1969

Stock shortage problem: A Case history

Robert M. Shehan

Follow this and additional works at: https://egrove.olemiss.edu/dl_tr

Part of the Accounting Commons, and the Taxation Commons

Recommended Citation
Tempo, Vol. 15, no. 2 (1969, June), p. 09-14

This Article is brought to you for free and open access by the Deloitte Collection at eGrove. It has been accepted for inclusion in Touche Ross Publications by an authorized administrator of eGrove. For more information, please contact egrove@olemiss.edu.
THE STOCK SHORTAGE PROBLEM
The retail industry is currently caught in a profit squeeze: sales are increasing but earnings are heading in the opposite direction.

Contributing to the squeeze are the obvious expenses, such as labor and rental, but these expenses are virtually uncontrollable. Let us not waste time with them when there is another major contributor to the profit squeeze which is controllable—the recent, alarming growth of stock shortages.

Statistics published annually by the National Retail Merchants Association Controllers Congress show a 20 percent rise in stock shortages between 1965 and 1967 to a current 1.63 percent of sales. And observers predict that shortage results for 1968, when available, will show an additional increase.

Store presidents and controllers who have been looking into the shortage control problem agree that the fundamental concepts of store stock shortage controls are the same as they were many years ago. It is the operating conditions, or the environment, which have changed. Because of this, there is obviously a greater need for retailers to observe the old maxims of sound internal control systems that assure a well-disciplined, regimented organization.

Among the environmental changes affecting stock shortages are the longer hours, and perhaps more days, which stores are open. This brings in more part-time employees, probably greater employee turnover and less experienced employees. It seems that the apparent rise in employee thefts, and the increase in errors in internal store handling, are directly related to the less experienced and perhaps less loyal average employee of today.

And there is probably more pilferage than we like to admit. This is easier now because merchandise is beautifully displayed and more accessible to customers.

The ever-growing top management pressures to increase profitability by cutting costs is another factor. The result is that many stores cut-back on internal checks and training and followup programs under the guise of a calculated risk decision.

There are some instances of such cut back or work simplification decisions made intelligently, but there are even more instances of deliberate risk actions—deliberate because management did not accurately compare the costs of the functions and controls eliminated with the potential losses these functions and controls were designed to prevent. Such actions, of course, increase the exposure to stock shortage.

With these changes in mind, let us take a store-wide tour with a controller, newly hired by a department store in a large metropolitan area. The controller had been hired with a mandate from the store president to control stock shortages.

The controller quickly learned that the stock shortage results in his store had exceeded the national average for the past three years, and the trend was becoming worse. Morale in the store was low because the abnormally high shortages had cut into profits and store bonuses based on profits had not been what they used to be.

A quick survey of the store's bookkeeping system told the controller:

Internal store accounting, audit and operating procedures were not in writing. There were only brief physical inventory instructions. The rare management directives that did exist were tacked to the store bulletin board—and those precious few were innocuous;

Internal audit activity had been eliminated because the results of past audits presumably had not justified the cost of the program.

Walks onto the selling floor revealed that there had been no mention to the employees of the store's goals in controlling stock shortages; the employees felt that the store controller had the total responsibility for minimizing stock losses.

The controller saw that housekeeping in the receiving, marking and shipping areas was deplorable. During peak seasons, particularly Christmas, little merchandise was checked in properly at the receiving location; in fact, there was some indication that in December, merchandise was often received directly in selling departments to clear the area promptly.

It was evident that with this inadequate check-in, the store was paying for merchandise not actually received. Damaged merchandise, discovered after the goods had passed through several hands, could not always be charged back to the vendor.

The marking room supervisor confessed that, under pressure from buyers, he would sometimes allow merchandise to be delivered directly to the selling floor.
without being marked.

Some merchandise was being pre-marked by several vendors before shipment. The controller learned that this merchandise was not being checked for quantities and pricing. It seemed that on the basis of past reliability of these vendors, a calculated risk decision had been made to eliminate checking.

Walking out to the shipping dock, the controller saw that some merchandise did not bear a sales ticket or register validation to show that a customer had been charged. It was obvious that the shipping and delivery area personnel did not understand the need for assurance that all shipments had been billed and accounted for.

A visit to the accounts payable department and some testing of invoices disclosed that, again to cut costs, no one was checking prices and extensions on invoices.

Also, the controller learned, in answer to a question about physical inventory cut-off procedures, that the system did not appear to be working as well as it had. One of the employees told him that the “before inventory” and “after inventory” stamps were no longer used to effect a clean accounts payable cut-off at physical inventory date because the department supervisor had become convinced that visual informal sorting was enough. This employee reported that some 15 or 20 invoices, representing prior year receipts, were processed initially in this current year.

Down on the selling floor the controller observed: the furniture and hardware department managers had a supply of price tags available to replace missing tags; there was no uniform handling of returned merchandise, so sales clerks liberally interpreted the store’s policy on customer satisfaction. One part-time employee innocently announced that if she recognized the item as one sold by the store, she accepted it without a sales check and another approval and rang up a refund.

While there did seem to be a system for recording markups and markdowns, the controller discovered that a number of misunderstandings existed. For example, no one was accountable for markdown forms, nor was it considered necessary to have two people involved in each markdown. And there was evidence that price changes were not recorded promptly.

Discussions with audit clerks disclosed that in some instances there was a lack of appreciation of the audit objectives.

After his interviews and tours the controller sat down with the store president to outline a three-part program for corrective action.

The program, which was established on an action priority basis, called for communication of management attitudes and objectives to all employees; definition in writing of job responsibilities and company procedures; beefing up of employee training programs.

The first part specifically called for announcement in storewide meetings that stock shortage control is the direct responsibility of the manager, but that supervisory employees in areas affecting shortage and the store controller must be an integral part of the team efforts to minimize shortages.

A stock control committee which was to meet bi-weekly and report to the president was to be established.

Phase one also called for a demanding storewide goal for inventory shortage and emphasis of management interest in stock shortage control. Each buyer would be asked to establish, and then report quarterly on, a program for his section.

Phase two called specifically for preparation some months prior to the next physical inventory and written instructions for all departments on job responsibilities and company procedures.

The controller wanted written instructions to cover existing store practices because during his inspection of the store he had noted that with a turnover of employees, girls were doing what their predecessor had instructed them to do. But there was evidence that the first girls had decided on their own that certain shortcuts were appropriate. Also, the controller was concerned about the accounts payable department’s not checking vendor prices and extensions on a calculated risk decision basis.

The controller envisioned in this phase an evaluation or reassessment of all the accounting and operating procedures relating to inventory control. He also would expect approval by management of the procedures developed, before they were formalized in store manuals.

Phase three emphasized employee training. Training programs, which had deteriorated in the past several years, would have to be re-established on a higher level. Not only must the program provide an indoctrination with store objectives and individual responsibilities for new employees, but it must also be a continual reminder of required store procedures for older employees—particularly supervisors.

Also, the controller intended in this phase to let the employees know that they were to be supervised and that their errors would be detected. He wanted them to
understand that company procedures must be followed rigorously to minimize the stock shortages caused by faulty record keeping and checking and marking of merchandise.

The store president was disturbed by the controller's presentation of a planned stock shortage program. He immediately retorted that there were no fresh or new ideas in the controller's recommended approach to the problem. And he was concerned about the inevitable increased costs of a store operation to cope with such a program.

It took considerable effort, but the controller assured the president that his concerns were not entirely warranted.

The controller argued that he had observed that in a vain search for new approaches, stores had become complacent about the proven stock control techniques. He said there was a tendency for all in the business to philosophize, discuss and argue on such matters as management attitudes, well-conceived systems, procedures, internal checks and disciplined performance by employees, with constant follow-up by management, but very few stores put these prerequisites to good inventory control into effect.

Yes, there would be greater costs in terms of probably two additional employees, the controller had to admit. One of these could be an executive trainee, or a new employee who could later head up an internal audit department. This additional employee would be charged with writing up the present procedures. The other person would represent an addition to the personnel department as a training director.

But what was probably the convincing argument was the controller's demonstration that the profit improvement could be achieved with as much as a 10 percent reduction in stock shortages. These savings would far exceed the salaries of the two new employees.

Finally, the controller indicated that he would request re-establishment of an internal audit function at the store. However, in the interest of economy—and to avoid tackling too many problems at one time—he would delay his request for six months.

Continuing to answer the president's criticism, the controller said he planned to introduce an interesting internal check in the accounts payable computer application which would protect against duplicate payments. He also suggested that the internal auditor could more effectively use the computer to check the propriety of numerous store transactions. This use of the computer would result in greater audit coverage, with less effort on the part of the auditor.

After the controller completed his argument, the president agreed that the controller had taken the right approach to the problem and approved the program.

Two years after that meeting, stock shortages were drastically reduced. This occurred even though there had been a disappointing first year which resulted from a longer-than-expected time to turn the store into a disciplined operating unit.