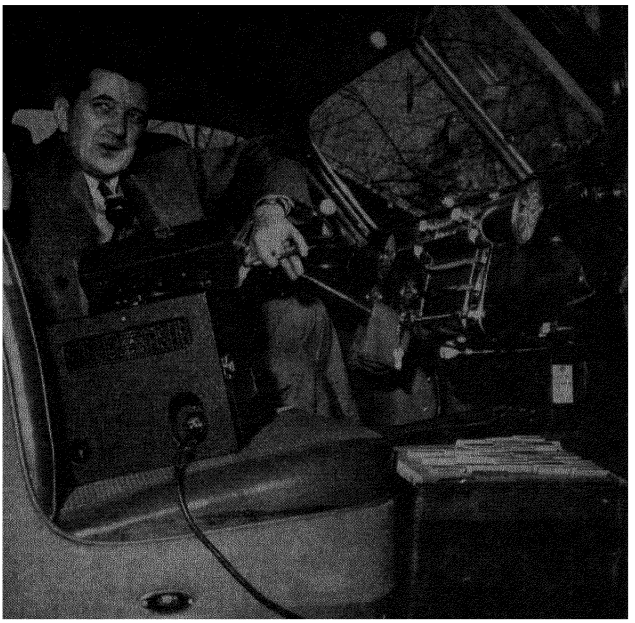
## Selling through the sales organization

There is no satisfactory substitute for the effective personal presentation of an idea! Advertising does not always create sufficient demand for merchandise and service. It must often be supplemented with human elements—competent people who can forcefully present the product to the prospect. Some products cannot be easily sold in any other way. Other products can be sold better and more economically by means of advertising alone. Ideally, advertising and personal selling complement each other.

*Courtesy The Dayton Rubber Company*

*Figure 20-1. Sales Exhibits.* Salesmen are inspired in many ways, not the least of which is through effective exhibition booths at trade shows. Here a large manufacturer brings a colorful, eye-appealing exhibit to a national trade show of industries in which his potential market is greatest.

*The Sales Manager and His Staff.* At the head of a sales organization is a competent leader known as the sales manager. He is usually a man with successful sales experience and one who is capable of organizing, leading, and inspiring those under his supervision. The nature of all saleswork is primarily promotion, push, or drive, and the sales manager is the dynamo or generator of ideas that make successful selling. He is one of the most important members of any business organization because he cultivates demand for products and thus creates sales and income for the business.



*Courtesy E. I. du Pont de Nemours & Company*

*Figure 20-2.* This salesman dictates his reports and letters by means of a portable machine after he calls on a customer, while the situation is still fresh in his mind. The recorded discs are mailed in to the office for transcription.

The results of a comprehensive survey that reflects the duties and responsibilities of the average sales executive are summarized in Figure 20-3.[1] There are ten distinct areas of work in which the sales executive is expected to hold responsibility. These are: (1) administration of sales department, (2) budgets, (3) sales planning, (4) sales training, (5) sales force, (6) sales promotion, (7) merchandising, (8) advertising, (9) research, and (10) public relations.

Subordinate functions are shown directly under each area. The corresponding bar charts show the extent to which the sales executive develops the ten responsibilities. The first level shows the work he actually does himself. For example, the average sales executive recruits 44 percent of his salesmen personally and does the selecting in 55 percent of the cases.

At the second, third, and fourth levels, the sales executive "supervises directly," "supervises generally," or is "consulted."

One of the sales manager's most important responsibilities is that of

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[1] *Sales Management,* March, 1949, Vol. 62, No. 5, pp. 4, 5.

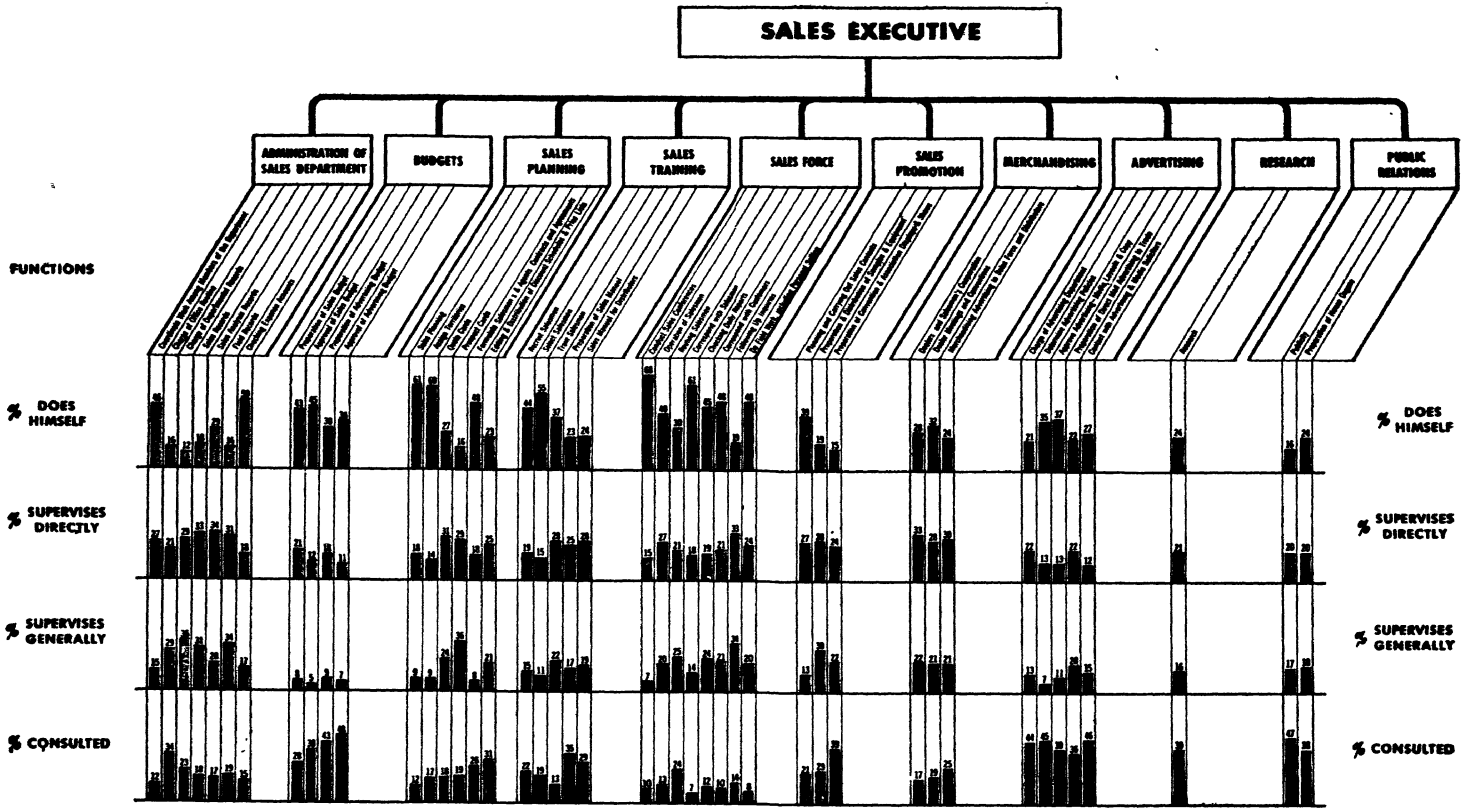
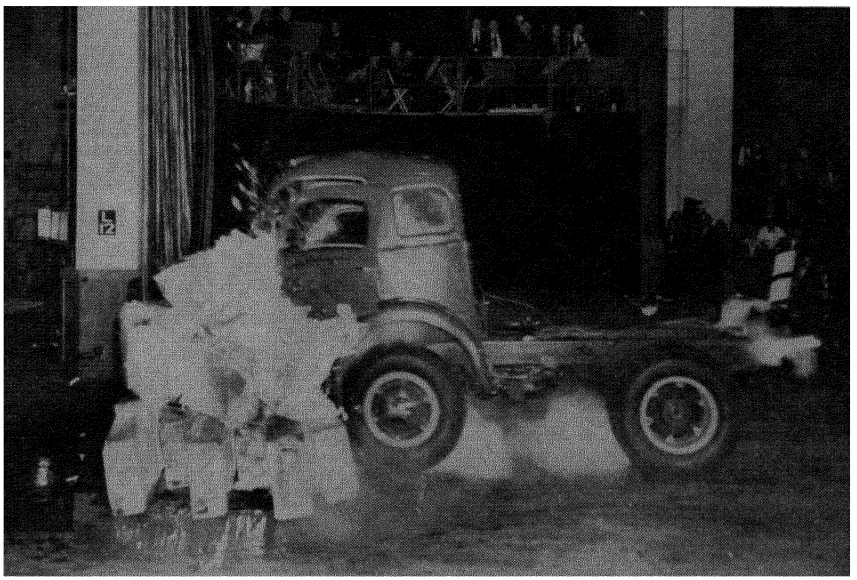



*Figure 20-3. The Responsibilities of Sales Executives.*

choosing competent assistants. This requires keen insight into human nature and broad experience and training with sales organizations. The sales manager selects the right people, orients them into the organization, and gives them sales training.

Although there are tests designed to measure applicants' potentialities for a sales job, each sales manager usually has his own technique for selecting his salesmen.



*Courtesy The White Motor Company*

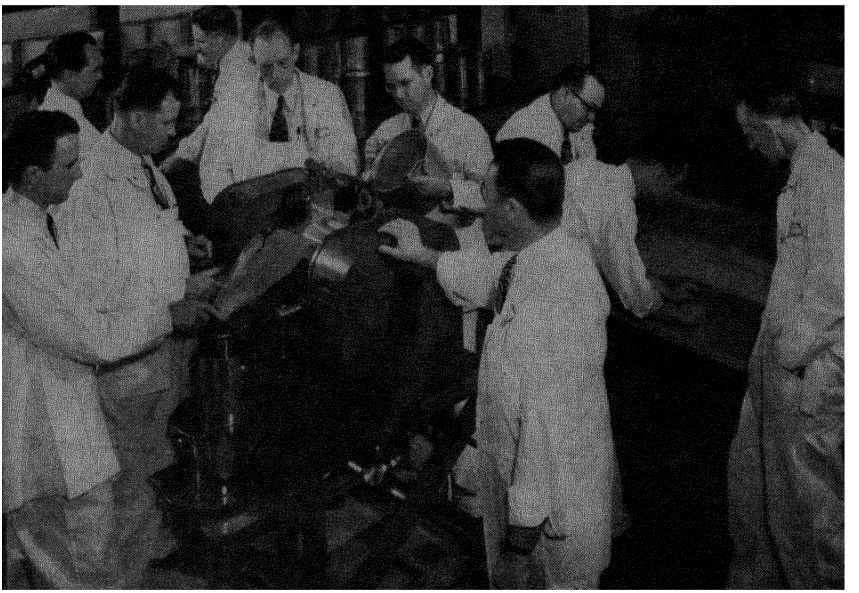
*Figure 20-4. Dramatic Demonstration of Product.* This illustration shows one of the company's trucks being crashed into a 16,000-pound wall of ice at 60 miles an hour to prove the strength of its construction.

*Sales Quotas.* Selling organizations generally build their work around budgets or sales quotas. Their entire personnel organization and facilities are geared up to achieve certain set goals. Quotas are usually developed with three ideas in mind: (1) previous sales, (2) immediate facilities, and (3) reasonable expansion plans for the future. Effective sales quotas, however, must be closely correlated with other aspects of the business. For example, sales and production quotas are by nature intimately related. Each has an important function and the two should not be competitive but rather complementary.

*Sales Presentation.* Any type of selling is a particularly delicate process because it involves contact between human beings. Yet selling affords rich rewards. On the general subject of salesmanship, we must

confine our discussion to six high points that contribute to good selling. These naturally center around sales personnel, because they originate and develop sales-promotion schemes.

1. *A good salesman is sold on his product and its usefulness to customers.* It almost goes without saying that a salesman cannot go far in his work without believing in what he sells. First, a good salesman wants to sell and usually selects a line of merchandise that has specific customer appeal. He fortifies himself with facts about the construction of the product, its performance statistics, uses, competitive value, and guarantee. These inspire his interest, self-assurance, and enthusiasm for selling.



*Courtesy Pittsburgh Plate Glass Company*

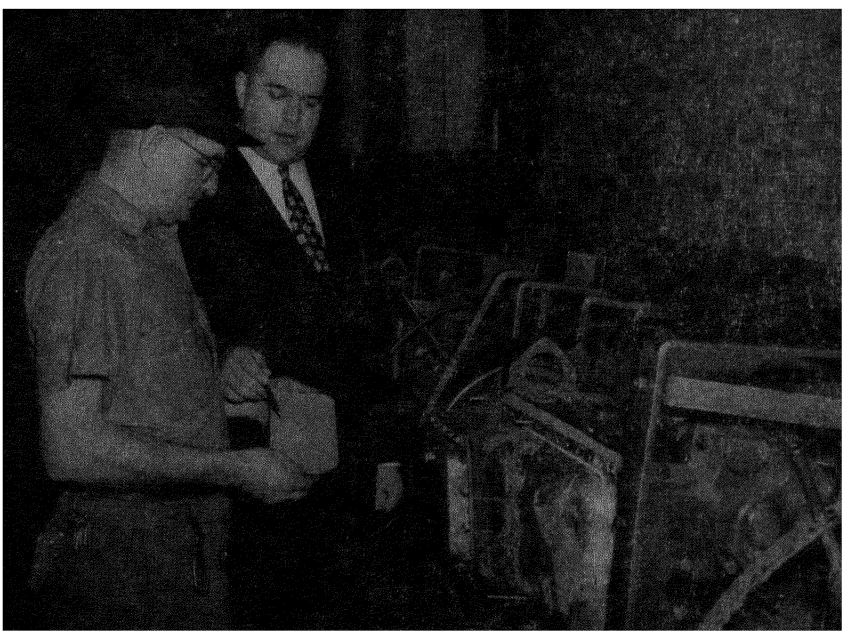
*Figure 20-5.* As a part of their sales training, salesmen learn in this laboratory how paint is made and tested.

But the real test of good selling ability is at the point of contact with customers. Much of the justification for salespeople lies in their ability to bring buyer and seller together. Understanding the customer gives a salesman power to sell. The lack of this knowledge prevents him from applying his sales talk to the customer's need.

The salesman and his customer are distinguished by the following characteristics:

| SALESMAN | CUSTOMER |
|---|---|
| *Reinforced with:* | *Possessed with:* |
| Desire to sell | Wants and willingness to buy |
| Knowledge of product | Curiosity about product |
| Effective display techniques | Feelings that can be handled when properly diagnosed |
| Demonstration ability | Means or credit to facilitate buying |
| Experience in dealing with people | Sensitive personality that may or may not accept the salesman's message |

In broad economic terms, a good salesman understands that shifts in working characteristics of the population affect customer wants. The entrance of women into business occupations means less time for making clothes, cooking meals, or doing housework. Alert sales promoters then offer laborsaving devices, precooked or frozen foods, and push-button electrical gadgets to make housework easy for women who divide their time between business and home.



*Courtesy Armstrong Cork Company*

*Figure 20-6.* This salesman is conferring with the foreman of motor assembly and testing in a large motor-truck factory to make sure that the performance given by his product is satisfactory.

Specifically, a good salesman knows something of the type of person who does the buying. It has been known for a long time that women either do or directly influence most of the buying in retail

stores. Appeals may be directed to women, or the salesman may be sagacious enough to appeal to women through men without their knowledge.

Table XX-1 analyzes the buyers of 19 commodities in the retail field.[2]

TABLE XX-1. WHO ARE THE BUYERS OF GOODS?
(Percentages)

| *Commodity* | *Women* | *Men* | *Men and Women* | *Young People (Under 18)* |
|---|---|---|---|---|
| Men's suits | 3 | 76 | 21 | |
| Automobiles | 5 | 60 | 35 | |
| Hardware | 7 | 90 | 2 | 1 |
| Gasoline and oil (automobile) | 9 | 85 | 4 | 2 |
| Fuel | 16 | 82 | 2 | . |
| Men's toilet articles | 25 | 74 | 1 | |
| Men's furnishings | 27 | 64 | 8 | 1 |
| Furniture | 31 | 11 | 58 | |
| Electrical appliances | 41 | 37 | 22 | .. |
| Drugs | 50 | 43 | 6 | 1 |
| Rugs | 51 | 6 | 43 | |
| Jewelry | 55 | 23 | 20 | 2 |
| Boys' clothing | 55 | 16 | 29 | .. |
| Girls' clothing | 59 | 1 | 40 | |
| Groceries | 74 | 17 | 4 | 5 |
| Draperies | 93 | 2 | 5 | |
| Kitchenware | 94 | 4 | 2 | .. |
| Women's toilet articles | 97 | 2 | | 1 |
| Women's clothing | 98 | 1 | 1 | |

2. *A good salesman sizes up his customer.* A good salesman tries to get the customer's point of view early in the sale. That is, he tries to classify the customer he is facing. How can this be done? Chiefly through observation of physical characteristics, and experience in observing human behavior.

A customer's clothes and the way he wears them are often a dead giveaway of his personality and buying power. Salespeople usually look for quality in materials and styles, and workmanship in tailoring; but they do not rely entirely upon appearances for information about a customer's buying power. Sometimes the best-dressed people are least able to buy; they often owe for what they wear! On the other hand, poorly dressed customers sometimes have large bank accounts and are willing to spend freely, if not recklessly, when salespeople acquire their confidence.

[2] Adapted from Converse, P. D., and Huegy, H. W., *The Elements of Marketing*, 3rd rev. ed., p. 24. New York: Prentice-Hall, Inc., 1946.

Another thing the salesman looks for in sizing up a customer is the way the customer carries himself. Head high, chest out, and quick, unhesitating steps spell self-assurance. Facial expressions generally tell if the customer is pleasant, happy, serious, thoughtful, grouchy, or irritable.

*Courtesy E. I. du Pont de Nemours & Company*

*Figure 20-7. Good Dealer Relations.* The salesman builds goodwill and confidence by knowing his product and its uses. In this illustration the salesman (right) discusses coated fabrics used for footballs, soccer balls, and other athletic equipment. He also explains how low-cost fabrics have widened the use of sporting goods.

3. *A good salesman has a positive attitude toward his customer.* Selling is a positive experience. Everything related to a sale should lead ultimately to winning the prospect's confidence. Therefore, the best approach to the customer is friendly, helpful, sincere, and pleasant. Positive impressions come in the greeting. Because a salesman anticipates defensive evasions like, "No, I am just looking," or, "No, I am not interested," he makes sure that his greeting—"Good Morning,"

or "How are you this morning, Mrs. Simpson?"—sounds sincere and not forced.

Furthermore, a good salesman avoids negative tones in his sales talk. An effective lead would be: "Wouldn't you like to see our new line of hosiery?" The negative would be: "You wouldn't like to see our new line of hosiery, would you?"

A good salesman does not overlook the most insignificant customer —a child, an old person, someone mentally infirm, or a pauper. "Lookers" vex some salespeople, but they often turn out to be good customers.

Two other points add to the positive attitude in selling: (1) Never argue with a customer. (2) Always think in terms of results or effects.

4. *A good salesman knows how to present his merchandise to his customers.* Good taste dictates that a salesman prepare himself physically for a favorable personal impression. He should be neat, well-groomed, and conservatively dressed. Negative effects sometimes originate in a salesman's overdressing and thus drawing the customer's attention away from the merchandise.

Every kind of merchandise—large, small, expensive, or cheap—demands the respect of its salesman.

A good salesman gives the product his best build-up. Inspiration comes from clever displays and advertising services that take insignificant, commonplace things like cosmetics or even kitchen accessories and make them look like exquisite jewels in plush and velvet. Merchandise is usually shown to customers under good light, at a convenient level, and at a proper angle for easy viewing.

5. *A good salesman has a definite plan for selling.* Effective selling, or sales engineering as it is sometimes called, is as thoroughly planned as any other managerial function. Planning often fixes outlines and mechanical patterns that seem artificial. Good results come when the salesman fixes in his mind the four fundamental stages of the sale cycle. These cannot be timed precisely, nor can they always be segregated and evaluated. They sometimes overlap. The salesman looks for four periods:

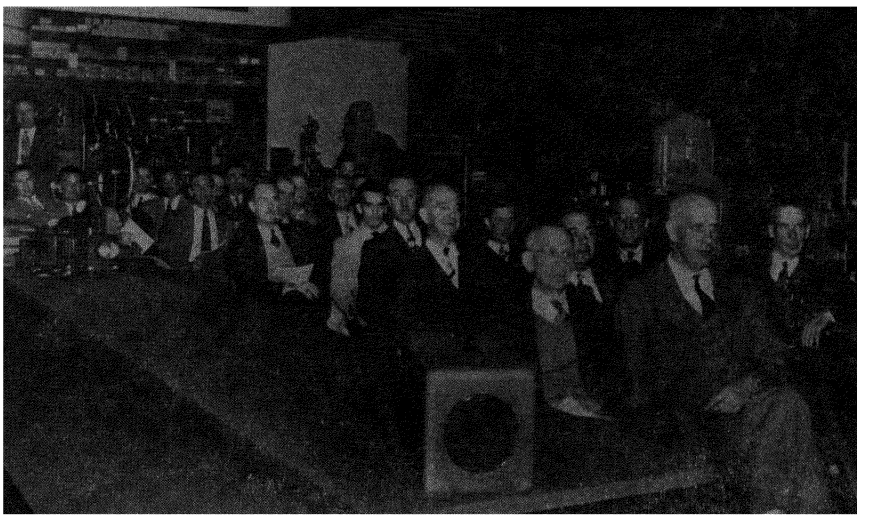
1. Attention stage
2. Interest stage
3. Desire stage
4. Action stage

The fourth stage is usually the most difficult to introduce. Most prospects can be worked up through the first three stages, but it takes expert training, long experience, and accurate thinking to close the

sale. One way in which action is aroused is by making the outright suggestion that the customer buy the thing he is looking at. It is often helpful to remove other articles from the customer's field of vision so that it will be easier for him to make a choice.

Repeat demonstrations are also good in bringing the customer through to the final stage of the sale. Trial offers, opinions of others (testimonials) and price concessions or credit terms are used, too.

6. *A good salesman is able to remove buying obstacles.* All selling techniques make provision for overcoming negative elements that detract from a sale. Customers offer obstacles because of their reaction to the sales talk and the product or because of their buying power and general attitude. No salesman can expect to remove all obstacles, but he can minimize many apparent obstacles that stand in the way.



*Courtesy The Dayton Rubber Company*

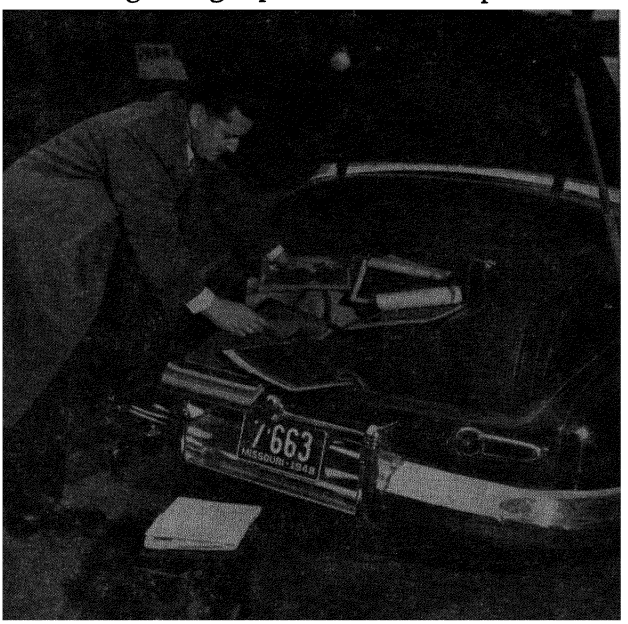
*Figure 20-8. The Sales Meeting.* This is the kind of meeting held by one large rubber company with more than 300 distributors during one year. Reports from sales managers indicate that sales definitely increase after such educational meetings. Note the use of visual aids.

Most objections are concerned with either *price* or *merchandise description.* Price objections can usually be met by showing value. With accurate knowledge of the product and its service, a good salesman can show a customer its dollar-for-dollar superiority to other products of the same kind.

Objections to the merchandise itself or differences in opinion about uses and special selling features can be easily dissolved in most cases

by fortifying the sales talk with knowledge of competitive brands, information about ways in which the product can be used, and cleverness in weaving positive ideas into the customer's thinking.

*Stimulating the Sales Organization.* After sales budgets have been set up and quotas assigned to individual salesmen in a territory or in a retail store, there must be some motivation or drive behind the organization to keep it functioning properly. The best way to provide this is by maintaining strong supervision over the personnel. Individual




*Courtesy E. I. du Pont de Nemours & Company*

*Figure 20-9. Busy Day Ahead.* Since most traveling salesmen are on their own time, they like to get an early start. This salesman is filling the trunk of his car with samples, brief cases, files, and luggage to serve his needs for the average trip of about 200 miles a day.

sales reports and progress charts for the salesmen will, of course, give the sales manager facts upon which to base supervisory policies. Sales meetings, conventions, and conferences present selling ideas that can be used by members of the sales organization. One city sales group for electrical appliances, for example, has two sales meetings each day, morning and afternoon, for the purpose of presenting to the salesmen the latest pertinent information about the product and its usefulness, as well as solutions to sales problems.

Premiums, bonus plans, special concessions, free vacations, and the

like are often valuable as stimulants to a sales organization. Ordinarily, however, these are not necessary; with good supervision and adequate pay, salesmen will usually take the initiative and sell their products without special inducements. The importance of training courses for salesmen cannot be overemphasized, because training produces results and pays its own way. Salesmen are not born, they are made!

*Payment Plans for Salesmen.* Salesmen sometimes work for a flat salary. Many like this plan because it provides a feeling of economic security. Salary plans are frowned upon by good sales organizations, however, because they do not develop the best qualities in their salesmen. It has been aptly said that a *good* salesman will not work for a straight salary.

A more appropriate system for the payment of salesmen is the commission plan, either with or without a guaranteed minimum salary. Commission plans pay each salesman according to the amount he sells. For example, a salesman who works on a 3 percent commission would compute his pay by multiplying his net sales by 3 percent. Some sales organizations guarantee a salary of a certain amount in addition to paying a certain percentage of sales as a commission.

Any compensation given a traveling salesman for transportation, lodging, food, and incidentals is usually in addition to his regular pay for selling the merchandise.

Inasmuch as some selling requires a great deal more of a salesman than serving customers, other factors are often considered in determining a salesman's pay. A comprehensive commission plan would recognize these factors:

1. Amount of new business obtained;
2. Number of calls made on customers;
3. Customer complaints;
4. Ratio between selling expenses and sales;
5. Number of repeat orders received;
6. Location of new customers;
7. Number of "difficult" new customers obtained;
8. Excessive returns of merchandise;
9. Proportion of cash to credit business obtained; and
10. Paying characteristics of customers obtained.

Although all these considerations do not invariably apply, they are important factors and should be taken into account by sales organizations in paying their employees.

## Selling through display

There is an area of salesmanship somewhat removed from sales promotion through personal representatives. This area is known as *display*. Although related to the field of advertising, its features are sufficiently representative of selling techniques to justify their inclusion in this chapter. Display sells and aids in selling a substantial volume of merchandise. This is particularly true in retail stores.

*Courtesy Standard Brands, Inc., Roasters of Chase and Sanborn Coffee*

*Figure 20-10. Remembering When.* Modern store display has come a long way since grandfather's time.

Most display programs are intimately related to modernizing the appearance of the entire store or building. Effective displays fit best into surroundings that are thus complementary to them. It has been estimated that 18,000 retail outlets have been modernized since World War II and that modernizing represents a two-billion-dollar business annually in the United States.[3]

[3] *Investor's Reader* (published by Merrill Lynch, Pierce, Fenner & Beane, New York), July 6, 1949, Vol. 13, No. 1, p. 5.

*Exterior Display.* The shape, color, style, and general appearance of the exterior of a factory or store building contribute to customer interest in and respect for products and services sold. Therefore, engineers, designers, and promoters spare little expense in securing attractive signs, full-view glass fronts, modern architecture, and well-kept lawns and parking areas.

*Courtesy Pittsburgh Plate Glass Company*

*Figure 20-11. Modern Interior Display.* This company not only gives effective sales training to its employees but also utilizes the most modern display equipment to make selling easy and buying a pleasure. Note the tendency in stock arrangement to save space by displaying only one of a kind.

Window display plays a vital role in all four stages of the sales cycle —attention, interest, desire, and action—but especially in the first two. The basic goal is to make the display sell the merchandise. The appeal must be visual, of course, and should be designed to arouse strong human interest. The usefulness, seasonal appropriateness, price, guaranteed value, appearance, or some other characteristic of the merchandise may be featured. Window displays, however, cannot sell merchandise by themselves. They must be co-ordinated with other sales devices and techniques. Repetition of sales ideas in many interior and exterior places as well as in advertising copy impresses the customer.

*Interior Display.* Interior display should be designed for three types of customers: (1) the in-and-out customer, who knows what he wants, buys it, and gets out; (2) the shopper-for-wants customer, who knows what he wants but prefers to look around for comparisons in quality and price; and (3) the general shopper, who has nothing particular in mind but likes to look through the entire store and study prices.

Display includes both merchandise and its surroundings. Many background elements indirectly build up the appearance of the merchandise.

We shall consider briefly five phases of interior display:

1. Effective displays begin with modern fixtures and equipment, and arrangements of aisle space to make shopping easy. Shelves and drawers are usually maintained at a level that does not obstruct the view to other parts of the store.

The arrangement of store fixtures can accelerate sales and increase profits. As an illustration, Table XX-2 shows the effect of building up displays at the ends of counters.[4] As reported in this survey of the Baltimore market, sales of spiced wafers of Brand B increased 1217 percent during the special display week. In like manner, sales of canned mincemeat increased 900 percent.

2. Departmental displays are grouped in ways that make shopping convenient. Customers are properly routed by means of directories, signs, bulletins, or information desks.

3. Merchandise is arranged in a neat and orderly way and is free from dust, lint, and marks of handling.

4. Any interior display has particular need for good light. Artificial lighting can contribute much to the appearance of merchandise displayed. General displays are maintained under normal light; special displays are often illuminated by spotlights and indirect sources of strong light.

5. Effective display depends on the absence of unpleasant elements, such as noise, undesirable store traffic, untidy storage, poorly groomed personnel, or overdressed salespeople.

### Good locations help sell merchandise

Finding a desirable retail location extends beyond the choice of a desirable community. Street, block, and position within the block are scrutinized for advantages in selling positions. Corner locations are generally preferred because of double traffic patterns at intersections.

[4] *Sales Management,* February 15, 1949, Vol. 62, No. 4, p. 78.

TABLE XX-2. HOW END DISPLAYS INCREASED SALES IN THE BALTIMORE MARKET.

| *Display* | *Unit sales Normal wk.* | *Unit sales Display wk.* | *Per-centage Increase* |
|---|---|---|---|
| 1. Canned Sauerkraut | 52 | 249 | 379% |
| Canned Beans | 161 | 748 | 365% |
| 2. Cider (1 gal.) | 11 | 34 | 209% |
| 3. Cider (½ gal.) | 10 | 85 | 750% |
| Spiced Wafers—Brand A | 12 | 62 | 417% |
| 4. Crackers (lb. box) | 32 | 202 | 531% |
| Crackers (8 oz. box) | 58 | 169 | 191% |
| Jam-Schimmel | 32 | 117 | 266% |
| 5. Royal pudding | 100 | 528 | 428% |
| Coffee (lb. bag) | 111 | 496 | 347% |
| 6. Chocolate syrup | 150 | 339 | 126% |
| Evaporated milk | 752 | 864 | 15% |
| 7. Tomato soup | 274 | 281 | 3% |
| Crackers (salted) | 72 | 208 | 189% |
| 8. Spiced wafers—Brand A | (12) | 32 | 167% |
| Spiced wafers—Brand B | 6 | 79 | 1217% |
| 9. Paper napkins | 93 | 183 | 97% |
| 10. Cleanser | 47 | 225 | 379% |
| Bleach (½ gal.) | 46 | 45 | —2% |
| 11. Pineapple juice | 88 | 360 | 309% |
| Cranberry sauce | 89 | 288 | 224% |
| 12. Table syrup (12 oz.) | 51 | 103 | 102% |
| Pancake Flour (2 lb. 8 oz.) | 85 | 117 | 38% |
| Pancake Flour (1 lb. 4 oz.) | 106 | 241 | 127% |
| 13. Canned Peaches | 94 | 115 | 22% |
| Canned Applesauce | 89 | 455 | 411% |
| 14. Canned Tomatoes | 211 | 544 | 158% |
| 15. Canned Mincemeat | 3 | 30 | 900% |
| Pie Crust Mix | 54 | 102 | 89% |
| Canned pumpkin | 31 | 174 | 461% |
| 16. Sugar (5 lb. bag) | 897 | 1619 | 80% |
| 17. Shortening | 22 | 204 | 827% |
| 18. Facial tissue | 478 | 760 | 59% |
| Laundry soap (unwrapped) | 601 | 634 | 5% |
| Totals | 4,918 | 10,692 | |

Some retailers, on the other hand, prefer inside locations because they have the advantage of cheaper rent and the added pulling power of stores on either side. Also, inside locations often afford customers more deliberation in window shopping.

The importance of traffic in retail-store locations was well expressed by one of America's great chain-variety-store owners. He said: "I set

my traps where the mice are thickest." But traffic in front of retail stores does not necessarily mean potential buyers. Transfers between bus lines or subway connections bring large numbers of people together from offices, factories, and department stores yet numbers count little unless buying habits are favorable to sales. Obviously, working people late from work and hungry for their evening meal are conditioned to buying nothing except food, rest, or relaxation.

The value of good locations is expressed not only by high real-estate values but also in tangible sales statistics, low distribution costs, low operating costs, and extra goodwill. The best locations are often called "100% locations."

Five common errors made in choosing retail store locations are:

1. Selecting a location because of low rent without considering potential sales.
2. Selecting a location because it is available and can be occupied immediately.
3. Selecting a location because of friendship with the property owner.
4. Selecting a location because it has been profitable to others whose business abilities may be different from those of the proposed management.
5. Selecting a location that is uncomplementary to the type of business proposed. Some locations are good for one kind of business but not for another.

Selling in a retail store consists of a lot more than an intelligent market analysis or a good location. Selling as a function works effectively only when *all* the forces of sales management are concentrated on the process.

## Selling as a Career

For extroverts who have analytical minds, are ambitious, and are not afraid of work, selling occupations should be attractive. Selling offers almost unlimited opportunities to the young man or woman who wants to work with people and serve them with useful products. No other occupation offers more variety, chances for promotion, incentive, and personal satisfaction.

Selling jobs can be unpleasant for those who do not like changes, challenging problems, and human relations. Conversely, most salespeople would be unhappy with the routine of office work.

Selling jobs are many in kind. Most of the selling in retail stores is

performed by clerks. Some salesmen are known as house-to-house callers. Appliance salesmen and equipment dealers work much on the same basis as house-to-house salesmen, but they are usually permanent personnel who call on a rather select clientele. Insurance salesmen have grown to be more than just salesmen; they serve as counselors and specialists in aiding people with personal insurance problems.

Retail and wholesale salesmen sell to a special type of customer—dealers. Selling to retail or wholesale dealers differs from selling to consumers chiefly in the quantities of merchandise sold, the selling appeals used, and the permanency of dealer accounts.

A rather comprehensive survey of the pay received by salesmen from 487 leading manufacturers and distributors was made by the Dartnell Corporation in 1946.[5] Although this report does not necessarily represent the average earnings of salesmen everywhere, it does show the average for these 487 companies, which represent many different selling positions in various geographical sections of the country. Table XX-3 shows the average earnings.

TABLE XX-3. EARNINGS OF SALESMEN IN 487 COMPANIES.

| *Average Annual Earnings* | *Year* |
|---|---|
| $6,177 | 1946 |
| 3,765 | 1943 |
| 3,008 | 1940 |
| 2,986 | 1933 |
| 3,872 | 1929 |

Here we see that the average annual earnings increased more than 100 percent between 1940 and 1946. The increase is accounted for not only by sharp increases in salaries paid but also by large commissions earned on merchandise selling for higher prices than formerly. Of course, changes in general price levels must also be taken into account.

The ultimate objective of many salesmen is a position as a sales executive. What are the qualifications for such a position and how long should a good salesman take to become one? The answers to these and many other questions have been investigated by the National Sales Executives in a study that included 10,000 key sales executives. Here are a few of the findings: [6]

1. More than 87 percent of the sales executives graduated from high school.
2. Seventy-five percent graduated from college.

[5] *Opportunities in Selling*, rev. ed., p. 25. Washington: Industrial Series No. 65, U. S. Department of Commerce, 1947.

[6] Adapted from "Portrait of a Modern Sales Executive." *Sales Management*, February 15, 1949, Vol. 62, No. 4, after page 104 in NFSE News, subpage 3.

3. More than 27 percent are owners, presidents, or vice presidents of their own companies.

4. Almost half of the group earn more than $15,000 annually.

5. More than 62 percent of the group believe that their college education assisted greatly in their selling career. Thirty-five percent believed college work helped them some. Fewer than 3 percent believed college training did not help them at all.

6. Sales executives are mostly young men between 35 and 55 (72 percent). Almost half are between 40 and 50.

## Terms for Study

Budgeting
Buying obstacles
Commission plan
Compensation
Comprehensive
Domestic status
Dynamics
Exterior display
Extrovert
Fortifying the sales talk
Incentive plan
Indirect sources of strong light
Interest appeal
Obstructing elements
Overdressed salespeople
Pay scales
Prospect
Public relations
Sales executive
Sales meetings
Sales presentation
Sales quotas
Sizing up the customer
Testimonial

## Questions

1. How would you measure the effectiveness of a sales organization?

2. In what ways is the selling power of advertising limited by distribution facilities?

3. Does a good salesman perform an economic service? Discuss.

4. Would you ever sell a customer something he does not want?

5. How does knowledge of merchandise contribute to good salesmanship?

6. "When a salesman is paid a commission on his sales, he often feels quite independent; his feeling is similar to that of being in business for himself." Explain the implications of this statement.

7. What are the essentials of a good sales presentation?

8. How can a good salesman remove buying obstacles?

9. How can a sales organization be stimulated to sell more merchandise?

10. How would you go about collecting materials for an effective sales presentation?

11. How can an individual develop self-confidence in his sales ability?

12. Explain the relationships between marketing and selling.

13. What relationship exists between the selling functions performed by salespeople and advertising appeals used in newspapers?

14. Why would you say women have been reluctant to enter sales occupations dominated by men?

15. Explain fully the meaning of this statement: "A good salesman must know more than the price and delivery terms of his merchandise."

16. What suggestions could you make toward stimulating a sales organization to sell more merchandise?

17. How should selling through display be correlated with other phases of salesmanship?

18. Explain the meaning of sizing up the customer.

## Problems and Projects

1. Set up five strong arguments to show the importance of the selling function in a business.

2. After referring to Figure 20-3, which outlines the duties and responsibilities of a sales executive, list your personal deficiencies for this type of work and make suggestions for overcoming them.

3. Assume you have the management of a chain of five local grocery stores. Use an annual sales budget of $850,000 for the five stores. This budget is developed on the following seasonal basis:

| | |
|---|---|
| Fall | 22 percent |
| Winter | 32 percent |
| Spring | 26 percent |
| Summer | 20 percent |

Now divide this budget among the five stores on the following basis:

Store No. 1 sells 40 percent
Store No. 2 sells 20 percent
Store No. 3 sells 10 percent
Store No. 4 sells 15 percent
Store No. 5 sells 15 percent

How much merchandise would each store be required to sell during each of the four seasons?

4. A new salesman for a shoe store was recently tested by the supervisor in a unique way. The supervisor sent his wife to the store to pose as "the woman who can't make up her mind." How would you handle such a customer?

5. Outline the steps you would take in preparing a sales presentation for a new patented safety tube for automobile tires.

6. Review your recent buying experiences and find one case in which the salesperson used testimonials effectively. Why do you think these testimonials were good, although some other person might think otherwise?

7. Analyze your personality for positive and negative qualities. How does this analysis relate to successful selling?

8. Set up your own promotion plan for selling portable typewriters to students. List the channels through which advertising and selling forces could be brought to bear. How would you relate these processes of advertising and selling? Use your imagination in relating these selling ideas.

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CHAPTER XXI

# ADVERTISING

## Nature of Advertising

### Definition and purpose

The Teachers' Committee on Definitions of the National Association of Marketing Teachers has defined advertising in the following way: "any paid form of nonpersonal presentation of goods, services, or ideas to a group . . ." [1]

Advertising must begin with the product. The management of a business decides what is to be sold, who is to buy it, and what means of selling can be employed.

When demand for goods is greater than supply, there is less need for advertising, because buyers seek markets. When supply exceeds demand, skill in selling becomes eminently important. The second of these situations is common in our modern machine age, for we can normally produce more than we are capable of consuming.

The basic purpose of all advertising is to create or stimulate demand for products; thus the chief aim of advertising is selling. It is a tool employed by management for building sales volume, partly by means of creating goodwill. Results are determined by the appeals used. These may be either rational (factual) or irrational (emotional), depending upon the characteristics of the population and the nature of the product being sold. Rational appeals are generally limited to industrial sales where dollars and cents count and to consumer sales where buyers appreciate facts rather than emotional impressions.

Emotional, or irrational, appeals are used in the case of most consumer goods because most people are sensitive to them. Advertising men have developed appeals to the senses as well as to the emotions. Emotional appeals commonly used by advertisers are: (1) imitation, (2) profit or gain, (3) affection, (4) acquisitiveness, (5) health, education, and safety, (6) recreational interests, and (7) ownership.

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[1] "Definitions of Marketing Terms." *National Marketing Review*, 1935, Vol. 1, No. 2, p. 149.

## What can advertising do?

Psychologists and advertisers alike are unable to visualize the limitless potentialities in the field of advertising and selling. They have only begun to explore the possibilities. Ten specific things are possible through advertising:

1. Reaching buyers among the masses at relatively low cost per unit contacted.
2. Contacting buyers who are out of geographical range of regular salesmen.
3. Aiding work of salesmen before and after visitation (time is saved in finding prospects, traveling, waiting, explaining, and conditioning the customer).
4. Creating new styles and fashions.
5. Creating desire for ownership of product.
6. Making sales.
7. Stimulating inquiries.
8. Creating good will and prestige for product.
9. Building customer confidence in firm.
10. Attracting good sales personnel to the company.

However, all of these cannot be achieved at the same time. Results are governed by the kind and size of an advertising program. The fundamentals of advertising are the same everywhere, but the size of the staff, the personnel employed, and the budgeting of work are different in different organizations. Actually, the advertising function in a small business is often incidental to the many other responsibilities of management.

## Social significance of advertising

Every person in America is continually in touch with some form of advertising almost every hour of the day and night. Newspapers, magazines, radio, television, billboards, and card advertising constantly remind the consumer of the goods and services that are available for his use.

But the buying process involves more than a sale; advertising influences social standards. What we consume and how we consume it affect our way of living, our progress, and our civilization as a whole. For example, advertising is directly responsible for introducing more color into the home, causing some babies to live on cod-liver oil and strained food sold in glass jars, bringing cigarettes from the poolroom

into the living room, packaging tea in small individual bags, and providing push buttons for housework.

## Measuring the Effectiveness of Advertising

The pulling power of advertising cannot be accurately estimated in advance. Sales do not completely tell the story. Goodwill is always involved and its influence in gaining buyers for any product is far-reaching. However, when other sales-producing factors remain constant in proportion to the growth of a business, increases in sales volume do offer good evidence of effective advertising.

*Courtesy Armstrong Cork Company*

*Figure 21-1.* The letters of inquiry sorted in this mailing section provide one means of measuring the public's response to the company's advertising.

Managers tabulate the pulling power of advertising by making special offers. Coupons are often printed in code, or they are restricted to a particular issue of a magazine or newspaper. How many readers are reached by a single advertisement can be judged from the response. Of course, coupons do not necessarily indicate potential sales; they may indicate only curiosity on the part of some readers.

### Cost approach to advertising

Advertising is a necessary business expense, the amount of which is best determined by experience. However, the problem of selling

through advertising does not consist simply of *launching* an advertising program. Advertising is often nonproductive in the early stages and does not pay its own way. Yet the cost of advertising must be carried through all stages. The point was forcefully expressed by John Wanamaker, one of America's great exponents of advertising, when he said: [2]

> If there is one enterprise on earth that a "quitter" should leave alone, it is advertising. To make a success of advertising, one must be prepared to stick like a barnacle on a boat's bottom. He should know before he begins that he must spend money—lots of it. Somebody must tell him that he cannot hope to reap results with his expenditure early in the game.
>
> Advertising does not jerk. It pulls. It begins very gently at first, but the pull is steady. It increases day by day and year by year until it exerts an irresistible power.

The statement is often made that a business cannot afford to advertise. The answer to this is that a business can't afford *not* to advertise. The ability of advertising to create demand for goods is a recognized fact. The following examples show the results of not advertising in three cases: [3]

*Case No. 1*

THIS AXLE BROKE—FOR GOOD

This is about a truck axle manufacturer who produced 90% of all of the truck axles sold in the United States. With a good backlog of orders this company decided to stop advertising.

At that time, Timken had only a small part of the axle business, but wanted more and with a continuous advertising program went after it in an aggressive manner.

The first company's business dropped until it was only 10% of the total. The management decided to regain its former position through a short-term advertising program but found that they could not rebuild overnight a position they had sacrificed during the years of the sellers market. Their attempt to hold even the slim share of the truck axle business remaining was without success and eventually they closed their books and were taken over by another concern.

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[2] "Good Forever." *Printers' Ink*, September 1, 1938, Vol. 184, No. 9, p. 90.

[3] *Don't Sell Out Too Cheap* (mimeographed pamphlet), pp. 1-3. New York: Associated Business Publications. (These case histories were originally published by the Eastern Industrial Advertisers Association.)

*Case No. 2*

WOULD YOU PAY $6,500,000 TO SAVE $35,000?

From an $8,000,000 business to a $1,500,000 business in three years. That's the price this company paid for cutting advertising. Spending $35,000 a year in business papers, this company decided, during a very prosperous period, to curtail its appropriation. In one year they cut their advertising 75% and finally eliminated it entirely. Other sales efforts were fully maintained.

From that time on business dropped steadily and didn't recover. Competitors, on the other hand, continued their advertising and made inroads into this company's business from every angle. In the cement machinery field, where they had been top-notch, they lost their leadership. In the mine hoist field they were supplanted by another advertiser. In the smaller locomotive field, where they had never feared competition, they were forced to surrender their supremacy to two other companies. Although they were well known in the sugar mill industry, business in that field faded. They, therefore, had to give ground on all sides. The company has recently been reorganized.

*Case No. 3*

CONDENSING ADVERTISING CONDENSED THIS BUSINESS. . . .

Fifty years of manufacturing condensers is a long time and it is no wonder that this company was acknowledged as a leading manufacturer of this equipment. During the heydays, however, they became too busy—had all the business they could handle and cut their advertising appropriation to ⅓ of its former size.

Where they were formerly leaders in this industry, they were not among the first five or six manufacturers when this study was made. It was not their inability to manufacture the product but the loss of reputation and recognition that had forced them down.

As a matter of fact, other condenser manufacturers with more business than they could handle occasionally offered this company their excess business.

Statistics concerning advertising expenses of a business are usually available from its accounting department. Trade associations and government agencies also publish reliable statistics. In order to obtain the best results, businesses should model their advertising budgets after the operating methods of other business organizations that are of a similar nature.

Retail-advertising budgets are based on percentages of retail sales. It is important from a cost-accounting point of view that the percentage be maintained near the specified amount. As an illustration,

the following businesses normally spend approximately these percentages of net sales for advertising:

| | |
|---|---|
| Bookstores | 1.0% |
| Drugstores | .8% |
| Florists and nurseries | 1.4% |
| Haberdashery stores | 1.2% |
| Musical-instrument stores | 2.2% |

This means that a musical-instrument store, for example, would probably spend about $264 for advertising during a period for which its net sales amounted to $12,000.

## Advertising Media

Evaluating advertising media is sometimes merely a matter of determining how much each costs per prospective customer reached by means of it. For example, newspaper advertising may cost less per reader than post-card advertising. A large company advertising in 231 newspapers that were read in 54,000,000 homes was asked whether the same number of prospects could not be contacted more economically by post card. Here is the analysis that gave the answer: Half-page space in 231 newspapers reaching 54,000,000 readers cost $71,730. Buying, printing, addressing, and mailing post cards to 54,000,000 prospects would cost $1,350,000.[4]

Effective advertising should be based upon more than cost accounting of the different media; advertising involves the delicate managerial responsibility of deciding which media are most desirable in more ways than cost. Selling objectives must be accomplished, and some media are better for selling some products than others. Trade journals are excellent contacts for selling specialized equipment, and the professional journals are ideal for advertising high-class office furniture. But radio spot advertising of television equipment in a low-income community would be an unwise venture.

Choosing advertising media intelligently is a major problem of management. More than $3,000,000,000 was spent in advertising in the United States during 1946 for eight classes of advertising media; this represented 1.9 percent of the national income. Expenditures in each of these are shown in Table XXI-1.[5]

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[4] *Sales Management,* February 15, 1949, Vol. 62, No. 4, p. 67.

[5] Zeisel, Hans, "1946 Advertising Volume Greatest in U. S. History." *Printers' Ink,* March 28, 1947, Vol. 218, No. 13, pp. 34-35.

TABLE XXI-1. EXPENDITURE FOR EIGHT CLASSES OF ADVERTISING MEDIA.

| | *Amount* | *Percent of Total* |
|---|---|---|
| Newspapers | $ 963,800,000 | 30.9 |
| Radio | 489,400,000 | 15.7 |
| Magazines | 430,400,000 | 13.8 |
| Direct mail | 278,800,000 | 9.0 |
| Business papers | 178,000,000 | 5.7 |
| Outdoor advertising | 85,900,000 | 2.7 |
| Farm papers | 35,800,000 | 1.2 |
| Miscellaneous | 654,500,000 | 21.0 |
| | $3,116,600,000 | 100.0 |

## Newspapers

The amount of money invested in newspaper advertising during 1946 (nearly $964,000,000) places this medium first in importance.[6] Newspapers are traditionally taken for granted as media for advertising. The foundation and growth of every major newspaper has been built around the revenues afforded through advertising contracts. Readers and many advertisers accept newspaper advertising as a routine procedure, and there are good reasons for this attitude.

1. Newspapers are economical as a means of contacting a large trade area. A full-page newspaper ad in a Chicago daily, for example, costs about $2,000. If the circulation of the paper is more than one million, possibly 500 readers can be contacted at a cost of $1.00. One penny, therefore, would buy five readers. Compared with the cost of postage used in direct-mail advertising, the cost per person for newspaper coverage is negligible.

2. Newspaper advertising can be localized to appeal to one community, or several communities can be tied in with national newspaper advertising. There are probably more than 1,500 daily newspapers and 500 Sunday papers in the United States. Thousands of small-town and city weekly papers bring the total to more than 16,000.

3. Newspaper advertising covers the market thoroughly. More than 90 percent of all families in the United States can be reached through newspapers.

4. Newspapers are timely. Advertising appeals can be directed from day to day according to the character of the market and the product being sold.

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[6] *Ibid.*

The fact that newspaper advertising is timely makes it a potent tool for selling, because markets change quickly. The flexibility of newspapers makes them sensitive to competitive selling. Evidence of this condition is seen in the varying amounts spent for newspaper advertising when our economy shifts from a sellers' market to a buyers' market and vice versa.

**Hudson Motor Car Co.**, *Detroit*

**HUDSON AUTOMOBILES**

**OBJECTIVE** To introduce a new type of car and stimulate traffic in dealer showrooms.

**METHOD** Three advertisements were run in 1,248 dailies in approximately 1,000 markets, and 852 weekly newspapers in 852 smaller markets. First ad stressed the Hudson organization, the second was strongly localized with local maps showing dealer and distributor locations, while the third announced actual arrival on display of the 1948 Hudson. Space sizes ranged from full pages to ads of 1,800, 1,400, 1,000 and 800 lines, with 65% of the appropriation allotted to newspapers, 25% to magazines and 10% to spot radio.

**RESULTS** More than 4,000,000 people visited Hudson showrooms across the country on "Announcement Day" alone. In the first week, a total of 10,000,000 people saw the new Hudson. The company considered the campaign "one of the most—if not the most—successful new car announcement programs in automotive history."

**from the advertiser:** *"Newspapers were used as the principal medium because of their point-of-sale advantage, which allowed advertising emphasis to be placed in areas where distributors and dealers were located. The soundness of this policy was evidenced by the huge crowds attracted to inspect the new Hudson. The flexibility of newspapers was of particular value in permitting close timing, since it was necessary to dovetail the national announcement date with factory production schedules and distribution of sample cars to dealers."*

M. M. Roberts
*Director of Advertising & Merchandising*

**from the agency:** *"Newspapers were used as the primary medium for this campaign because they allowed local advertising to be placed in areas where it would give direct support to Hudson distributors and dealers. That this was sound policy is indicated by the tremendous interest in the new Hudson and by the great crowds who visited Hudson showrooms."*

George Johnston
*Vice President*

**Campaign by Brooke, Smith, French & Dorrance, Inc.**, *Detroit*

*Courtesy American Newspaper Publishers Association and Brooke, Smith, French & Dorrance, Inc.*

*Figure 21-2.* This is a summary of a successful newspaper-advertising campaign.

The strength of advertising campaigns in newspapers is reflected in the case illustrated in Figures 21-2 and 21-3, taken from the *Blue Book of Newspaper Advertising, 1948.*

*Courtesy American Newspaper Publishers Association and Brooke, Smith, French & Dorrance, Inc.*

*Figure 21-3.* The advertisement shown here is one of those used in the campaign described in Figure 21-2.

## Radio and television

Radio is one of our newest advertising media, but it already rates second. There are more radio stations in operation than newspapers. In 1949 we had more than 1,700 standard broadcasting stations in operation, and construction permits for 300 more were issued.

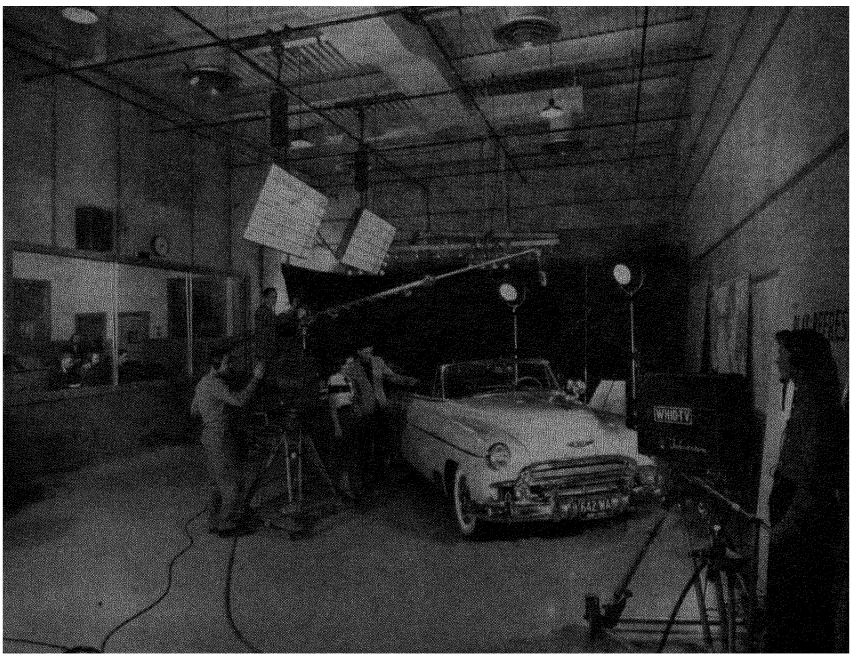
Radio advertising has strong selling appeal because:

1. It is highly adaptable to local communities or to larger regions through network hookups.

2. It has an unusually large listening audience. More than 90 percent of the American homes are equipped with radio receivers.

3. It is flexible. Copy can be changed to comply with current events even while programs are on the air. Insurance underwriting companies often use large fires or explosions as the basis of their appeals in selling policies. Clothing salesmen, florists, food dispensers, and accessory salesmen capitalize on athletic events in designing appeals to match the spirit of the day.

4. It is economical to use. Virtually a world-wide audience can be reached inexpensively.



*Design and construction by The Austin Company*

*Figure 21-4. Television Studio.* Although television requires many of the same facilities as radio, note the many special features shown here: special lights, portable equipment, and appropriate background.

The television industry became a reality because it was built upon the blueprints of the radio industry. The public in general accepted television not only because of its novelty but also because of its possibilities as a means of communication. Although the microphone took

many years to gain an entrance into the political chambers of Congress, television cameras have already put both Congress and the President in homes all over the country.

More than three million television sets are estimated to be in use.[7] A survey has indicated that the television audience numbers between twelve and fourteen million.[8] It is estimated that within a few years eighteen million sets will be in use and coast-to-coast television network service with radio relays and coaxial cables will be in full operation. If the present rate of growth is maintained, the radio-television industry will probably soon rank among the ten leading industries in the United States.

*Courtesy Fort Worth* Star Telegram, *Station WBAP, and Glenn Advertising Inc*

*Figure 21-5.* The close relationship between radio and television is attested by the fact that a single station such as the one shown here can house AM, FM, and TV facilities.

The center of television's appeal for advertisers lies in the fact that 85 percent of everything we learn comes through our eyes. Television combines eye and ear appeals. Furthermore, it reaches new potential buyers of advertised products. Special groups, such as shut-ins and the hospitalized, can now see things they were unable to before.

Television programs will remain free to users because they are sustained by advertisers. In three years the number of companies paying for television has jumped from less than a score to over 1,000.[9] The market reached by television will continue to increase.

A comparison of the uses made of network radio and network television advertising in terms of convenience merchandise vs. shopping

[7] "Estimated TV Set Ownership." *Advertising Age,* December 5, 1949, Vol. 20, No. 49, p. 52.

[8] Morgan, C. F., "Realistic Appraisal of Television." *Magazine of Wall Street,* December 17, 1949, Vol. 85, No. 6, p. 284.

[9] *Ibid.*

goods and services is seen in Figure 21-6. In 1929 only about 35.3 percent of network radio advertising was used in selling convenience merchandise, but in 1934 the proportion had increased to nearly 80 percent. The largest percentage was spent for such advertising in 1939.

The expenditures for television time in the first four months of 1949 seem similar to those for network radio advertising twenty years ago with respect to convenience goods.

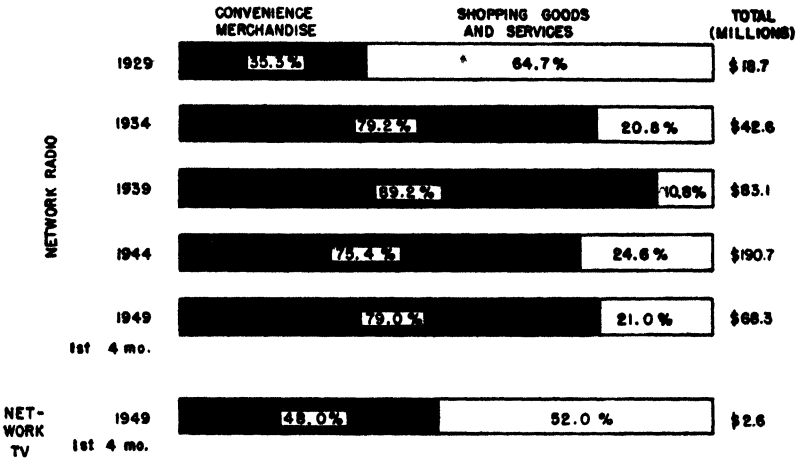


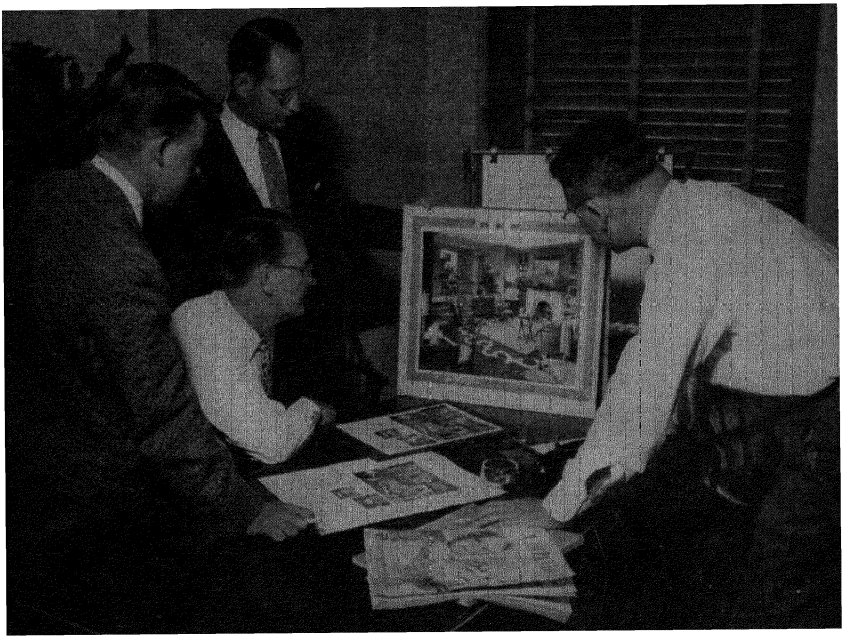

*Figure 21-6. Network Radio and Network Television Advertising Appropriations for Convenience Merchandise and for Shopping Goods and Services.* All information is based on Publishers Information Bureau reports. "Convenience merchandise" includes food products, food beverages, confectionery and soft drinks, toilet goods, medical supplies, smoking materials, household soaps and cleansers, gasoline, and oil. "Shopping goods and services" includes all other advertising. (SOURCE: Magazine Advertising Bureau, *Bulletin,* June 29, 1949.)

## Magazines

Various studies of magazines rank them about third in importance as an advertising medium. In one study, this rank is based on dollars invested in magazine advertising ($430,400,000).[10] Because nearly 70 percent of the American people above the age of 15 read magazines, it was possible in 1948 to advertise nearly 18,000 individual products by use of this medium. The circulation of all Audit Bureau of Circula-

[10] Zeisel, Hans, "1946 Advertising Volume Greatest in U. S. History." *Printers' Ink,* March 28, 1947, Vol. 218, No. 13, pp. 34-35.

tions magazines increased more than 85 percent between 1939 and 1948, whereas daily newspaper circulations increased only 31.8 percent.[11]



*Courtesy Armstrong Cork Company*

*Figure 21-7. Approving Magazine Copy.* In this typical scene in the advertising and promotion department of a large company, officials are conferring about the desirability of illustrations to be used in magazine advertising.

Why are magazines so important as advertising media? These reasons afford an explanation:

1. Magazines are extraordinary in physical appearance. They have eye appeal because of extravagant uses of color and modern designs in composition. They are the antithesis of old-fashioned means of advertising display. Pictures give a realistic idea of the product's appearance.
2. Magazines give the advertiser an opportunity to place his copy between feature stories that draw attention to it.
3. Magazines can present nationwide coverage.
4. Magazines bring together a wide variety of products that tend to sell each other by being displayed together.

[11] *Magazines and Advertising.* New York: Magazine Advertising Bureau, Inc., 1948.

5. Magazines are inexpensive advertising media, notwithstanding the fact that one full-page black-and-white ad in one issue of the *Saturday Evening Post,* for instance, may cost as much as $14,000. The large number of people who see such an ad makes the cost per reader low.

### Direct-mail advertising

Direct-mail advertising is any kind of advertising that goes directly to the prospective buyer through the mails. In its broadest sense the term includes both form and individually typed letters, folders, booklets, samples, and special mailing leaflets. Advertisers, however, are keen in defining the different specialties in the direct-mail field in order to build up specialized selling power.

"Anything that can be sold can be sold by direct mail" is a familiar slogan among advertising men. The truth of this statement is seen in the myriad uses to which direct-mail advertising has been put. Clothing, food, appliances, correspondence courses, homes, automobiles, burial lots, insurance, and jewelry are only a few of the thousands of things that have been successfully sold by mail.

No matter what other forms of advertising are available to salesmen, almost all of them use some direct-mail advertising. As a medium it has strong universal appeal because of its flexibility, low cost, and availability to the advertiser. The coverage may include millions of prospects or again it may be limited to a few select customers. For example, a highly effective type of direct-mail advertising is that used by retail salespeople when they write informal post cards to their best customers and announce special merchandise.

Success in direct-mail advertising centers chiefly around two factors: (1) the skill with which the market has been evaluated, and (2) the potency of the mailing list. Mailing lists must be current and correct.

### Outdoor advertising

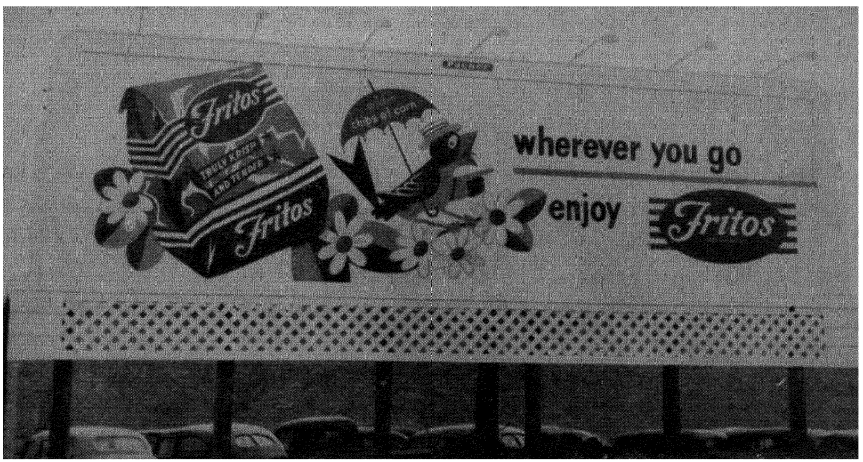
Changes in the transportation habits of the American people are probably more responsible for the importance of outdoor advertising than any other thing. We are a nation on wheels, moving incessantly from place to place for business reasons, for pleasure, or for no good reason except that we like to ride! The mobile character of our population provides an audience for impressive outdoor displays.

Three forms of outdoor advertising are used extensively:

1. Electric signs that feature trade-marks, lettering, caricatures, or pictures of the product;

2. Bulletin displays, which are painted signs on large display boards, with or without electrical connections for night vision, and which are often so striking in appearance that they look more like portraits than advertising; and

3. Poster displays, which are signs made by pasting lithographed sheets of paper on advertising signboards.




*Courtesy The Packer Corporation of Texas and Glenn Advertising Inc.*

*Figure 21-8. Outdoor Advertising.* Bright colors and striking design in outdoor advertising create consumer interest in the advertised product.

The value of any form of advertising is largely determined by the number of people who see the copy. This is called its circulation. But the number of people who see an outdoor sign is not always a measure of its value. An effective sign must be placed at a convenient angle for vision, it must be at the proper elevation, and it must not be obstructed from view.

Authenticated circulation statistics for outdoor-advertising units are generally released by the Traffic Audit Bureau, Inc. (T.A.B.). This bureau is a nonprofit service organization under the directorship of the Association of National Advertisers, Inc., the American Association of Advertising Agencies, the Outdoor Advertising Association of America, Inc., and the Poster Advertising Association of Canada. The Bureau is to outdoor advertisers what the Audit Bureau of Circulations (A.B.C.) is to newspaper and magazine advertisers.

### Card advertising

Card advertising is much like poster advertising. The layout is usually made up of pictures and brief copy. The effectiveness of this advertising is determined by the quality of the copy and the precision used in evaluating the market. Markets may be either local, regional, or national. Cards are almost as adaptable as billboards and equally timely. Most card advertising used in multiple installations are either lithographed, hand-painted, or duplicated by silk-screen processes.

The cost of card advertising varies with the size of the city, the size of the card, the number of cards used, and the variety of installations. A typical card contract costs approximately one dollar for each card per month of service.

### Other advertising media

There will continue to be almost as many new ideas among advertisers as there are people in the advertising field. Although the industry has become standardized in the more customary media, there are other effective means of advertising. Novelties and gifts that carry the names of advertisers are typical of minor media. Novelty advertising has some advantages, but it is often difficult for a buyer of such advertising to separate his own personal fancy for a novelty from its intrinsic value as an advertisement.

Box-top premiums and free offers often bring in a landslide of responses and cause great increases in sales. One prominent American magazine states that at least 12,000,000 people were affected in 1947 by the "contest bug." Advertisers gave away about $2,000,000 in prizes during the same year. Correspondence schools have been organized to teach people how to win, and some companies sell "reasonable facsimiles" in bulk to contestants.

## The Advertising Agency

The growth of American advertising has developed a new industry —the advertising industry. It is composed of printing establishments, artists, engravers, photographers, signwriters, mechanics, and advertising agencies.

An advertising agency is a service organization that works between the company desiring to advertise its product and the various media that carry advertising. Agency service, as defined by the American Association of Advertising Agencies, "consists of interpreting to the

*Courtesy Procter & Gamble*

*Figure 21-9. Advertising Based on Tests of Product.* These laboratory tests of soap characteristics form the basis for effective advertising statements about what the product is capable of doing for the user.

public, or to that part of it which it is desired to reach, the advantages of a product or service." [12] This interpretation includes:

1. A study of the client's product or service
2. An analysis of the present and potential market
3. A knowledge of the distribution factors related to sales
4. A knowledge of all available media and means which can be used effectively in selling the product to consumers, retailers, or wholesalers
5. The formation of a plan and its presentation to the client
6. Development of the plan

[12] *The Structure of the Advertising Agency Business*, p. 13. New York: American Association of Advertising Agencies, 1948.

7. Close cooperation with the client's sales organization to insure the greatest results from the advertising.[13]

Many business organizations prefer to use an advertising agency because the agency gives a specialized type of professional service that cannot be afforded privately. Furthermore, many business organizations do not have the personnel to accommodate a high-class professional advertising service. Agency contracts allow a business to use as much or as little of the facilities afforded by the agency as are needed, and it may use these facilities on a percentage and service-charge basis of compensation.

Advertising agencies serve the public in much the same manner as public accounting firms do; that is, the agencies render a professional service for a stated fee. An agency may handle all details for the client, or only a portion of them. The staff of the agency is usually made up of a number of different specialists, such as media men, layout men, artists, production men, copy writers, engravers, photographers, printing specialists, and research workers. In some cases work requiring such skills as photography, printing, and engraving is let out to other firms.

## Advertising as a Career

Advertising as a career does not often exist in a very small business because of the obvious limitations of size. In larger retail establishments, factories, wholesale organizations, and even financial institutions, there is a place for specialization in advertising. A comprehensive picture of advertising as a career can be seen through the organization of an advertising agency.

### Positions in an advertising agency

*The Media Man.* The media man makes comparisons and selects the most desirable media to use within the provisions of the budget available for the purpose at hand. After selecting the media, he usually contracts for space and sends the mats, negatives, and copy to the publisher.

*The Layout Man.* The duties of the layout man are to confer with the account executive and the client, as well as with members of the staff, and be able to determine from such conferences the tone and general content of the advertisement. He may supervise the work of

[13] *Ibid.*, pp. 14-15.

the artists and the photography, and he usually determines the size and face of type to be used.

*The Artist.* The artist must complete in detail the art work outlined by the layout man. He must be skillful in sketching and drawing, for he must do a wide variety of art work.

*The Production Man.* The production man usually has training in printing, engraving, or lithography. He may be a former newspaper man. His duties are to send out the copy (pictures and text) to the printer, engraver, lithographer, or electrotyper in a form suitable for reproduction.

*The Copy Writer.* The duties of the copy writer are to present the facts about the product in the tone decided upon in conference with staff members. He must be able to explain clearly and concisely what the illustrations and layout of the advertisement suggest.

Of all the specialists, the copy writer must have the broadest qualifications. He must use originality and correct English, and he must have acquired through either experience or research a knowledge of the product being advertised and how it is made. He works with the layout, production, and art specialists in order to achieve the desired tone of the advertisement.

*The Account Executive.* In an agency the person who correlates the details of a specific account or of several accounts is termed an account executive. This person needs to be an expert in one or more advertising specialties and must have a general knowledge of all phases of the work. He should be able to size up the client's business, suggest ways of improvement, and confer with his client in planning the client's over-all advertising campaign. He must also be able to offer suggestions for improving the firm's business papers, letterheads, invoices, labels, and so forth.

*The Advertising Manager.* The duties of an advertising manager range from the employment, training, and supervision of the specialists to executive control of the agency (or department). He may be called upon to perform any or all of the functions of the various specialists, depending upon the size of the agency or department.

Like the manager of any other department of a business, he must have executive ability. He must have, in addition, a sound basic knowledge of the principles of advertising and a detailed knowledge of one or more specialized fields. It is to his advantage if he has worked up through one of the specialized fields, for then he is better able to understand the problems of the specialists.

### Essential personal traits

In addition to the particular abilities needed by the different specialists, some of the general qualifications of those who desire to engage in advertising work are:

1. Ability to sell.
2. Better than average intelligence.
3. Good health.
4. Patience and endurance.
5. Sense of humor.
6. Foresight and organizational ability.
7. Knowledge of human nature.
8. Neat appearance and good speech.
9. Executive abilities.
10. Imagination and initiative.
11. General knowledge of many types of businesses and a knowledge of how business functions.

Probably the most important qualification of the advertising man is being able to sell. He must first sell himself to his client and then sell his ideas and services. Writing and drawing abilities are of great assistance, because some ideas can be presented clearly only by means of a graphic representation.

A knowledge of business in general makes it easier for the layout man, the artist, and the copy writer to visualize the type of person the advertisement must reach, the dress of the persons to be pictured, and the language to be used in the advertisement.

### Promotion possibilities

In advertising, promotion depends upon ability to produce results. The advertising specialist can move up by transferring from one job to another within the organization or by moving from one kind of work, such as agency work, to another, such as department-store work. Frequently some client will recognize the ability of any agency employee and offer him a position as head of his firm's advertising department.

Trained advertising personnel may advance in lines other than advertising. The knowledge of business principles and business functions necessary for successful work in advertising also qualifies one for work in other fields.

The highest level of employment for the advertising man is that of

managing or owning an agency. Since advertising is essentially a service type of business, establishing an agency requires a relatively small capital investment and growth can be proportional to business success.

### A.A.A.A. examination for advertising

The American Association of Advertising Agencies conducts a yearly examination to test young people of high calibre for their aptitudes in advertising and to inform them of various kinds of advertising services within the industry. These examinations were sponsored in 1949 by more than 200 advertising executives. They are given especially for employees of concerns other than advertising agencies and for students in the last year of college. People with some advertising and selling experience are especially invited to take the examinations.

### Terms for Study

Agency contracts
Agency employee
Audit Bureau of Circulations
Billboards
Box-top premiums
Bulletin display
Card advertising
Card contracts
Caricatures
Circulation
Client
Commercially sponsored
Copy writer
Direct-mail advertising
Layout
Listening audience
Media
Media men
Novelty advertising
Pulling power
Rational appeals
Reader audience
Traffic Audit Bureau

### Questions

1. In what ways is the selling power of advertising limited by distribution?
2. How does good advertising provide the consumer with reliable information about the goods or services being sold?
3. Discuss the limitations of professional people's use of advertising.
4. In what ways has advertising raised the American standard of living?
5. What is the basic purpose of all advertising?
6. What are the emotional appeals that can be used effectively in selling food?
7. What is meant by the term *cost approach to advertising*?
8. In what ways does the Traffic Audit Bureau serve outdoor advertisers?
9. How would you defend the position of the advertising agency? (Answer such questions as these: Why are the agency's services needed? Could their services be better performed by the business? Are agencies really more effective than other plans for advertising?)
10. What similarities do you see in qualifications needed for a selling career and an advertising career?

11. How can the effectiveness of advertising be measured?

12. What are some of the distinctive characteristics of newspaper advertising?

13. What advantages or disadvantages does magazine advertising have in comparison with newspaper advertising?

14. Do you feel that television advertising will ultimately replace radio advertising? Why?

15. Do you think most outdoor advertising is good or bad? Why?

16. Under what financial terms do advertising agencies serve their clients?

17. Explain the value of A.A.A.A. examinations in the field of advertising.

## Problems and Projects

1. How would you go about selecting the advertising media for selling a line of concrete building blocks in your home community?

2. Consult a local retailer for his opinion about the relative importance of advertising media used in his business. If he is only slightly impressed with some media, attempt to find out why he continues to use them. Are factors other than immediate sales involved in such cases?

3. Check one representative page of your Sunday newspaper. What percentage of the advertising would you classify as commodity advertising and what percentage as advertising to sustain goodwill?

4. Select an effective advertisement from a current magazine and classify the appeals used in the copy according to: (1) health improvement, (2) pride in personal appearance, (3) love of family, (4) financial gain, (5) ambition, (6) social approval, or (7) other.

5. A Dallas manufacturer used a booklet offer in advertising his product and checked sales by restricting the advertisement to one magazine. A full-page color advertisement was used in a leading national magazine at a cost of $3,000. At first it seemed impossible to justify the expenditure, but after inquiries started coming in by the thousands, the manufacturer felt better about his investment. During the month following the appearance of the advertisement, sales increased more than enough to afford a profit equal to the cost of the advertisement. What other values do you see in this experience in expensive advertising? Would you suggest expanding the advertising program? If so, how much expansion could be justified?

6. In what ways has advertising affected the standard of living in your community? List direct and indirect effects.

7. A local haberdashery has annual net sales of $120,000. From personal experience and on the basis of standard ratios the owner feels that his advertising budget should be approximately 1 percent of his net sales. From your personal experience determine how this merchant could most effectively plot an advertising program. Use the standard media and show your choices in both amounts and percentages by seasons.

8. Examine the advertising plan for the Hudson Motor Car Co. as illustrated in Figures 21-2 and 21-3 with an idea of verifying the over-all results in terms of your own experience with the product. In what ways has local advertising been related to the national advertising of the car?

9. List five major factors that would be involved in planning a national television program for advertising a new product.

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# INDEX


A

A.A.A.A. (*see* American Association of Advertising Agencies)
A.B.A. (*see* American Bankers Association)
A.B.C. (*see* Audit Bureau of Circulations)
Ability tests, 10-11
Absenteeism, 243-244
Acceptor, defined, 283
Accident insurance, 316-317
Accountant, 159-160
Accounting, 2, 149-172
  business law, related to, 4
  Civil Service classifications, 168
  double-entry systems, 152-153
  economics, related to, 4
  employment opportunities, 169-170
  equations, 153, 155
  fields, 168-169
  financial statements, 160-167
  importance, 149-152
  journals, 153-154
  ledgers, 153-154
  machine, 159-160
  nature, 152-160
  opportunities, 169-170
  personal qualifications, 170-172
  posting, 153
  promotional opportunities, 169-170
  qualifications, 170-172
  ratios, 166-167
  records, 122, 153
  related fields, 3
  single-entry systems, 152-153
  small business, 135
  statements, 160-167
Accounts-receivable records, 155
Achievement tests, 11
Acid-test ratio, 166
Actuarial Society of America, 325-326
Actuary:
  insurance, 325-326
  need for, 196
Administrative management, 102-103
Advertising, 2, 525-545
  A.A.A.A. examination, 545
  agency, 540-542
  appeals, 525
  card, 540
  career, 542-545
  cost approach, 527-530
  defined, 525
  direct-mail, 538
  magazine, 536-538
  measuring effectiveness, 527-530
  media, 530-540
Advertising (*Cont.*):
  nature, 525-527
  newspaper, 531-533
  outdoor, 538-539
  positions in agency, 542-543
  purpose, 525
  radio, 533-536
  social significance, 526-527
  television, 534-536
A.F. of L. (*see* American Federation of Labor)
Africa, trade with, 418
Agent, insurance, 309
Agreement, labor, the, 266-268
Agriculture:
  percentage of population engaged in, 56-57
  production, 409
Air Mail Act, 346
Airways:
  regulation, 346
  transportation by, 467-469
Alden, Inc., 490
Allied lines, 310-316
Amalgamated Clothing Workers Union, 259
American Arbitration Association, 270
American Association of Advertising Agencies, 539, 540-541, 545
American Bankers Association, 232
  numbers, 278
American Council on Education, 10
American Federation of Labor, 259-260
American Home Economics Association, 34
American Institute of Accountants, 171
American Institute of Actuaries, 325-326
American Institute of Banking, 300
American Institute of Laundering, 399
American Medical Association, 342
American plan, 144
American Standards Association, 217, 362
American Telephone and Telegraph Company, 83, 86, 347
American Warehousemen's Association, 446-447
Analysis, job, 228-229
Analytical processes, 365-368
A&P (*see* Great Atlantic & Pacific Tea Company, The)
*Apparel Store, Establishing and Operating an,* 136
Appeals, advertising, 525
Appliances, office, 210-212
Applications, 12, 15-16
Apprenticeship training, 232
Aptitude tests, 10-11
Arbitration, 269-270
Aristocratic state, 50
Arithmetic average, 182

Arkwright's roller process, 49
Armstrong Cork Company, 433
Articles of Partnership, 78-79
Assembling processes, 368-369
Assembly-line technique, 274
Assets, defined, 153, 160
Association of National Advertisers, Inc., 539
Audit Bureau of Circulations, 536-537, 539
Authorized capital stock, 89
*Automobile Repair Business, Establishing and Operating an,* 136
Automobiles, assembly of, 368
Averages, 181-183
  mean, 182
  median, 182
  mode, 183

B

Bailee, defined, 444
Balance sheet, 160-164
Bank draft, 281
Bankers' bill, 284
Banking, 2, 276-290
  careers, 299-300
  commercial banks, 277-287
  investment banks, 289-290
  qualifications, 299-300
  savings banks, 287-289
  statistics for the United States, 190
  types of banks, 276-277
Banking Acts, 347
Bank statement, 278-279
Bar graphs, 192-193
Barometers, business, 52
Bathtubs, percentage owned by Americans, 25
Batton, Barton, Durstine & Osborn, 398
*Beauty Shop, Establishing and Operating a,* 136
Bennett Mechanical Comprehension Test, 11
Better Business Bureaus, 342
Big business, growth of, 51
Big Inch pipe line, 472
Bills:
  of exchange, 283-284
  of lading, 283-284
Bituminous Coal Act, 353
Bodily injury liability insurance, 318
Bonds, 95, 292-293
  coupon, 293
  debenture, 292-293
  fidelity, 320-321
  income, 292-293
  schedule, 320
  surety, 320-321
Bookkeeper, 149
Book value, 291
Boycott, 264
Broken lot, 441
Brokers, 86, 434
  insurance, 309
  real-estate, 140-141
Brotherhoods, railroad, 259-260
Budgets, 217-218
  American families', 32
  student's, 38
Building, 209-210
Building and loan associations, 296-297
"Bulk service building," 483
Bulletins, 121
Bureaus of Business Research, 178
Burglary insurance, 318-319
Business, areas of, 2
Business barometers, 52
Business cycle, 64-69
Business information, sources of, 135-136
Business management (*see* Management)
Business ownership, motives for, 17
Business risks, 304-328
Business secretary, 221
Bus lines, regulation of, 345

C

CAA (*see* Civil Aeronautics Authority)
CAB (*see* Civil Aeronautics Board)
Cafeteria, school, 40-41
California Fruit Growers Association, 413
California-orange dollar:
  circle graph, 189
  table, 394
Capital:
  corporation, 89
  defined, 153
Capitalism, 50-53
  defined, 51
  features, 51-53
Card advertising, 540
Card-sorting machine, 159
Career, choice of, 1
Carload lots, 436-437
Carload rate, 457
Cash discounts, 405
Cashier's check, 280-281
Caste system, 50
Casualty insurance, 317-320
CEA (*see* Commodity Exchange Authority)
*Census of Business,* 180
*Census of Manufactures,* 180
*Census of the United States,* 180
Centralized inspection, 386
Certificates of beneficial interest, 97
Certified check, 281, 282
Certified Public Accountant, 171-172
  examination in business law, 4
Certified Washable Seal, 399
Chain stores, 488, 490-491, 494-495
  taxes, 344
Chamber of Commerce of the United States, 264
Charts:
  clearness, 4
  organization, 120
Chattel-mortgage loans, 285
Checking-account service, 278-280
Checks, 278-281
Child labor, legislation affecting, 350
Chrysler, 83
C.I.O. (*see* Congress of Industrial Organizations)
Circular graphs, 195

Civil Aeronautics Authority, 346
Civil Aeronautics Board, 346
C.l. (*see* Carload lots)
Clan, 50
Class rates, 454-456
Clayton Antitrust Act, 333, 337
Clerical service (*see* Office management)
Climate of U.S., 54
Closed corporations, 91-92
Closed shop, 263
Cluett, Peabody & Company, 80
Coal:
  mechanization of industry, 360
  regulation of industry, 352-353
Cobb, Irvin S., 223
Code of Ethics, 220
Coinsurance, 314-315
Collateral trust bonds, 292
Collective bargaining, 260-268
College degree, as employment requirement, 6
Collision insurance, 317-318
Color dynamics, 248-249
Comish, Newell H., 139
*Commerce Yearbook*, 180
Commercial banks:
  defined, 276
  services rendered, 277-287
Commercial Credit Company, 297
Commercial draft, 283
Commercial hotels, 143-144
Commission merchants, 434
Commodity, defined, 333
Commodity approach to marketing, 405-409
Commodity Exchange Act, 349
Commodity rates, 454-456
Common stock, 92-94, 290-291
Commonwealth Edison Company, 86
Communications, regulation of, 346-347
Company training, 6
Competition:
  small business, 132-133
  under capitalism, 52
Compound interest, 288
Compulsory arbitration, 269
Conciliation, 268-270
Conciliation Service (*see* Federal Mediation and Conciliation Service)
Congress of Industrial Organizations, 259
Connally Act, 352
Consequential loss, 315-316
Conservation of natural resources, 352
Consolidated Edison Company of New York, 86
Consumer:
  buying habits, 30-31
  characteristics, 24-37
  king, 32
  occupational classification, 28
  position in national economy, 24-28
  purchasing power, 31-33
  spending, 29-31
  student as, 37-41
  types, 26-28
Consumer goods, 406-407
*Consumer Market Data Handbook*, 180
Consumers' co-operatives, 410-411
Consumership approach to business training, 24-41
Consumer spending units, income distribution of, 25
Consumers' Price Index, 30, 191
Continental Oil Company, 156
Continuous production process, 374
Control:
  government (*see* Government regulation)
  office, 213-218
  production, 380-386
Convenience goods, 406
Co-operative agencies, 410-415
Copartnership Articles, 78-79
Copeland Act, 336
Copper, 365
Copyrights, 343
Corner, defined, 349
Corporation, 82-96, 494
  advantages, 85-87
  bonds, 95
  by-laws, 91
  charter, 89-91
  closed, 91-92
  common stock, 92-94
  defined, 84
  disadvantages, 87-88
  financing, 290
  historical growth, 84-85
  open, 92
  organizing, 88-89
  ownership, 91-95
  preferred stock, 94-95
  proxy, 93-94
  small business, 133
  social impact, 95-96
  stock, 92-95
Correlation, 188
Correspondence, 206-207
Cost of goods sold, formula for calculating, 164
Council on Industrial Relations for the Electrical Contracting Industry, 270
Coupon bonds, 293
Court injunction, 266
C.P.A. (*see* Certified Public Accountant)
Craft unions, 258
Credit:
  C's, three, of, 152
  letter of, 284-285, 286
  small business, 131
  three C's of, 152
*Credit Sources for Small Business*, 136
C's, three, of credit, 152
Cumulative preferred stock, 95
Current assets, defined, 160
Current liabilities, defined, 163
Current ratio, 166
Customer's draft, 284
Cycles, economic, 64-69
Cyclical fluctuations, 186-187

D

*Dartmouth College* case, 84
Dartnell Corporation, 521

da Vinci, Leonardo, 47
Debenture bonds, 292-293
Decline, as stage of business cycle, 68
*Decorating Contracting Business, Establishing and Operating a Painting and*, 136
Deductible plan for insurance, 317-318
Deferred charges to expense, defined, 162-163
Deferred credits to income, defined, 163
Degree, college, as employment requirement, 6
Delivery service, 466-467, 485
Demand, creating, 395
Demurrage charge, 461
Denz, Fred, 246-247
Department of Commerce bulletins, 135-136
Departments in business, 108-112
Department stores, 488-489
  sales, 187, 481
Deposit ticket, 278
Depreciation:
  defined, 162
  reserves, 162
Depression, as stage of business cycle, 68-69
Description, job, 228-229
Design, as aid in storage, 436
*Dictionary of Occupational Titles*, 57
Direct-mail advertising, 538
Discounts, 405
Display, 516-518
Disputes, labor, settlement of, 268-272
Distribution, 424-447 (*see also* Marketing)
  cost, 391-394
  middlemen, 424-426, 434-435
  transportation, 451
  warehousing services, 435-447
  wholesalers, 426-434
*Distribution Cost Analysis*, 136
Diversion, 459-460
*Domestic Commerce*, 180
Double-entry systems of accounting, 152-153
Drafts, 283-284
Drawee, defined, 283
*Dry Cleaning Business, Establishing and Operating a*, 136
Dun & Bradstreet, 152

E

Earning power of labor, 58-60
Earnings, average, in major industrial groups, 20
Earthquakes, insurance against, 315
Eastern Gas and Fuel Association, 97
Eastman Kodak Company, 75, 242
Econometer, 65
Economics, 47-69
  accounting, related to, 4
Economy of the U.S.:
  cycles, 64-69
  elements, 47, 48
  history, 47-50
  physical description, 53-55
Educational characteristics of labor, 60, 62-63
Education of personnel, 232-233
*Electrical Appliance and Radio Shop, Establishing and Operating an*, 136
Elizabeth, Queen, 53
Employees:
  liability to, 304
  number, 18
Employers, number of, 18
Employers' associations, 264-266
Employment, 229-231
  areas, 2
  finding, 12-16
  qualifications, 5-6
Endowment insurance, 316
Equipment, office, 210-212
*Establishing and Operating* series, 135-316
European plan, 144
Evaluation of aptitude, 7-12
Exchanges, stock, 293-294
Exclusive listing, 141
Executive management, 103
Executive secretary, 221
Executive training, 232
Export-Import Bank, 298
Exterior display, 517
Extractive processes, 365

F

Fabricating processes, 369
Factory processes, 357
Fair Labor Standards Act, 350
Family, 50
Farm Credit Administration, 298-299
Farmers' co-operatives, 413-414
Farms:
  number of acres, 54
  products, 408
F.C.A. (*see* Farm Credit Administration)
FCC (*see* Federal Communications Commission)
FDIC (*see* Federal Deposit Insurance Corporation)
Federal Communications Commission, 346-347
Federal Deposit Insurance Corporation, 289, 347-348
Federal Food, Drug, and Cosmetic Act, 336
Federal grants-in-aid, 324-325
Federal Import Milk Act, 335, 336
Federal Mediation and Conciliation Service, 270-271
Federal Mediation Board, 270
Federal Petroleum Agency, 352
Federal Reserve Act, 347
*Federal Reserve Bulletin*, 181
Federal Reserve System, 277
Federal Savings and Loan Insurance Corporation, 296
Federal Securities and Exchange Commission, 87
Federal Social Security Act, 322
Federal Tea Act, 335, 336
Federal Tender Board, 352
Federal Trade Commission, 333, 337, 341, 343-344
Feld-Crawford Bill, 339
Feudal system, 50
Fidelity bonds, 320-321
Field agent, insurance, 327

Field warehouses, 443
Filing, 207-209
Film-A-Record, 204
Finance, 2, 276-300
  banking, 276-290
  careers, 299-300
  government agencies, 298-299
  long-term financing, 290-293
  marketing, 404-405
  planning, 294-296
Financial statements, 160-167
  balance sheet, 160-164
  income-and-expense statement, 164-166
  ratios, 166-167
Fire, property losses from, 311
Fire insurance, 310-316
Fixed assets, defined, 160, 162
Fixed liabilities, defined, 163
Flood, insurance against, 315-316
Floor inspection, 386
Flying shuttle, Kay's, 49
"F.o.b. warehouse," 485
Food and Drug Administration,, 336
Food requirements, 28
Ford, Benson, quoted, 17
Ford Motor Company, 92
*Foreign Commerce Weekly*, 180
*Foreign Commerce Yearbook*, 180
Foreign trade, 416-418
Forms, office, 204-205
Form utility, 357
Franchises, 343
Free enterprise (*see* Capitalism)
Freight cars, 459
F. & R. Lazarus & Co., 483
FTC (*see* Federal Trade Commission)
Fuel:
  production, 371
  regulation of industry, 351-353
Fuller Brush Company, 425, 493
Functional organization, 108, 115-116
Futures, 306

G

Gantt Task and Bonus system, 241
Garage liability insurance, 321
Gas, natural, transportation of, 472
General-merchandise store, 486
General Motors Corporation, 35, 83, 242, 297
General partnership, 77-81
Geographical distribution of manufacturing, 372
Get-rich schemes, 17
Gillette Safety Razor Company, 88
Going into business for yourself, 16-17
Goldsborough, Judge, 266
Goods:
  consumer, 406-407
  convenience, 406
  farm products, 408
  industrial, 407-408
  producer, 407-408
  shopping, 406
  specialty, 406-407
Goodyear Tire and Rubber Company, 364
Government regulation, 53, 331-353
  advertising, 341-342
  airways, 346
  bus lines, 345
  coal, 352-353
  communications, 346-347
  competition, unfair, 337-340
  copyrights, 343
  corporations, 88
  financial organizations, 347-349
  franchises, 343
  fuel industries, 351-353
  labor, 270-272, 350-351
  licenses, 343
  monopolies, 333-335
  objectives, 332
  oil, 352
  patents, 343
  permits, 343
  prices, 336-337
  public utilities, 344-347
  quality, 335-336
  railroads, 345
  reason for, 331-333
  taxation, 344
  trade-marks, 343
*Government Regulation, Small Business and*, 136
Grading merchandise, 402-403
Grants-in-aid, federal, 324-325
Graphs, 189-195
Great Atlantic & Pacific Tea Company, The, 494
Grievances, handling, 245-246
*Grocery Store, Establishing and Operating a*, 136
Gross profit, defined, 164
Group insurance, 316-317
Guided interview, 13

H

Hail, insurance against, 315
Halsey Premium plan, 241-242
Hargreaves' jenny, 49
Health, 233-235
  grants-in-aid, 324-325
  insurance, 316-317
Hedging, 305-307
Heinz, H. J., 75, 127
Hepburn Act, 345
Hepner, H. W., 10
Hibbard, Spencer, Bartlett & Company, 432
Highways, 451 (*see also* Motor transportation)
Hopper cars, 458
Horizontal promotion, 238
Hotels:
  American plan, 144
  European plan, 144
  management, 143-145
  manager, 144-145
  organization, 144
  types, 143-144
Hours, working, legislation affecting, 350

House dresses, women's wants concerning, 34-35
House-to-house dealer, 492-493
Hucksters, 493
Hughes, Chief Justice, 223

I

Immigration to U.S., 56
Income:
  family, average, 26
  national, 24-25
  school cafeteria, 40
Income-and-expense statement, 164-166
Income bonds, 292-293
Independent stores, 493-494
Independent unions, 259-260
Index:
  multiple-factor, 398
  of Industrial Production for the Years 1919-1946, 61
  of Wages and Prices, 60
  of Wholesale Commodity Prices, 185
Index numbers, 4, 67, 184-185
Individual proprietorship (*see* Proprietorship)
Indoctrination, 231
Industrial banks, 298
Industrial goods, 407-408
Industrial management, 123
*Industrial Market Date Handbook*, 180
Industrial-operations analysis, 196
Industrial production, 61
Industrial relations:
  defined, 226
  department (*see* Personnel management)
Industrial Revolution, 47-50
  effects, 49-50
Industrial (Small Business) Series, 135-136
Industrial unions, 258-259
Industrial users, classification of, 407
Information, business, sources of, 135-136
Injunction, court, 266
Inland marine insurance, 322
*Inquiry into the Wealth of Nations, An*, 53
Insolvency, 129
Inspection, 385-386
Instructions, 121
Insurable interest, defined, 309
Insurance, 2, 304-328
  accident, 316-317
  actuary, 325-326
  agent, 327-328
  allied lines, 310-316
  automobile, 317-318
  bodily injury liability, 318
  bonds, 320-321
  burglary, 318-319
  careers, 325-328
  casualty, 317-320
  coinsurance, 314-315
  collision, 317-318
  companies, 307-308
  consequential loss, 315-316
  deductible plan, 317-318
  deferred charge to expense, 163
Insurance (*Cont.*):
  earthquake, 315
  endowment, 316
  fidelity bonds, 320-321
  field agent, 327
  field-office occupations, 327-328
  fire, 310-316
  flood, 315-316
  garage liability, 321
  general agent, 328
  group, 316-317
  hail, 315
  health, 316-317
  home-office occupations, 325-327
  investment specialist, 326-327
  kinds, 310-322
  larceny, 318-319
  life, 316-317
  limited payment, 316
  marine, 322
  old-age and survivors', 322-323
  ordinary life, 316
  policies, 309-310
  products liability, 320
  property damage, 318
  public liability, 320
  robbery, 318-319
  schedule bonds, 320
  self-insurance, 305-306
  social security, 322-325
  statistician, 326
  surety bonds, 320-321
  survivors', old-age and, 322-323
  term, 316
  theft, 318-319
  "3D" policy, 319
  underwriter, 326
  unemployment, 324
  water damage, 316
  whole life, 316
  windstorm, 315
  workmen's compensation, 319-320
*Insurance Brokerage Business, Establishing and Operating a Real Estate and*, 136
Insurance companies:
  investments, 297
  loans, 297
Intelligence:
  levels, 10
  tests, 10
Intelligence quotient, 10
Interest, compound, 288
Interest tests, 10
Interior display, 518
Internal organization, 112-122
  charts, 120
  control, methods of, 120-122
  defined, 112-113
  instructions, 121
  nature, 112-113
  objectives, 113-114
  orders, 121
  plans, 114-120
    functional, 115-116
    line, 114-115

Internal organization (*Cont.*):
plans (*Cont.*):
line-and-staff, 117-120
purpose, 112-113
records, 121-122
reports, 121
retailing, 495-496
International Association of Machinists, 260
International Business Machines Corporation, 159, 365
International Harvester, 75
International Ladies Garment Workers Union, 259
Interstate Commerce Act, 345
Interstate Commerce Commission, 335, 346, 352
control over railway rates, 457
Interviews, 13-15
employment, 229-230
Inventory (*see also* Supplies):
control, 375-380
risks, 484-485
Inventory-turnover ratio, 167
Investment banks, 289-290
defined, 276
work in, 300
Investment Company and Investment Advisers Act, 349
Investment specialist, insurance, 326-327
Invoices, sales, 155
I.Q. (*see* Intelligence quotient)
Irrational advertising appeals, 525
Irrigation, 54

J

Jenny, Hargreaves', 49
Job analysis and description, 228-229
"Jobbing" type of industry, 374
*Job Descriptions for the Retail Trade*, 497-498
Job training, 232
Johns-Manville Corporation, 364
Joint-stock company, 82
Jones & Laughlin Steel Corporation, 249
Journals, 153-154
Jurisdictional limitations, 262-263

K

Kaiser-Frazer Corporation, 242
Kaltenborn, H. V., 223
Kay's flying shuttle, 49
"King Consumer," 32
Kolect-A-Matic, 157
Kuder Preference Test, 10

L

Labor:
characteristics, 57-63
disputes, settlement of, 268-272
earning power, 58-60
education, 60, 62-63
legislation, 350-351
number, 56-57
organizations, 258-260
Labor (*Cont.*):
output, 63
production, 371
small business, 133
specialization of, 362-364
technological achievements, 63
turnover, 244-245
Labor agreement, the, 266-268
Labor-management relations, 2, 256-272
collective bargaining, 260-268
disputes, settlement of, 268-272
government, role of, 270-272
importance, 256-257
labor agreement, the, 266-268
legislation, 272
Labor-Management Relations Law, 351
*Laissez faire*, 53
Larceny insurance, 318-319
*Laundry, Establishing and Operating a*, 136
Law:
business, 4
of supply and demand, 52
Layout, 210
plant, 373-375
Lazarus & Co. (*see* F. & R. Lazarus & Co.)
L.c.l. (*see* Less-than-carload lots)
Leaders, loss, 338-339
Ledgers, 153-154
Less-than-carload lots, 436-437
Less-than-carload rate, 457
"Let alone" (*see Laissez faire*)
Letter of credit, 284-285, 286
Letters (*see* Correspondence)
Lewis, John L., 266
Liabilities, defined, 153, 160, 163
Liability:
corporation, 85, 92
general partnership, 80
joint-stock company, 82
limited partnership, 81
Massachusetts Trust, 97
proprietorship, 77
public, 304
stockholder's, 92
Licenses, 343
Life insurance, 316-317
Life work, choice of, 1
Limitation of output, 263
Limited partnership, 81-82
Limited partnership association, 81-82
Limited payment insurance, 316
Line-and-staff organization, 117-120
Line graphs, 189-191
Line-plan organization, 114-115
Liquidation, 295-296
Listings, property, 141
Little Big Inch pipe line, 472
Lloyd's, 308
Loan companies, 297-298
Loans:
chattel-mortgage, 285
security, 285
short-term, 281-283
"Local" rates, 457
Location, choice of, 175-176, 369-373, 519-520

Lockout, 266
Long-term financing, 290-293
Loss leaders, 338-339

M

McCann-Erickson Agency, 398
McMurry, Robert N., and Company, 227
Macy & Company (*see* R. H. Macy & Company)
Magazine advertising, 536-538
Mail, 205-206
Mail-order houses, 451-452, 489-492
Maloney Act, 349
Management, 2, 101-112 (*see also* Office management; Personnel management)
  administrative, 102-103
  courses, 122-123
  defined, 101-102
  development, 107-108
  levels, 106-107
  objectives, 104-105
  office (*see* Office management)
  opportunities, 123
  personnel (*see* Personnel management)
  phases of operation, 102
  positions, 123
  purposes, 102
  small business, 134-135
Mann-Elkins Act, 345, 346
Manuals, 121
Manufacturers:
  prices, 52
  wholesalers' service to, 432-433
Manufacturer's agent, 435
Manufacturing, 357 (*see also* Production)
  geographical distribution, 372
  percentage of population engaged in, 56-57
Maps, statistical, 195
Margarine, taxes on, 344
Marine insurance, 322
Marketing, 2, 390-421
  commodity approach, 405-409
  consumer goods, 406-407
  consumers' co-operatives, 410-411
  convenience goods, 406
  co-operative agencies, 410-415
  cost, 391-394
  demand, creating, 395
  discounts, 405
  employment opportunities, 418-421
  farmers' co-operatives, 413-414
  farm products, 408
  finance, 404-405
  foreign trade, 416-418
  functions, 394-405
  General Manager, duties of, 419-421
  geographic divisions, 397
  grading merchandise, 402-403
  industrial goods, 407-408
  market, analyzing the, 395-399
  merchant co-operatives, 411-413
  multiple-factor index, 398
  opportunities, 418-421
  procuring supplies, 400-401
Marketing (*Cont.*):
  producer goods, 407-408
  product, knowledge of, 398-399
  promotional opportunities, 418-421
  retail co-operatives, 411-413
  risk-bearing, 401-402
  selling, 395
  shopping goods, 406
  sources of data, 396-398
  specialty goods, 406-407
  standardizing merchandise, 402-403
  storage, 405
  supplies, procuring, 400-401
  testing laboratories, 399
  transportation, 405
  wants, discovering, 395-399
  wholesale co-operatives, 413
Market research, 177, 395-399
  sources, 396-398
*Market Research Sources*, 180
Markets:
  production, 370
  stock, 293-294
Market value, 291
Marshall, Chief Justice, 84
Massachusetts Trust, 96-98
Massachusetts Utilities Association, 97
Mass production, 360-361
Materials purchases, 375-380
Mean, arithmetic, 182
Measurements, methods of, 181-188
  averages, 181-183
  correlation, 188
  cyclical fluctuations, 186-187
  index numbers, 184-185
  seasonal fluctuations, 187-188
  secular trends, 186
  time series, 185-188
Meat Inspection Acts, 335, 336
Meat-packing industry, 365, 368
Mechanical-aptitude tests, 10-11
Mechanization, 360
  layout, 374
Median, 182-183
Mediation, 268-270
Merchant co-operatives, 411-413
Merrill Lynch, Pierce, Fenner & Beane, 80
*Metal Working Shop, Establishing and Operating a*, 135
Microfilming records, 204
Middle management, 106-107, 108
Middlemen, 408 (*see also* Wholesalers; Retailers)
  brokers, 434
  commission merchants, 434
  importance, 424-426
  manufacturer's agent, 435
  sales agent, 435
Midwest Exchange, 294
Military state, 50
Miller-Tydings Act, 333, 338-339
Minnesota Paper Form Board, 11
Mitsui chain, 494
Mode, 183
Monopolies, curbing, 333-335

Montgomery Ward, 80, 451-452, 490, 498
*Monthly Labor Review*, 180-181
Morris Plan banks, 298
Mortgage bonds, 292
Motion study, 384
Motor transportation, 464-467
Multiple-factor index, 398
Music, in personnel management, 248
Mutual companies, 308

N

National Association of Manufacturers, 264
National Association of Marketing Teachers, 525
National Association of Securities Dealers, Inc., 349
National Association of Suggestion Systems, 246
National banks, defined, 276
National Federation of Telephone Workers, 260
National income, 24-25
National Industrial Conference Board, 5
National Industrial Recovery Act, 351, 352, 353
National Labor Relations Act, 351
National Labor Relations Board, 272
National Office Management Association, 220
National Railroad Adjustment Board, 270
National Research Council, 28
National Safety Council, 235-236
National Sales Executives, 521-522
Natural gas, transportation of, 472
Natural resources of U.S., 54-55
  conservation, 352
Negotiable promissory note, 282
Negotiable warehouse receipts, 446
Net labor turnover, 244
Net profit, defined, 164
Net worth, defined, 155 (*see also* Proprietorship)
New England Power Association, 97
New industries, opportunities within, 17
New Process shirts, 425
Newspaper advertising, 531-533
New York Stock Exchange, 293
Niagara district, 371
Nonassessable policies, 309
Noncumulative preferred stock, 95
Nonnegotiable warehouse receipts, 446
Nonparticipating preferred stock, 292
No-par value, 291
Numerical tables, 189
Numeric filing, 209

O

Ocean marine insurance, 322
Office management, 2, 110, 201-219
  appliances, 210-212
  budgets, 217-218
  building, 209-210
  control, 213-218
  correspondence, 206-207
Office Management (*Cont.*):
  equipment, 210-212
  filing, 207-209
  forms, 204-205
  functions, 201-202
  layout, 210
  mail, 205-206
  manuals, 217
  personnel management, 212
  procedures, 213-214
  records and reports, 202-205
  services rendered, 201-202
  standards, 214-217
  supplies, 212
Office manager, 218-219
Office manuals, 217
Office standards, 214-217
Office workers, types of, 219
Official classification, 455
Oil, crude, transportation of, 472
Oil industry, regulation of, 352
Old-age and survivors' insurance, 322-323
Oleomargarine, taxes on, 344
"100% locations," 520
Open corporation, 92
Open listing, 141
Open shop, 263
Operating management, 106-107
Operating statement (*see* Income-and-expense statement)
Order bill of lading, 283-284
Orders, 121
  purchase, 377
Ordinary life insurance, 316
Organization (*see also* Internal organization):
  forms, 73-98
  retailing, 493-497
  small business, 133-134
Orientation, 231
Otis Self-Administering Intelligence Test, 10
Outdoor advertising, 538-539
Outdoor Advertising Association of America, Inc., 539
Overcapitalization, 295
Overhead expenses, of school cafeteria, 41
Overstocking, 134
Ownership, 73-98 (*see also* Proprietorship)

P

*Painting and Decorating Contracting Business, Establishing and Operating a*, 136
Parking facilities, 496-497
Participating preferred stock, 292
Partnership, 494
  defined, 77-78
  financing, 290
  forming, 78-79
  general, 77-81
  insurance, 310
  limited, 81-82
  organizing, 78-79
  small business, 133
Par value, 291
Patents, 343

Payroll of university, how distributed, 39
Penney, J. C., 75, 128, 498
Pepperell Manufacturing Company, 97
Percentage change, how to compute, 23, 42
Permits, 343
Personal secretary, 221
Personnel management, 2, 108-109, 226-253
  absenteeism, 243-244
  benefits, 236-237
  business and industry, 250-251
  career, 249-253
  color dynamics, 248-249
  communication, three-way, 246
  defined, 226
  education, 232-233
  educational institutions, 249-250
  employee suggestions, 246-247
  employment, 229-231
  government service, 250
  grievances, handling, 245-246
  health, 233-235
  indoctrination, 231
  job analysis and description, 228-229
  labor organizations, 251
  labor turnover, 244-245
  morale, maintenance of, 242-249
  music, 248
  nature of personnel work, 228-249
  orientation, 231
  placement, 229-231
  preparation, 251-252
  promotion, 238
  qualifications, 251-252
  records, 122
  rest periods, 247-248
  safety, 233-236
  salaries, 238-242
  separation, 238
  services, 236-237
  significance, 226-228
  suggestions, employee, 246-247
  training, 232-233
  transfer, 237-238
  wages, 238-242
Petroleum, 365-367
  transportation, 470-472
PhotoMetric process, 35
Picketing, 263-264
Pictographs, 193-194
Piece wages, 239-240
Pie graphs, 195
Pipe-line transportation, 470-472
Placement, 229-231
Place utility, 357, 451
Planning board, 384
Plant layout, 373-375
Plant location, choice of, 369-373
Plastic industry, 17
Pooling, 460
Population of U.S., 56
Postage meter machines, 206
Postal Telegraph Company, 347
Poster Advertising Association of Canada, 539
Posting, 153
Post Roads Act, 346
Power·
  in layout, 374-375
  in production, 371
Preferential rates, 456-457
Preferential union shop, 263
Preferred stock, 94-95, 291-292
Price-fixing, 334, 338-340
Price-maintenance agreements, 334, 338-340
Prices, 36-37
  small business, 132-133
  under capitalism, 52
Primary boycott, 264
Private banks, defined, 276
Private secretary, 221
Private warehouses, 437-443
Procedures, office, 213-214
Procter & Gamble, 80
Procurement of supplies, 400-401
Producer goods, 407-408
Production, 2, 357-387
  agricultural, 409
  analytical processes, 365-368
  assembling processes, 368-369
  careers, 386-387
  characteristics, 358-365
  control, 380-386
  defined, 357
  dispatching, 383-384
  extractive processes, 365
  fabricating processes, 369
  fuel, 371
  geographical distribution, 372
  importance, 357-358
  industrial, 61
  inspection, 385-386
  inventory control, 375-380
  labor, 362-364, 371
  large-scale operations, 360-361
  layout, 373-375
  location, choice of, 369-373
  management, 110
  markets, 370
  mass, 360-361
  materials purchases, 375-380
  mechanization, 360
  motion study, 384
  operational control, 384-386
  planning, 380, 382
  planning board, 384
  plant layout, 373-375
  plant location, choice of, 369-373
  power, 371
  processes, 365-369
  progress charts, 384
  purchasing, 376-377
  raw materials, 369-373
  research, 364-365
  routing, 382
  salaries, 358
  scheduling, 382-383
  specialization of labor, 362-364
  standardization, 361-362
  storage, 377-378
  synthetic processes, 368
  time study, 384-385

Production (*Cont.*):
transportation, 370-371
wages, 358
Produc-trol, 383
Products liability insurance, 320
Profit:
defined, 53, 164
under capitalism, 52
Profit-and-loss statement (*see* Income-and-expense statement)
Profit-sharing plans, 242
Progress charts, 384
Promissory note, 282-283
Promotion, 109, 238
Property:
risks involving, 304
under capitalism, 52
Property damage insurance, 318
Property listings, 141
Proprietorship, 74-77, 494
defined, 160, 163-164
financing, 290
small business, 133
Prosperity, as stage of business cycle, 65-68
Proxy, 93-94
Psychology, role of, in business cycle, 68
Public liability, 304
Public liability insurance, 320
Public utilities, regulation of, 344-347
Punch card, 158, 159
Purchasing, 376-377
retail store, 481-482
small business, 134
Purdue Mechanical Adaptability Test, 11
Pure Food and Drug Act, 335
Purposes of book, 1

Q

Qualifications for employment, 5-6
Queen Elizabeth, 53
Quotas, sales, 507

R

Radio advertising, 533-536
*Radio Shop, Establishing and Operating an Electrical Appliance and,* 136
Railroad brotherhoods, 259-260
Railroads (*see* Railways)
Railway Express Agency, 468
Railways, 454-461
automobile cars, 458
carload rate, 457
class rates, 454-456
commodity rates, 454-456
delivery service, 458
demurrage charge, 461
diversion, 459-460
freight cars, 459
hopper cars, 458
in-transit privileges, 460
less-than-carload rate, 457
loading service, 458
"local" rates, 457
Railways (*Cont.*):
pick-up service, 458
pooling, 460
preferential rates, 456-457
rates, 454-457
reconsignment, 459-460
refrigerator cars, 458
regulation of, 345
special cars, 458-459
special service features, 457-461
tank cars, 458
terminal services, 460-461
territorial classifications, 454-456
"through" rates, 457
track storage, 461
Rainfall, annual, in U.S., 54
Rate of stock turnover, 132
Rational advertising appeals, 525
Raw materials:
production, 369-370
purchase, 375-380
*Real Estate and Insurance Brokerage Business, Establishing and Operating a,* 136
Real-estate business:
fields, 140
management, 140-142
opportunities, 142
property listings, 141
property management, 142
Real Silk Hosiery Mills, 425, 493
Receipts, warehouse, 446
Reciprocal associations, 308
Reconsignment, 459-460
Reconstruction Finance Corporation, 298-299
*Record Keeping for Small Stores,* 136
Records, 121-122 (*see also* Accounting)
accounts-receivable, 155
office management, 202-205
small business, 135
Recovery, as stage of business cycle, 69
Refrigerator cars, 458
Refrigerators, percentage owned by Americans, 25
Registered bonds, 293
Regulation, government, 331-353 (*see also* Government regulation)
Related field, proper choice of, 3
Remington Rand, Inc., 159
Renaissance, 47
Reorganization, 295
Reports, 15, 121
Requisition, purchase, 377
Resale price maintenance, 334, 338-340
Research, 175-198
government publications, 179-181
market, 177
nature, 177-178
production, 364-365
publications, 178-181
significance, 175-177
Residential hotels, 143
Resort hotels, 143
Restaurants:
consumer likes, 139
growth, 137

Restaurants (*Cont.*):
management, 137-140
opportunities, 139-140
organization, 138
types, 137
Rest periods, 247-248
Retail co-operatives, 411-413
Retailer:
defined, 479
position as middleman, 425
wholesalers' service to, 429-432
Retailing, 2, 479-498
capital, 483-484
career, 497, 498
chain store, 488, 490-491, 494-495
control division, 496
defined, 479
delivery service, 485
department store, 488-489
functions of retail stores, 481-485
general-merchandise store, 486
house-to-house dealer, 492-493
importance, 479-481
independent stores, 493-494
internal organization, 495-496
mail-order house, 489-492
merchandising division, 495
operations division, 496
organization plans, 493-497
parking facilities, 496-497
purchasing, 481-482
qualifications, 499
risks, 484-485
sales of retail stores, 481
selling (*see* Selling)
selling division, 495-496
specialty store, 486
storage, 482-483
supermarket, 486-487
transportation, 485
types of stores, 485-493
variety store, 487-488
Retail prices, 52
R.F.C. (*see* Reconstruction Finance Corporation)
R. H. Macy & Company, 339
Risk-bearing, 401-402
Risks:
business, 304-328
retailing, 484-485
small business, 134
Robbery insurance, 318-319
Robert N. McMurry and Company, 227
Robinson-Patman Act, 333, 337
Roller process, Arkwright's, 49
Rose, Billy, 223
Routing production work, 382

S

Safety, 233-236
Salaries:
manufacturing industries, 358
university, how distributed, 39
Sales agent, 435
Sales invoices, 155
Sales management, 110-112
Salesmen:
payment plans, 515
qualifications, 508-514
Sales organization, 504-515
Sales records, 122
Sampling, 177
*Saturday Evening Post*, 538
Savings and loan associations, 296-297
Savings banks:
defined, 276
services rendered, 287-289
*Sawmill, Establishing and Operating a Small*, 136
Scale models, 111
Schedule bonds, 320
Scheduling production work, 382-383
Sears, Roebuck, 451-452, 490, 498
Seasonal fluctuations, 187-188
SEC (*see* Securities and Exchange Commission)
Secondary boycott, 264
Secretarial work, 2
teaching, preparation for, 4
Secretaryship, 219-223
Secular trends, 186
Securities (*see also* Stocks; Bonds):
factors affecting, 294-296
underwriting, 289-290
Securities Act, 348
Securities and Exchange Act, 348
Securities and Exchange Commission, 348-349
Self-evaluation, 7-9
Self-insurance, 305-306
Self-interest, recognition under capitalism, 51-52
Self-Rating Chart, 8
Selling, 2, 110-112, 395, 503-521
career, 520-522
display, 516-518
payment plans, 515
quotas, 507
sales organization, 504-515
small business, 135
stages, 512
Senate Small Business Committee, 135
Separation, 238
Service, 33-35
*Service Station, Establishing and Operating a*, 136
Settlement of labor disputes, 268-272
Shares of stock, 89
Sherman Antitrust Act, 333, 334
*Shoe Repair Business, Establishing and Operating a*, 135
Shopping goods, 406
Shorthand, preparation for teaching, 4
Short-term loans, 281-283
Shuttle, flying, Kay's, 49
Sight draft, 283-284
Single-entry systems of accounting, 152-153
Single proprietorship (*see* Proprietorship)
Skill tests, 11
Small business, 127-145
business information, sources of, 135-316

Small business (*Cont.*):
capital needs, estimating, 131-132
characteristics, 129
competition, 132-133
defined, 128-129
failure, causes of, 129-130
labor, 133
management, 134-135
organization, 130-134
personal inventory, 132
prices, 132-133
purchasing, 134
records, 135
restaurant management, 137-140
selling, 135
time handicap, 134
Smith, Adam, 53
Smokeless and Appalachian Coal Association, 264
Social security, 322-325
Social Security Act, 351
Sole proprietorship (*see* Proprietorship)
Sources of business information, 135-136
Southern classification, 455
Specialization of labor, 362-364
Special partners (*see* Limited partnership)
Specialty goods, 406-407
Specialty store, 486
Speculation, 134
Spiegel, Inc., 490
Spot market, 306
Standardization, 262
merchandise, 402-403
production, 361-362
Standard of living, American, 25
Standard Oil Company, 333-334
Standards, 37, 402-403
Stanley household products, 425
State banks, defined, 276
Statements (*see also* Financial statements):
bank, 278-279
*Statistical Abstract of the United States,* 180
Statistician, insurance, 326
Statistics, 2, 175-198 (*see also* Measurement, methods of)
accounting, relation to, 175
career, 195-198
government publications, 179-181
importance, 4-5
market research, 177
measurement, methods of, 181-188
nature, 177-178
personal qualifications, 197
preparation, 197
presentation of data, 188-195
publications, private, 178-179
significance, 175-177
steps, 177-178
Steam power, 49
Stenographer, 219
Stenographic proficiency test, 11
Stenography, preparation for teaching, 4
Stock, 92-95
certificates, 89
common, 92-94, 290-291
Stock (*Cont.*):
corporation, 89
preferred, 94-95, 291-292
shares, 89
transfers, 86
turnover, rate of, 132
Stock companies, 307-308
Stock exchanges, 86, 293-294
Stockholders' meetings, 92-94
Stock markets, 86, 293-294
Stop-payment order, 280
Storage, 357, 405 (*see also* Warehouses)
design as aid, 436
production, 377-378
retail store, 482-483
track, 461
Stores:
chain, 494-495
independent, 493-494
Strikes, 264
benefits gained by workers, 257
idleness resulting from, 257
workers involved, 257
Strong Vocational Interest Blank, 10
Suggestions, employee, 246-247
Supermarket, 486-487
Supervisory training, 232
Supplies:
office, 212
procuring, 400-401
Supply and demand, law of, 52
Surety bonds, 320-321
*Survey of Current Business,* 180
Survivors' insurance, old-age and, 322-323
Synthetic-fibre industry, 17
Synthetic processes, 368

T

T.A.B. (*see* Traffic Audit Bureau, Inc.)
Tables, numerical, 189
Taft-Hartley Act, 351
Tank cars, 458
Taste, 35-36
Taxes:
corporation, 87-88
regulatory, 344
trusts, 97-98
Taylor, Frederick W., 107-108, 110, 116, 122, 240, 362
principles, 107
Taylor Differential Piece-Rate plan, 240-241
Teaching, preparation for, as secondary field, 4
Telegraph, regulation of, 346-347
Telephone, regulation of, 346-347
Television:
advertising, 534-536
industry, 17
Temporary National Economic Committee, 133
Tennessee Valley Authority, 371
Term insurance, 316
Testing laboratories, 399
Tests, 9-12
Theft insurance, 318-319
Thompson, Dorothy, 223

Three C's of credit, 152
"3D" insurance policy, 319
"Through" rates, 457
Thurston Intelligence Test, 10
Timber, acreage, 54
Time cards, 239
Time draft, 284
Time series, 185-188
  cyclical fluctuations, 186-187
  seasonal fluctuations, 187-188
  secular trends, 186
Time study, 108, 215-216, 384-385
Time utility, 357, 435
Time wages, 239
Top management, 106-107
Trade acceptance, 283, 284
Trade-marks, 343
Traffic Audit Bureau, Inc., 539
Traffic management, 112
Training:
  company, 6
  of personnel, 232-233
Training Within Industry Foundation, 233
Traits, objectionable, 13
Transfer, 237-238
Transportation, 2, 112, 357, 405, 450-475
  airways, 467-469
  carload lots, 436-437
  delivery service, 466-467
  distribution, role in, 451
  gas, natural, 472
  highways, mileage, 451
  importance, 450-451
  internal, 453
  less-than-carload lots, 436-437
  motor, 464-467
  natural gas, 472
  oil, crude, 472
  petroleum, 470-472
  pipe-line, 470-472
  production, 370-371
  railways, 454-461
  retailing, 485
  role in distribution, 451
  traffic department, 472-475
  waterways, 462-463
Transportation Acts, 345
Treasury receipts and expenditures, 192, 195
Trucks, 464 (*see also* Motor transportation)
Trust (*see* Massachusetts Trust)
Trust certificates, 97
Trusteeship, defined, 96
Turnover:
  labor, 244-245
  stock, rate of, 132
Typewriting:
  teaching, preparation for, 4
  testing proficiency, 11

U

Undercapitalization, 296
Underwriter, insurance, 326
Underwriting securities, 289-290
Unemployment insurance, 324
Unguided interview, 13
Uniform Limited Partnership Act, 81
Uniform Partnership Act, 77
Uniform Warehouse Receipts Act, 446
Union agreements, wage earners under, 261, 262
Unions (*see* Labor: organizations)
Union shop, 263
United Automobile Workers, 259
United Mine Workers of America, 259, 260, 266
United States:
  economy (*see* Economy of the U.S.)
  population, 56
  size, 53-54
United States Steel, 83
Universal Credit Company, 297
Universal Standard Workmen's Compensation and Employers' Liability Policy, 319
University receipts and expenditures, 38-39
Use tax, 344

V

Variety store, 487-488
Vertical promotion, 238
Vestibule training, 232
Voluntary arbitration, 269
Voucher check, 280

W

Wage and Hour Law, 350
Wage-incentive plans, 240-242
Wage policy, 267
Wages:
  legislation affecting, 350-351
  manufacturing industries, 358
Wagner Act, 351
Wagner-Lea Act, 349
Wanamaker, John, 528
Wants, human, 28-29
Warehouses, 435-447
  field, 443
  private, 437-443
  public, 438, 444-445
  receipts, 446
War Industries Board, 361-362
Water damage, insurance against, 316
Waterways, transportation by, 462-463
Washington, D.C., buying habits of consumers in, 30
Wash sale, defined, 349
*Wealth of Nations, The*, 53
Weighted index numbers, 184-185
Welfare, grants-in-aid for, 324-325
Wenzel, George L., 138-139
Western classification, 455
Western Electric, 83
Western Union Company, 347
Wheeler-Lea Act, 334, 341
Whitney, Eli, 361
Whole life insurance, 316
Wholesale co-operatives, 413

Wholesale Price Index, 187
Wholesale prices, 52
Wholesalers, 2, 400, 426-434
  advantages of using, 426-427
  assembly services, 430-431
  catalogue service, 431-432
  centers, 428
  financial services, 432
  functions, 427
  manufacturers, service to, 432-433
Wholesalers (*Cont.*):
  middlemen, 425
  retailers, service to, 429-432
Wilson, Woodrow, 223
Window display, 517
Windstorm, insurance against, 315
Withdrawal ticket, 288-289
Woolworth, F. W., 75, 128
Working capital, 166
Workmen's compensation insurance, 319-320