Do Consolidations Result in Reduction of Distribution Expenses?[1]

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IT IS impossible for me to conceive of any question which is more difficult to answer than that which I have recently been asked to discuss. "Do consolidations result in reduction of distribution expenses?" The man who can think of a query which is so complicated and so all inclusive has my sincere admiration, and I am convinced that the attempt to answer it has been a contributing factor in the illness of our Vice President, Mr. Judson. A complete answer would require not a mere paper such as I have been asked to prepare, but a whole library.

Unquestionably this is the most important problem facing American business men today. Consolidations during the first twenty years of this century were almost invariably based upon effecting economies in production. To a very large extent the possibility of effecting major savings in the cost of goods has been eliminated by the work which has already been done. It goes without saying that further ways of decreasing costs of production are being and will be developed, and I sincerely trust that this process will never cease. However, it must be recognized that, speaking in general terms, further savings in the costs of production will be in terms of fractions of per cent, or in pennies per unit.

Again, speaking in general, we may say that the substantial profits of the past have been earned by the companies who first learned how to produce more cheaply than their competitors. The profits of the future will go to the companies who learn how to distribute with greatest economy.

At this point it might be well for me to state frankly that I do not believe any one man can give a comprehensive and conclusive answer. There are numerous consolidations, with which you are all familiar, which have been eminently successful. Almost every detail of the formation and subsequent operation of these mergers has been given to the public through our newspapers and magazines. We reached a point a few short months ago where we seemed to feel that there was some form of magic relating to the very word "merger," and our faith in the infallibility of this process is attested by the hundreds of millions of dollars which were placed at the disposal of those who, reversing the biblical injunction, were engaged in the process of making one company grow where two or more companies grew before.

Fortunately, or unfortunately, developments of the past forty-five days have brought very forcibly to our attention the fact that we have numerous mergers and consolidations which have received very little publicity, and which are not, and probably never will be, really successful.

Within the past few weeks we have read and heard many explanations for the crash in security prices on the Stock Exchange of the United States. Somewhere among these I read an article, in which paper and by whom I have forgotten, to the general effect that part of our ills were due to the fact that many consolidations had been effected solely because there was a "finder's commission" to the promoter, and a handsome profit to the banker who floated the securities.

It is a very simple matter to take the balance sheets and operating statements of two or more companies and to set down their figures in parallel columns. Working out estimates as to what might happen if these companies were consolidated has a distinct fascination. The process that is ordinarily followed includes an estimated increase in sales, an estimated saving in cost of sales, an estimated decrease in selling expenses and in administrative expenses, and consequently the estimated future operating profit is enormously increased.

Following the same process the balance sheet figures are totaled and then these totals changed to allow for amounts by which fixed investments can be decreased, inventories lowered, cash balances increased, fixed charges reduced, and so on.

In theory all of the estimates are correct, and the resultant figures are usually highly satisfactory from every angle. Theoretically, if two competing companies are consolidated sales should increase. It would seem that eliminating the competition between two selling organizations and concentrating the efforts of those organizations under one executive should result in increasing sales both by obtaining a larger share of the existing business, and by increasing the market. Similarly, the consolidation of production facilities and the elimination of the least efficient plants should make it possible to decrease direct costs and to scale down overheads. In theory at least both sales and administrative expenses should be decreased following a consolidation. Only one set of officers will be required, only one sales manager will be necessary; one production manager can be eliminated, and so on.

Again in theory, where two or more companies are merged it should be possible to carry on the combined businesses with less plant and machinery, with less inventory, with smaller fixed charges, and as a consequence of all of these things the net profits available for dividends should be tremendously increased.

It is very unfortunate that actual results obtained by consolidations do not always work out according to the estimates, and the fundamental reason for this is that no one has devised any method of estimating future results of the most important element in any consolidation—the human beings who are to be picked out of their separate organizations and thrown together, without their advice or consent, to work under circumstances which may or may not be pleasant, with new associates whom they may or may not like, and at tasks for which they may or may not be prepared.

Any of us can take two factories and place them under common ownership with full assurance that we will have so many square feet of floor space, so many machines and other facilities. Any one of us can take two bank balances and add them together with full assurance that the result will be a given number of dollars; but no formula has been devised whereby we can put together two presidents, or two sales managers, or two stenographers, or two workmen, with any assurance that the net result will be even one competent executive, or one aggressive merchandiser or one satisfactory secretary, or one efficient producer.

It is because of this essential human element that many consolidations fail to measure up to the estimates prepared by promoters. It is an unfortunate fact that most mergers which have been effected have entirely disregarded the persons who are to operate and manage the combination. The general feeling seems to be that if terms and conditions as to securities can be agreed upon, and the president of one company made chairman of the board, while the president of the other company becomes president of the consolidation, that no further thought need be given to the matter.

You are probably all familiar with the statistics regarding mergers prepared by Professor Arthur Stone Dewing of Harvard University. Out of thirty-five major industrial consolidations effected between 1893 and 1902, in only three instances were the actual earnings for the first year equal to the estimated earnings; in only thirteen cases were the earnings the first year for the consolidation equivalent to the earnings of the separate companies prior to the merger, and in only fourteen cases were the earnings in the tenth year after consolidation equal to the earnings of the separate companies. It is my belief that if the same information were available on all mergers which have been effected in this country to date that very much the same situation would be revealed.

The engineering work of Ford, Bacon & Davis, Incorporated, has brought us into intimate relationship with numerous public utility and industrial consolidations during the past thirty-five years. Our work is of a type and character which make it essential that we should procure an intimate knowledge of operations of these companies. This has enabled us to obtain a detailed cross section of American business, which is not usually available. It might, therefore, be of interest to cite some of the specific situations which we have seen develop, or which we have been in position to watch in subsequent periods. I will not go into the public utility consolidations, because of my understanding that the question raised was not intended to cover this field. I might say in passing, however, that the reduction which has been effected in the cost of distributing transportation, electricity, gas, water or other public utilities is negligible as compared with the reduction which these consolidations have effected in the cost of producing the service.

My personal experience has been confined to industrial operations, and as my experience with consolidations has been limited to companies man-

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