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"Confidential- from Washington"

ɨE GEORGE WASHINGTON VICTORY COUNCIL
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TO STERLING RUFFIN, M.D., 1890, Sc.D., 1932

'his bulletin is dedicated to Sterling Ruffin, distinguished practitioner and able teacher of medicine whose services to The ɛ Washington University have contributed greatly to the Medical School and through it to the community.

CLOYD H. MARVIN, *President,*
The George Washington University.

THE POST-WAR SERIES VI

Cost of Distribution for Essential Products

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IMPORTANCE OF DISTRIBUTION COSTS

. most important problem confronting the American ɛ today is that of providing adequate employment to :ain the American standards of living. Millions of re- ng soldiers are joining millions of civilians in wanting le variety of commodities. The quantities of such com- :ies bought by these tens of millions of consumers will d upon the post-war price level. Full employment in .facture, in transportation and in distribution may prove dependent upon a reduction of distribution costs.

: are all consumers and the costs of distribution like of production, are borne by the consumer. Because of distribution often are fully as large as, or larger costs of production, and because less has been accom- :d toward making distribution more efficient, the cutting arketing costs offers the broader avenue to lower con- · prices and a higher standard of living for all of us.

r prices and a higher standard of living for all of us.

ı the April 28th, 1944, issue of *Printers' Ink,* the presi- of a Boston advertising agency introduces an article on .r Major Evils of Distribution," as follows:

"*It costs too much* to distribute merchandise and vices. For every dollar of product value the consumer .ys an average of two dollars and ten cents. Sixty per nt of labor earnings are lost in the process of exchanging labor product for labor product. Is the maintenance of that kind of free enterprise all that business can offer to the world of tomorrow?"

In the March 23, 1944, issue of the *American Wool and Cotton Reporter* the leading article cites the costs of getting taffeta in the hands of the consumer as "several times" the original cost of the fabric and concludes:

> "From a manufacturing standpoint the important thing is to get busy on improved and more economical methods of distribution if production levels are to be maintained and employment held at full 100 per cent for those who need it."

COST OF DISTRIBUTION

It is not easy to ascertain the manufacturer's exact cost of distribution even for companies with detailed accounting systems. Depreciation and obsolescence, repairs and maintenance, corporate taxes, and research and development, usually should be prorated partly to production and partly to distribution. Administrative and general office expenses always are incurred partly in production and partly in distribution. The channels of distribution used by a corporation materially influence its distribution cost. The baker engaging in house-to-house bread selling, for example, has a much higher distribution cost than the wholesale baker selling to distributors and retail dealers.

Selling and delivery, wholly distribution expenses, vary widely from industry to industry. For example, in 1940, for 91 industry groups, selling and delivering expense varied from a minimum of 32 one-hundredths of a cent for crude petroleum producing companies, to a maximum of 35.55 cents per dollar for sewing machine manufacturers.

Advertising, also wholly a distribution expense, ranged for leading industries from a minimum of 6 one-hundredths of one cent for the shipbuilding industry, to 13.94 cents per dollar of sales for drugs and medicines. The combined items of selling and advertising aggregated only seven-tenths of one cent per dollar of sales for shipbuilding, and 25.35 cents out of each dollar of sales for drugs and medicines.

In many industries the manufacturer performs some of or all the functions of wholesale distribution. Particularly in food lines, associated retailers have formed wholesale organizations, while wholesalers supplement the distribution organizations of manufacturers.

In the food trade, cooperative wholesale grocers—that is, wholesalers buying for associated grocers—have achieved much lower distribution costs than old-line wholesalers. In 1939 the cost of the former was 5.87 cents per dollar of sales compared with 9.65 for the latter.

AGRICULTURE'S STAKE IN DISTRIBUTION

Following the Civil War, and again following World War I, American agriculture experienced long periods of declining prices. Agriculture is always one of the first industries to develop large production following a war. While every segment of our population is interested in efficient low-cost distribution to match our development in production techniques, no part of our population has a greater stake in low-cost distribution than agriculture.

The operations of American farmers today are highly specialized. Where products are produced far from centers of large consumption, it is easy for a complicated system of distribution to develop. The American farmer sells in the wholesale (or processor) market and purchases in the retail market. High distribution costs reduce farm income and thus restrict the sales of industries that sell to farmers.

The Federal Trade Commission in 1938 in a report to Congress said:

> ". . . Agricultural stability is not endangered as much by farm tenancy, or by the amount of farm mortgage debt as it is by the continuing disparity between the prices of farm products and the prices of many things farmers purchase. This disparity results not only in decreased earning capacity and market value of farm lands, but also in decreased ability of the farmer to meet interest payments and payments on the principal of his outstanding mortgage notes, thus still further endangering his equity in the dwindling value of farm land which is his principal capital asset.

Two examples will illustrate the manner in which the consumer's dollar has been traced back to the farmer.

1. *Bread*—In September, 1942, the average price of a loaf of bread was 9.27 cents. Of this amount the wheat farmer received 11.11 per cent. Elevators retained as their margin for handling the wheat 1.51 percent of the cost of a loaf of bread. The flour miller's production and distribution costs were 3.45 per cent. Transportation agencies handling wheat and flour received 2.80 per cent.

The baker's cost of ingredients, other than flour, was 11.44 per cent; his production and distribution cost, 41.10 per cent. The miller's and baker's profit combined was 6.04 per cent; the retailer and other distributors' gross margin (cost and profit), 22.55 per cent.

2. *Suits*—For the year 1939, for a $35 ready-to-wear man's or boy's suit, the farmer or wool grower received $2.31 fo the raw materials going into the suit, which was 6.6 cent out of each dollar of sales. The transporting, marketing and warehousing agencies handling the raw wool obtained $0.57 or 1.63 cents out of each dollar of sales. The scouring, top ping and spinning wool costs and profits were $2.78, or 7.9 cents out of each dollar of sales. The worsted cloth manu facturer's costs and profits were $4.19, or 11.97 cents p dollar of sales, of which his cost of production amounted 8.57 cents per dollar of sales, his cost of distribution 1.7 cents, and his profit 1.68 cents.

The cost and profits of the ready-to-wear suit manufac turer aggregated $12.35, which was 35.29 cents out of eac dollar of sales. The suit manufacturer's cost of productio accounted for 26.03 cents, his cost of distribution 7.26 cent and his profit 2 cents per dollar of sales. The average cloth ing retailer's costs and profits were $12.80 for a $35 suit, o which his cost of distribution was 32.26 cents per dollar o sales, and the compensation of officers and profits 4.31 cent

ADEQUATE REPORTS ON PRODUCTION AND DISTRIBUTION COSTS

All of our periods of maximum business activity hav coincided with the development of important new industrie Only successful ventures are a permanent benefit to th country. And only the Federal Government can collect an currently furnish facts and figures, sufficiently comprehensiv with respect to the aggregate profitableness of existing busi ness enterprises, as will minimize the risks of sowing ventur capital and vital energy on unproven ground.

Business men constantly want information with respec to production, prices, consumption, etc. Many industri trade associations sporadically gathering such information fo the use of their members, including those in such importan industries as lumber, cement, and drugs, have been charge with misusing such information in violation of the antitru laws.

The Temporary National Economic Committee in its fin report (1941) states:

> "One of the striking facts of experience in national economic policy formulation during the past decade, amply demonstrated by the experience of this committee, and more recently emphasized by the pressing problems of industrial mobilization confronting the national defense authorities, is the inadequacy of factual information concerning the structure and functioning of our industrial economy."
>
> "Looking to the post-war period we all know that business and Government will be confronted with a new, complex and difficult situation. We shall be able to make the necessary adjustments and keep the economy functioning at a high level only if we anticipate and provide the factual requirements which are essential for intelligent appraisal and proper action. Fact gathering must be continuous so that essential economic information will be available to businessmen, to Government, and to the public."

Our business leaders indicate today a laudable desire undertake the major responsibility for the functioning our general post-war economy after reconversion is complet The degree of their success depends upon the boldness wi which they attack the problem of reducing the costs of di tribution, the solution of which will insure an expandi production of consumer's durable goods.

GOVERNMENTAL CLIMATE

l Unfair methods of competition and unfair or deceptive s and practices in commerce as well as discriminatory dis- ɔunts and allowances continue to be chiefly sins of distribu- n despite the expanding nature of recent judicial definitions ıinterstate commerce.

The Federal Trade Commission and Robinson-Patman ᵗts, as well as the other antitrust statutes, are based on the .derlying philosophy that competition, if free and fair, will ɒvide in and of itself all the general regulation necessary, ɪd the Department of Justice and the Commission, therefore, : not given large regulatory powers but charged merely ɔth seeing that there *is* competition and that it is *fair*.

If illegal price cutting, misbranding and misrepresentation e stopped; if large distributors are precluded from arbitrarily voring certain customers; if there is an end to commercial ibery, inducing breach of contract, of "lifting" and then vertising a competitor's product at greatly reduced prices : the injury of the product's reputation, exclusive sales and .rchasing agreements, rebates and preferential contracts, quisition of exclusive or dominant control of machinery or w materials; if there is an end to stealing copyrights, imitat- g patented articles, mergers to suppress competition, or ıterlocking directorates to create monopoly—and if there is : end to combinations in restraint of trade—that is, combina- ons in which members of an industry voluntarily agree to strict unduly their own right to trade, as well as those mbinations which effect an undue extraneous restraint,— ill not distribution be so invigorated as to enjoy the rigors of competitive climate?

To the extent that the Federal Trade Commission has ıallenged and impeded the development and operation of onopolistic practices, it has promoted both technological iciency and social efficiency in distribution. This is exempli- d in several cases now in progress through the courts in hich a challenge is directed to the legality of certain systems delivered prices—the basing point system, the delivered ice zoning system and the so-called "f.o.b. plant freight qualized system." The systems have deprived customers of lvantage in delivered costs in dealing with nearby producers ho must sell f.o.b. destination under a program of matching ıd equalizing delivered prices; they differ only in the manner : accomplishing equalization of their costs of delivery. Uniform delivered prices" and "identical delivered price uotations" have as their companions such uneconomic ill inds as excessive cross hauling and phantom freight. Toward ıem the post-war Governmental climate may be forecast as ɒntinued cold.

What of the cumulus clouds of surplus war goods? Wise ıilitary planning presupposes an abundance of the infinite ariety of things needed to wage modern warfare—as it is nly a defeated nation which has no problems of surplus. The Government's tentative disposal plan is aimed not only o salvage taxpayer dollars from surplus jeeps, for example, ut also to least interfere with the normal post-war distribu- ion of competitive cars and tractors.

OUR NATIONAL OBJECTIVE

Expanding production, efficient distribution and non- vasteful consumption should be the goal of our post-war planning. In no other way can we contribute to the maxi- mum in the gigantic task of rebuilding that will confront the post-war world. Under the pressure of wartime demand our ndustries have learned valuable lessons in production econo- mies. This progress in the field of production should be matched in the field of distribution.

The question may well be asked whether increased income and excess profits taxes have not absorbed all of the savings resulting from increased manufacturing and processing efficiency. For the five years 1939 through 1943, twelve representative food processors increased their annual sales from approximately \$538,000,000 to \$999,000,000, partly, of course, the result of higher prices. For these twelve companies the State and Federal income taxes increased yearly as follows:

1939	\$ 7,357,000
1940	9,757,000
1941	18,434,000
1942	43,900,000
1943	46,199,000

Net profits after all interest, income and excess profits taxes were:

1939	\$25,188,000
1940	28,148,000
1941	32,522,000
1942	30,942,000
1943	31,675,000

This picture is typical of industries having a large war demand for their products, namely, an increase in profits of large and medium-sized companies notwithstanding higher taxes through 1941 and then a leveling off in 1942 and 1943 with net profits, however, remaining above the 1939 level.

It appears that our larger manufacturing, processing and transportation companies will emerge from this war generally in a strong financial condition so that they can turn their attention to developing a more efficient and therefore cheaper system of distribution.

In the last analysis, the quantity of production and distribution of any given commodity depends upon consumption. The manufacturer cannot long continue to produce and distribute his product unless the consumer will buy. Buyers' strikes following World War I caused by high prices paralyzed some trades. In protest against high clothing prices a United States Senator appeared in Congress dressed in overalls.

Balance is an essential element in the process of producing, distributing, or consuming goods. If we systematically produce and attempt to distribute more than we can consume, we destroy the balance between those three basic functions of our economy. We create a buyers' market and a stagnant industry. The systematic consumption of more than current production upsets the balance in the opposite direction and we have a sellers' market with its hectic activity.

In a seller's market there is always a tendency for manufacturers to increase their prices, but the greatest increase frequently comes in distribution. For example, following World War I, there was a shortage of anthracite coal; prices rose to such heights that the Federal Trade Commission was directed to make an inquiry as to the causes, and it was found that through pyramiding of middlemen's charges, the customary wholesaler's margin of 25 cents per ton for anthracite coal was increased to as much as \$5 and \$6 per ton.

There is no real social efficiency when we thus alternate between "boom and bust" with the consumer tormented by unemployment in the buyers' market and plagued by a zooming cost of living in the sellers' market. So just as there is need for the engineering and pioneering type of mind in the search for technological efficiency in the production and distribution of goods, there is need of engineers and pioneers in the search for efficiency in maintaining a proper balance between such production and distribution and consumption. Our individual interests as consumers in any long range view are necessarily paramount to our individual interests as producers or distributors.

The greatest spur to consumption is low price, the lowest price consistent with maintenance of productive and socially desirable enterprise is the Hallmark of efficiency. Therefore, whatever tends to lower prices tends to create efficiency through increased consumption. This in turn tends to stimulate production and distribution and to maintain all three in efficient balance. The theory underlying the competitive system is that it is the best method of inducing men of superior mental endowment to work efficiently to the end that society in general thereby may reap the benefit. Unless it does reap that benefit, organized society is merely maintaining a system under which the efficient may exploit the inefficient and the strong may exploit the weak.

The efficiency that reduces costs and then spreads the benefit throughout the whole social organism by reducing prices does not flourish in the hothouse climate of private monopoly. Even though such a monopoly may reduce its costs by more efficient methods, it has a strong incentive to monopolize the benefits unless prodded by the spur of competition.

In competitive sport the game is for one competitor to outdo the other and the contestants are expected to call upon their varying abilities and reserves of efficiency for that purpose. We would regard the game as fixed and fraudulent if this were not so. It is the effort to outdo the competitor that creates and releases unsuspected reservoirs of ability and efficiency in all the contestants. Let us not abandon that principle in business and have it become a mere routine like book-chess wherein White knows in advance every move Black may be expected to make.

And let not free enterprise deceive itself that it can remain free and at the same time deny to society the benefits of competitive efficiency, thereby periodically putting the mass of small consumers through the wringer of depression and unemployment and progressively wiping out the small producer.*

* Summary of an address given before the American Marketing Association.

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