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Quantitative measures

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Never have the forecasters, and would-be forecasters, suffered greater discredit. However, without pretense of knowledge, where there is no knowledge, it may be suggested that sensible spending, by those whose funds and credit permit, cannot help but create further purchasing power. But, cognizance needs to be taken of the fact that our foreign markets are disappearing rapidly. Production, therefore, needs to be scaled down to the point where there is no exportable surplus. Any plans for the near future would seem to require as a basis, an economy strongly domestic in character, the objectives of which are a constantly increasing number of those who may enjoy high standards of living, greater leisure, and free play of economic forces which will tend to synchronize domestic production with domestic consumption.

Quantitative Measurements

THE INFLUENCE of economic changes on the financial condition of individual enterprises is nowhere reflected more sharply than in stocks of merchandise. Cash may show an increase or decrease in amount when compared at two different dates and the change may have no secondary significance. Accounts receivable appearing in a lesser amount at the later of two dates indicate, from an economic point of view, that the enterprise at that time has less capital invested in that asset. Changes in inventories have a dual significance. They are stated in terms of dollars, but the dollar must be reinterpreted in the light of current prices.

The period from 1921 to 1929 was one of increasing prices. During that period the general price level mounted steadily and generously. The problem constantly presented was one of replacements at higher prices. The same quantities at successively later periods showed increasingly larger numbers of dollars tied up in inventories. The immediate future, from a business viewpoint, was not so troublesome, because the general movement was upward, and there was reasonable prospect of selling goods at increasingly higher prices.

Now the situation is reversed. Prices of cattle, for example, have declined to the lowest in twenty-five years. Two years ago, sirloin steak was selling at fifty-one cents a pound. On June 10, 1931, it sold at thirty-five cents a pound. Last year, in June, prime ribs retailed at forty-three cents a pound. Last week the retail price was twenty-three cents. The purchasing power of the retail meat-dollar has increased about eighty-seven per cent. The housewife with forty-three cents to spend for prime ribs of beef, may have almost two pounds now, instead of one pound a year ago. The housewife with twenty-three cents to spend now may have a pound of prime rib roast, whereas last year she might not have been able to buy any because of the high price.

The dealer's inventory of one pound of beef last year would have shown forty-three cents invested in that commodity. This year the inventory would show one pound at twenty-three cents. Ostensibly, there has been a reduction of forty-six and one-half per cent. in the inventory. In reality, the inventory has not been reduced. The value of the inventory, based on current prices, has declined.

This homely illustration suggests what may be expected in most lines of business, whether the inventory amounts to thousands or to millions of dollars. Prices generally have been following the curve applicable to meats, as may be seen from consulting the various price indices. Weekly average prices of representative commodities for the month of May, 1931, show the purchasing power of the dollar as 140.2, the year 1926 being used as the basis for comparison. For the same month in 1930, the purchasing power of the dollar, measured by the same commodities, was 112.8. The corresponding figure for 1929 was 104.3.

Price is the complement of purchasing power. Decreasing purchasing power denotes rising prices. Increasing purchasing power means falling prices. The rising trend of purchasing power since 1928 reflects the corresponding fall in prices. Index numbers, which serve to express the relation of average prices in subsequent years to the average prices of some given year selected as a base, bear out that conclusion. With the average prices of representative commodities for the year 1926 established as the basis for comparison and stated as 100, the corresponding figure for 1927 was 98.2; 1928 was 96.3; 1930 was 86.3. For the week ended June 12, 1931, the number was 69.7. This, incidentally, shades slightly the 1913 average of 69.8, but fails by a small margin to reach the extreme low of 67.3 established in December, 1914.

The effect of these price fluctuations may not be ignored. The importance of considering quantities as well as prices is equally apparent. The Great Atlantic and Pacific Tea Company reported recently that although sales for the five-week period ended May 30, 1931, showed a small decline in dollar volume, more goods, based on tonnage, were sold than in the corresponding weeks of last year. The report shows that in May, 1931, the company sold goods valued at $102,946,053.00, whereas the sales corresponding to the same period in 1930 amounted to $104,673,214.00, a decrease of 1.65 per cent. Quantitatively calculated, sales for May, 1931, increased over May, 1930, 15.24 per cent.

The auditor's interest in the amount involved in inventories may be considered to be primarily in the basis of valuation and the accuracy with which the value has been computed. There are those who hold that it is no part of his function to take the inventory, or to supervise that operation. Even so, a comparison of quantities might lead through inconsistencies to the discovery of inaccuracies, if it had no other value. But, in times like the present, consideration of quantities is of greater importance.

There is little justification, by those who pretend to efficient management, for having an inventory as high in quantity as previously, if the volume of sales shows substantial decline. A reduction in money-value may reflect no more than adjustment to current market prices. It may show the situation subsequent to having given effect to a large valuation loss. But if quantities have not been reduced, the prospect, in the face of a continuing price decline, is a further loss in value.

Comparison of quantities in inventories, at two dates, is not possible invariably, altho the cases are few, probably, where a record, either made from a physical count, or taken from the stock books, is not available. However, a rough approximation of comparative quantities may be made by the application of suitable tests in which index numbers may be helpful. An inventory at May 31, 1931, which is shown at the same value as at May 31, 1930, presents two possible situations: either the quantities, but not the prices, have been reduced, or the prices, and not the quantities, have been reduced. Either situation is bad. Inventories overstated with respect to value may represent a loss already suffered but not recognized. Inventories overstated as to quantities may represent a loss not only potential but probable in a long continuing market decline.

Excessive inventories mean unnecessary capital. Unnecessary capital is dormant capital. Dormant capital produces no operating profit. Many corporations today are seizing the opportunity to reduce their capital by purchasing their own capital stock. Inventories liquidated at a loss may produce current funds which, if not required for replacement of commodities, may be turned to uses productive of profits greater than the losses in the liquidation.