You can't judge your business by the past three years

Elijah Watt Sells
You Can't Judge Your Business by the Past Three Years

If it is to live through the next three years, you must not make the mistakes which cause 75 per cent of all businesses, that are started, to fail. What I have learned about these mistakes through years of investigation

By Elijah W. Sells
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If I were asked at the present moment for the most serviceable warning to a business man, I would say: “Don’t expect to stand on the record of your house for the past three years.”

The extraordinary conditions of the past three years cannot continue to exist. Already some reaction has been felt, and this is going to continue for some time.

As accountants, we know that firm after firm has made vast amounts of money during the past three or four years without deserving success. Firms which produced inferior goods, firms which have had bad management, firms which, under anything like present conditions, would have been dire failures, have made money despite these things, and have made it so easily that it is no wonder some of them are deceived into thinking it must be a result of their superior ability.

Nothing that I have to say in this article applies, with any force, to those years. But it is going to apply from now on. The real tug of war for business is just beginning. Firms which have made money simply because there was such a demand for goods at high prices that they could not help making money are going to find out that it takes something more than being in business to make a post-war success. A good many of these firms will go under.

If this sounds pessimistic, let us consider the ordinary records of business. At least seventy-five per cent of all concerns started, fail. I have verified this statement by calling on an authority in such matters. It is as nearly correct as is possible. Men who start out in business seem to know so little about it that it is a wonder even so large a proportion as twenty-five per cent succeeds.

Among our clients are all kinds of companies, from very small concerns up to railways, cities, and even Governments. Big companies fail in almost the same proportion as smaller ones; but their affairs are so complicated that it is difficult to use them to illustrate single points. Small businesses often bear for their success or failure upon a single point, because their affairs are simple.

Too Many Relatives on the Pay Roll

When an employer hires his help among strangers,” says Mr. Sells, “he is not likely to make the mistake of overloading his pay roll. But many firms are family affairs.

A certain manufacturing concern of long standing grew up there were places waiting for them in the plant. As a matter of course, the important positions, and a number of unimportant ones, were filled by sons, grandsons, nephews, nieces, and even odd cousins of the founder.

For a time, the business went on successfully. Outwardly it was as sound as ever. Orders continued to come in, because of the past history of the concern. Then slowly, but surely, it began to slide down-hill, and finally it wound up in the hands of a receiver. Probably none of the family realized to this day just why it failed. But had one of them been able to read his business without the veil of family affection getting between him and his books he never would have consented to the high wages and inefficient service he tolerated in the family.”

One of our clients went into business—

The amounts due him from the various purchasers of his goods are five thousand dollars less than those the shelves held last January.
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was in January, even though he has the same amount of cash on hand.

It seems incredible, when the facts are stated in plain English, that men should look at a part of their business and take it for the whole; but consider the history of the ordinary man who works himself up in the world:

A shoe manufacturer, for example, does not, as a rule, develop from the bookkeeping department. He begins by working at a bench; then he becomes in turn foreman, assistant superintendent, superintendent, and finally he goes into business for himself. This is the regular road that heads of manufacturing businesses have traveled. There are only occasional exceptions.

Now, where does such a man’s chief interest lie? In the production of good shoes. As a second thought, he knows that the shoes have to be sold; and as a remote third thought, he knows that some system of accounting must keep him informed as to how the production and selling balance. He hires a bookkeeper, looks at the cash balance every month. Perhaps he looks at the trial balance of his books, but his main interest is in the cash balance. When men who run a business in this manner succeed—and they do sometimes—it is largely a matter of luck.

As I said before, seventy-five per cent of businesses started, fail. At least fifty per cent of these fail because of lack of capital.

A MAN gets a brilliant idea and he cannot wait to begin. He starts out on a shoestring, and fails, as a matter of course.

According to our experience, any man who wants to start in business for himself needs:

1. To know the business.
2. To know where he is to get his capital.
3. To work with enthusiasm.
4. To know how to read his accounts.

On a liberal estimate, only ten per cent of all businesses employ public accountants; ninety per cent founder along some line, except where some man of unusual intelligence is able to read his own business.

An auto salesman, who ran a shop selling several lines of autos and of auto accessories, found himself in difficulties. This man was a first-class salesman and a good engineer. But the bookkeeper, to whom he entrusted his accounts, got away with a good deal of money. The owner, examining the books, but found that he had no idea of how much he had been mulcted. So he sent for our firm to go over his books.

After finding that, apart from the peculation, he was doing a good business, we suggested that he have a monthly audit and report made, so that it would be impossible for his bookkeeper to get away with funds a second time. He assented.

Like most men, this man had very little capital. He was financed in great part by the auto companies whose machines he sold. But he had never had a clear idea of his financial condition, and this, together with the fact that his bookkeeper had defaulted, caused his relationship with these companies to become strained. Yet he needed their backing. Before he had received many of his monthly reports, he was sending copies of them regularly to the company who were, or had been, backing him. The results were prompt. Relations became more cordial, credit was extended, money advanced. The president of one of the companies wrote him a personal note congratulating him upon the method he used to keep informed as to exactly where he stood.

WITH this approval, and with the absence of worry, he gained confidence and went to work with greater vigor. The war helped along, so we cannot credit all of his success to one factor. But war or no war, that man was on the road to success just as soon as he began to know his business. Added to his real ability, it gave him the power to get capital, which was what he most needed. He is an instance of a man who was able to read business is not confined to small concerns. A certain large manufacturer, making three classes of desks, called on us to go over his accounts. The factory was working on a well-defined basis. On desk number one, the salesmen were instructed to get all the orders they possibly could. On desk number two they were to take any orders that came along; on desk number three they were to take orders only when accompanied by an order for desk number one. "You see," the owner explained, "we are coining money on desk number one, making a fair amount on desk number two and not a cent on desk number three."

He thought he was right. But we installed a cost system for him, and before we had finished with it he had sent out a hasty order to reverse instructions. Number three was made the leader, and number one was sent out only on an order which included number three as well. The owner was right about desk number two; but by some process things had become badly mixed as to costs on desks one and three.

Another manufacturer was making both power and hand vacuum cleaners. There was an excellent market for both, but the manufacturer complained that he could not sell the hand vacuums cheaply enough to sell them at a price that would meet competition.

When we went over the books we found that certain fixed charges, such as insurance on a part of the factory, depreciation, a part of the executives’ salaries, etc., were being charged to the hand vacuum cleaners. This was correct; but the fact remained that the owner of the factory would have to pay these charges even if he did not manufacture a single hand cleaner. Shutting down that part of the factory would relieve him of neither insurance nor depreciation, and his executives could hardly be reduced enough to make a perceptible difference in charges. If these charges were taken off the hand vacuum cleaners, he could make a price that would meet competition. And if he could sell enough of the cleaners he could carry the charges, keep the lower price, and still make a profit.

When we convinced him of this he went to work on a drive to sell the hand cleaners. The market was good; he sold them, and made a good profit and a real one. There was no error in figures here; it was simply a matter of reading them to the biggest profit of the concern.

One of the biggest factors in the development of the public understanding of figures is the income tax. Several millions of people have been forced for the first time to consider themselves in figures. Most of them have accepted the tax conscientiously. They have worked out their own problems or called on public accountants for help. But every individual who pays a tax has a deep and vital interest in the amount of that tax. Perhaps he has had no idea of himself in figures before.

Not only do figures themselves tell tales, but their relation to other figures in other businesses tell tales which can be known only to men who have handled many of these accounts.

A CERTAIN public utility corporation doing an interstate business wanted to sell a controlling interest. The concern was temporarily held in disrepute. Its stock was in demand and was selling well above par. A capitalist who looked favorably on the concern offered to invest, provided an examination by public accountants proved satisfactory. The books seemed quite correct; but the examining accountant was uneasy at the very small amount of money which had been spent for repairs as compared with other years. His experience with the books and accounts of other public utility concerns made him doubt whether any utility should spend such small amounts on repairs.

He decided to make a more intensive examination and he went over in detail the bills of the concern. An\n
\nThe accountant was to give his report before the directors and the man who was considering putting money into the business. When the time arrived he rose and read his statement of the transference...
of the repair bills to investment charges. The president fidgeted uneasily. One director left the room hurriedly, mattering that he would have to be excused because of sudden illness. A second followed him without excuse. Both went to their brokers and threw their shares on the market, causing a drop in the market price of seventy per cent by the next morning. The capitalist did not invest.

Very often I am asked how large a concern should be, or what volume of business it should do, before it calls in a public accountant to keep its business big enough to need an accountant to go over them. The biggest job I have personally handled was when, with Mr. Haskins, we revised the accounting system of the United States Government under the Fifty-third Congress.

AUDITING the books of a big concern usually means auditing the auditor. Most big concerns possess an auditor who is an accountant. He acts as a check on the books of the company and seems to be able to find any mistake or peculation which may exist.

Another accountant is a certain large company which engages us to keep such a close watch on its financial affairs that no employee of the company, even the president himself, can take a bond or a coupon from the company vault without one of its representatives being present to see him do it.

One of the very small jobs a member of my firm was called on to undertake was that of installing a system of accounts for a small catering business. The man had begun by serving suppers and dinners, and pocketing the difference. By assigning to them the whole business, he was able to make a large profit. The only problem that remained was how to cover his debts. The solution was simple. He had carried a certain amount of stock without analyzing it in proportion to its carrying charges. On thinking it over he admitted that a reduction of ten per cent would not hurt business and he accepted the change. Frequently a business is injured by carrying stock too large to be profitable.

Very often merchants do not know how often they turn over their stock in a year.

"Your turnover is twice a year," is a frequent statement merchant should be able to make.

The silk merchant was bewildered. He had been doing business for years without analyzing it. When he was asked by the accountant to give a statement of his business for six months, he found that he had lost fifteen per cent of the money he had invested in the business.

THERE seems to be a popular idea that the stopping of thievery is the accountant's chief function. As a matter of fact, only a small proportion of all firms in business have any peculation. People always express surprise when some trusted official goes wrong. They forget that it is only the man who is trusted who has the chance to go wrong. There doesn't seem to be any limit to the number of schemes and sometimes amazingly complicated schemes and sometimes amazingly simple ones. An inactive bank account, where no statement is required because the holder of the account is not drawing checks, may be manipulated by the simple process of taking funds from the bank and charging them to that account. A teller, for example, can manipulate this way as long as the bank does not send out a statement. But, when banks are sending monthly statements to their depositors, even when accounts are inactive, this danger is lessened.

Frauds in banks often involve very complex systems, but sometimes surprisingly simple ones. An inactive bank account, where no statement is required because the holder of the account is not drawing checks, may be manipulated by the simple process of taking funds from the bank and charging them to that account. A teller, for example, can manipulate this way as long as the bank does not send out a statement. But, when banks are sending monthly statements to their depositors, even when accounts are inactive, this danger is lessened.

A bank clerk may take securities which a customer puts up as a loan, and speculate with them, replacing the amount in securities before the loan is repaid. As few men ever list their securities by number, and care little whether they get back the same securities they deposited, so long as the value is the same, this kind of thing may go on until the bank clerk fails in his speculation and can-
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Would You Walk Into a Trap Like This?

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them along the sidewalk. The newcomer in the drama was apparently intently figuring in a little book he carried.

Now, just notice how craftily the two players engaged game. Instead of instant mutual recognition, which might have led a suspicious man to think that the meeting was prearranged, Oakley was not able, apparently, to attract the new man's attention. So he stepped out of the car and went up to him, holding out a friendly hand. Even then, the man looked at him blankly.

"Good morning," said Oakley. "I don't know whether you remember me, but I met you a while ago in Kansas City."

The town, of course, was not Kansas City; but I shall say that it was.

"Sorry!" said Warren. "You have mistaken me for someone else."

"Oh, no, I haven't! Your name, I think, is Warren, and you are the agent of a New York firm of stock brokers."

Warren looked rather annoyed and repeated that the gentleman was mistaken.

"No," persisted Oakley; "I can recall the circumstances to you. You made a good deal of money for Judge Parker,