Distribution Costs[1]

What Should Be the Character of an Adequate Distribution Cost System?

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LET US review the definition of cost accounting given in the Taylor Society's latest book, *Scientific Management in American Industry.* "Cost Accounting *serves management by evaluating the losses in expected profits* when *management standards* are not attained, or the *gain in profits when organization ability is effective in raising management standards.* It points out the sources of these gains or losses promptly."

Taking this definition as a basis for this afternoon's discussion, we have two channels to pursue: One is a discussion of the routines of cost accounting; the other is a discussion of the reasons for such routines, with special emphasis on fixing responsibility.

When Dr. Person sent me the subject for today's discussion, the thought occurred to me, as probably it occurred to you, that this was an occasion for describing some method of analyzing the various selling expenses by lines of product and by mediums of distribution.

It is a great temptation in appearing before a group of the Taylor Society to go through what I believe is the burdensome detail of illustrating some one method. I believe we would obtain better results by guarding against such a temptation and making such analyses and illustrations of cost accounting methods secondary. I have tried to discuss the reasons for requiring such an accounting procedure, with the benefits accruing therefrom, rather than to spend considerable time on the details of any one method.

I shall later show some exhibits which illustrate the work that has been done in this field of distribution costs, so that we may see why such exhibits are in use and particularly how they are used by the line officers of an organization.

If we are to have an adequate discussion of the reasons for analyzing distribution costs, we should first ask ourselves who is responsible for distribution and how he may control his daily actions so as to distribute the product economically. In other words: What is the sales manager's job? What are his responsibilities? How will he attain these responsibilities? What types of information must he have before him to aid him in attaining these responsibilities? Let us discuss the sales manager's position in a general way.

First of all, he selects the proper distribution medium or a combination of possible distribution mediums. The latter is more nearly the true solution of his problem. He distributes through: (1) agents; (2) company salesmen directly under his control; (3) retail stores, or the usual distribution scheme of wholesaler, jobber and retailer; (4) direct mail to customers; (5) a combination of all these methods. In order to select the proper method of distributing goods, his records must be in shape to show him which combination is most useful for the type of product he sells in the various localities in the country.

After having selected the type of distribution he intends to follow he has two major factors in management which he must constantly control. One is the pricing of his product, and the second is the control of his salesmen and sales department. In this day of declining prices and enormous discounts given on purchases in volume, the sales manager must know the cost rates for various volumes. He must also know the trend of the market for his various products. He will probably find that certain products are in favor even at slightly advancing prices, while other products are meeting with severe competition. He might even find himself thrust out of the market on certain of his products due to better values being given by competitors.

These facts can be summed up in a definite policy concerning the type of business the company should go after. Recently the major executives of a concern we were working for were deadlocked on the type of business they should go after. The sales manager was convinced that if he could take

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some business below cost he could greatly increase the volume and thereby the net profits of the company. The general manager was of the opinion that the profits lay in specialties, and that there was no object in going after this big-volume production and selling below costs. The analysis, which we will go into later, convinced us that the general manager was right and the sales manager wrong. However, without this analysis it would never have been possible to win over the sales manager to a program of specialties. Seeing is believing in this day and age and no amount of talking is going to convince a man of long experience that his own ideas are incorrect. We must prove them by facts based on figures.

The sales manager's second responsibility is the control of salesmen. He has to place men in the various territories to fit the type of purchasing power they are to meet. There is no object in putting a high-priced salesman in a field which does not lend itself to that type of man. Conversely, it would be very poor economy to put a low-priced salesman to call on large accounts. The men must be placed where they fit best.

The sales manager must also control his salesmen so that most of them are reasonable profit makers. Some salesmen are by nature profit makers. It hurts their vanity to have to take an order at or near costs. Other salesmen are just chronic price cutters. They peddle their business rather than sell it. They call on the trade to find out what the price is and then insist on going below it.

Another factor is that some salesmen are natural business men while others are spendthrifts. Some spend very little to obtain business while others spend a great deal to obtain business which cannot support such expenditures. This matter of sales expense has always been of great interest to us. The big salesmen—the big profit makers, real go-getters—do not buy business through extravagent entertaining, but actually sell the service and the product, making the purchaser feel that the salesman is doing him a favor in selling him the merchandise.

The essence of success in any undertaking is the understanding of the other man's viewpoint. Therefore, before we definitely discuss routines for controlling sales and selling expense, and thus fix responsibility for distribution costs, we may first sum up the sales manager's problem as follows:

1. He must distribute goods through the various channels of trade economically.
2. Having selected the various mediums economically, he must so price his products that he is within the market and at the same time produce satisfactory profits for his company. Briefly, he must select the best business, for the type of company he represents, financially and otherwise.
3. He must select, place and control his subordinates or salesmen so as to accomplish the above two objectives, for after all they are his representatives and he rises or falls with their success. They will be successful only if intelligently directed.

He attains these objectives through forecasts and controls. These are commonly spoken of as budgets and costs. The form these budgets and costs are to take depends entirely on the multitude of factors previously mentioned. Naturally the sales department which sells through a few national jobbers does not need the detailed records and reports that one selling direct to its own representatives all over the world requires.

Our first principle should be to budget expenses for each method of distribution. If we sell entirely through agents and jobbers, a budget of the business as a whole as to sales, profits and expense, would be entirely adequate. If we sell direct to consumers, greater detail is necessary, as will be shown subsequently.

All distribution costs have to be allocated to lines of major product. The usual divisions for these major lines of product are the various classes of trade. This is based on the premise that various classes of trade classify and group the varying conditions which a selling department has to meet. As an illustration, one of our clients selling chains had four thousand different varieties of chains. These were grouped down to seven or eight classifications. You could not expect to control selling expense by applying the same selling percentage to sales for jewelers' chains as you would to supplying chains for bridges. Similarly, you could not apply the same selling percentages to chains that were sold to agents on the Pacific Coast, and in foreign countries, as you could to chains that were sold direct to manufacturers for re-use in their products.

The principle of making up such a distribution of selling cost between various lines, classes of trade, etc., is the same principle you use in manu-