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The story of how one CPA firm made it possible for one client company to change —

FROM MERCHANTS TO MERCHANDISERS

by Michael H. Hagler
Alexander Grant & Company

THE ABC COMPANY started its life as the branch office of a long-established European food trading firm during the First World War. Arrangements with domestic growers soon expanded into a domestic fruit business in this country but still the major part of the company's work was devoted to supplying American products to the parent European concern.

With the outbreak of the Second World War the company picture changed rapidly. The European concern was all but destroyed, its offices closed, its warehouses bombed out of existence. The American operations became the center of the complex. As such the American operation spread itself rapidly. It had already become a manufacturer on a small scale with the establishment of a packing company in cooperation with one of the large domestic fruit growers with which it had been dealing, and just before the war began it had established a working relationship with Cuban interests. With normal trading patterns disrupted by the war, the American company spread its interests to the Western Hemisphere, and set up branches of its own in South America.

After the war, the ABC Company found itself more or less transformed from a small branch office of a European concern to a small but flourishing manufacturing and importing company, marketing many of its foods under its own label. Cuban produce had by now become a large part of its business, and just before Castro completed his revolution, sales passed the million-case level.

Castro's revolútion was successful, however, and ABC found itself without its most important source of supply. It had enough other products it was handling to weather the crisis and soon found new sources of supply.

So far, the company had sold most of its packaged goods under its own brand names with a percentage of its sales made to other food processors and packers who put the products under their own labels.

One vital difference had begun to appear, however. Whereas most of the ABC Company's old imports had been marketed under their own brand name, and had been slightly exotic in nature, so that a market could be found for them no matter how much was brought in, now the nature of their business was changing. From marketing commodities, where the nature of the crop—and the size of the crop—could affect their marketing plans radically, they were gradually moving into the marketing of staples, where long-range planning was essential—and possible—where the food had first to be grown, then processed, then marketed here.

United States weather conditions in any one season can have a tremendous effect on the price manufacturers must pay for their raw materials. The ABC Company saw its opportunity and developed foreign sources in a variety of countries prepared to pack products meeting American specifications (in some cases even particular company specifications). Because of the number of countries dealt with by ABC, weather or growing conditions in any one country could be handled by switching to another source of supply.

But this transformed the former small importing company into a major bridge between manufacturers abroad and food processors in this country. It had, in effect, become an essential link in a manufacturing process, something it had never been before. It knew importing; it knew how to negotiate letters of credit, how to ship goods; how to ensure that the foods it imported met U.S. Food and Drug Administration requirements; it knew distribution and marketing within this country.

The one thing it didn't know was how to forecast demand within the country for the goods it was importing. It had been moving and growing almost too fast to learn. Some materials it imported and marketed were handled through food brokers and some it sold to food processors; supplies had to be contracted for months in advance if the processors—both domestic and foreign—were to keep their production lines busy.

This is where they came to us for help: They needed it.

We found that each of the products ABC imported and sold had its own product manager. We found that none of the product managers had any valid manner of predicting sales of his line; he would do it intuitively, and he wouldn't share the results of his intuition with company management, the other product managers, or the accounting department. So the cash flow position was chaotic—especially as the company, like most importing concerns, paid for the produce overseas, paid the shipping costs to bring it to this country, paid distribution costs to food brokers' warehouses within this country, and only invoiced the final customer when he had accepted the goods.

This was a small company. A computer and the right system would have gone a long way toward solving the problem but a computer wasn't economically justified. We also felt the main problem lay in the lack of scientific planning on the part of the product managers, many of whom never even referred to records of what their sales had been in the past year, much less in the previous quarter. Their standard answer to queries about why they didn't refer more carefully to their own records was that it wouldn't do any good: nobody could ever predict anything in the food business.

We felt the thrust of our work should be on developing a more rational attitude toward sales forecasting. If that could be done successfully, some of the other handicaps the company suffered would fall into place quickly enough. Purchasing could be geared to the sales forecast, funds could be planned to cover the necessary purchases, deliveries could be made on time and in sufficient quantity to meet processors' production responsibilities.

So we worked out a number of simple forms to aid the product managers in making reasonable forecasts. The company's major lines were divided into two main product groups, basically those products which were repacked by others or were used in the processing of others and those that were marketed primarily under the company name. We then prepared a sales forecast analysis and adjustment schedule for each product line with actual sales for each month of the previous year noted horizontally across the top and columns under each month for the current year (Exhibit 1, pages 50-51). Each product manager was asked to forecast sales for the current month, actual sales were recorded as the month ended and the variance between the forecast and the actual sales recorded.

This was done for each product line. Now the product managers could no longer rely on intuition as they had in the past. There were the actual sales of their product for the same month the previous year recorded on their forms. If their sales forecast for this year was significantly different, they had to ask themselves why. Did the product show seasonal peaks and valleys in sales for the previous year? Why? Were there any new factors that might affect sales this year? What were they?

In other words, each product manager was being forced to make his forecast on a more scientific basis than he had in the past. He could see each month how close his sales forecast had been to actual sales. If any trends were developing, the chart made it clear to him.

Naturally, the sales forecasts started to become more accurate and as they became more accurate the company could itself begin to develop more meaningful figures for inventory and purchases as well as delivery commitments. The form shown in Exhibit 2, page 52, was developed to show the monthly status of inventory, of inventory for the previous period, of the sales to date, and of the purchases to date. The last two categories were the most significant ones—the 12-month running sales forecast schedule and the consequent 12-month running purchase commitment schedule. This was summarized in tabular form for all company products, showing inventory of each for each month, change in inventory from the previous period, sales for that period, three-month sales forecast, and three-month purchase forecast, and, finally, what inventory should be as of that future date if sales forecasts were met, Exhibit 3, page 52.

This was a forecasting and planning tool, of course, but for far more than sales. Now the company

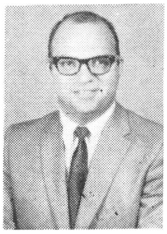

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EXHIBIT I

ABC CO., INC.

SALES FORECAST ANALYSIS AND ADJUSTMENT SCHEDULE
PRODUCT LINE

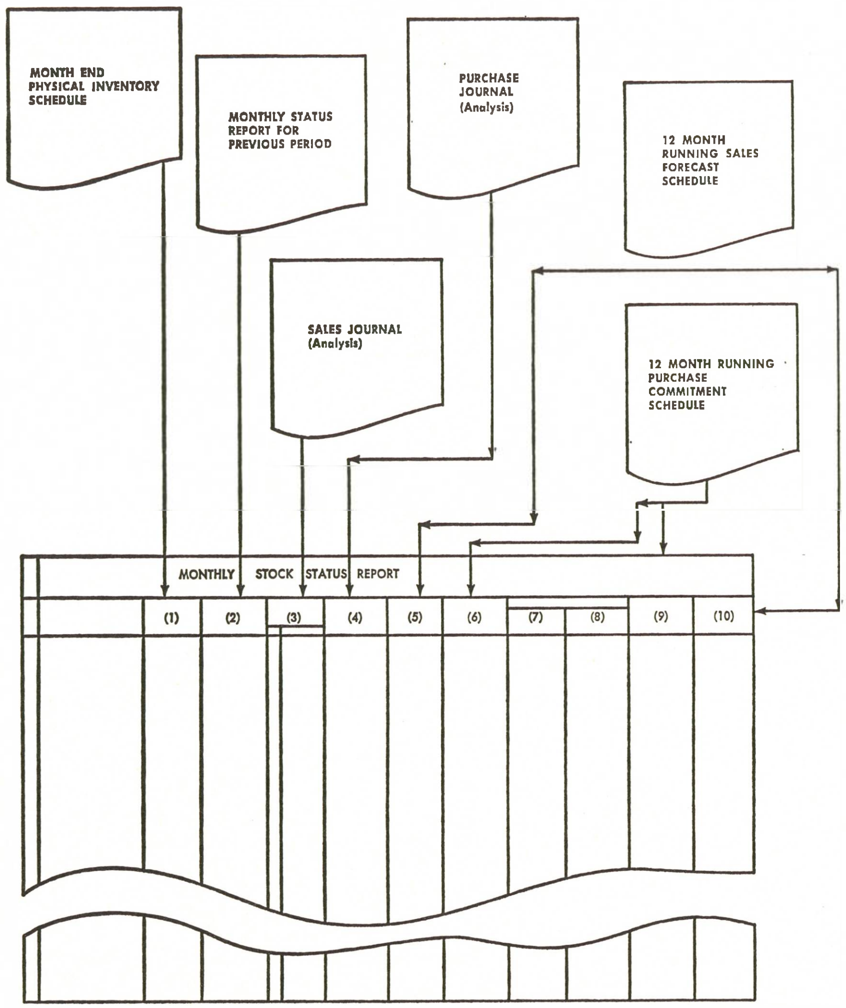
Date Forecast Is Prepared		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23
	Month Ending	May '70	Jun '70	Jul '70	Aug '70	Sep '70	Oct '70	Nov '70	Dec '70	Jan '71	Feb '71	Ma '7	pr 1	May '71	Jun '71	Jul '71	Aug '71	Sep '71	Oct '71	Cum. Sales '70-'71	Cum. Sales '69-'70		Quarterly Summary	
									(NOTE: 000 Omitted)														3 Month Total	
	Sales same month previous year ('69-'70)																						Month Ending	Amount
	Sales Forecast Actual Sales Forecast Variance																					Forecast Pply*	July '70 July '69	$
	Sales Forecast Actual Sales Forecast Variance																					Forecast Pply	Aug. '70 Aug. '69	
	Sales Forecast Actual Sales Forecast Variance																					Forecast Pply	Sep. '70 Sep. '69	
	Sales Forecast Actual Sales Forecast Variance																					Forecast Pply	Oct. '70 Oct. '69	
	Sales Forecast Actual Sales Forecast Variance																					Forecast Pply	Nov. '70 Nov. '69	
	Sales Forecast Actual Sales Forecast Variance																					Forecast Pply	Dec. '70 Dec. '69	

*Pply= Previous period last year.

EXHIBIT 2

ABC COMPANY, INC.
MONTHLY STATUS REPORT

SOURCE DATA FLOW DIAGRAM



had for the first time a rational basis on which to buy the semi-finished materials which it in turn sold to processors. And as sales forecast accuracy improved, all the other figures—commitments to buy, anticipated overages or shortages in inventory—improved as well. For, as the sales managers gained more familiarity and more confidence in the simple forecasting tool that had been supplied to them, as their sales forecasts came closer each month to the actual level of sales for that month, they would begin projecting their forecasts farther and farther into the future. This could make it possible for purchasing to buy its supplies at the most advantageous season and to ensure that inventory levels were always adequate to meet demands.

The monthly sales forecasts and actual sales figures were also summarized by years in graph form showing actual against forecasted sales for all products (Exhibit 4, page 53) as well as in tabular form (Exhibit 5, page 53) showing forecasted sales against actual sales for the previous year. All of these reports gave management a chance to spot trends almost as soon as they began to develop and to take action either to counteract them or exploit them.

Strangely, the product managers who at the beginning wouldn't even reveal their sales forecasts to each other began to pride themselves on the accuracy of their forecasts as soon as they were given a planning instrument to work with. The tabular graph (Exhibit 5) for all

EXHIBIT 3

ABC COMPANY, INC.
MONTHLY STATUS REPORT
Month ending ________________ 1971

Commodity	(1) Inventory as of / / 71	(2) Change from previous period (decrease)	(3) Sales for period $	(3) %	(4)	(5) 3 month sales forecast ending / / 71	(6) 3 month purchase forecast ending / / 71	(7) Projected inventory status as of / / 71 Long	(7) Short	(8)	(9) 9 month sales forecast ending / / 71
Product Line I											
Product A	$	$	$			$	$	$	$		$
Product B											
Product C											
Product D											
Sub-total											
Product Line II											
Product 1											
Product 2											
Product 3											
Product 4											
Sub-total											
All others											
TOTAL	$	$	$			$	$	$	$		$

sales shows how closely their forecasts matched reality. The peak in sales was reached a little earlier than their forecasts but only two months earlier, and certainly that discrepancy was analyzed and evaluated in making the next year's forecast.

What the forecast did show very clearly was that, despite the pessimistic warnings we were given when we first accepted the assignment, it is as possible to forecast in the food business as it is in any other.

This was not a very big or complicated assignment. But it did give the company the tools it needed to do a better job of sales planning and purchasing and, ultimately, of management planning and control itself.

And with this the one time merchant-importers had taken the essential first step toward becoming a link in a production process, and an important link. It had been done with no hurt feelings on the part of personnel—the product managers hadn't been forced into feeling they were competing with each other when their sales forecasts were first made public. And, in any event, it wouldn't have made too much difference. For as soon as they were forced to make sales forecasts on the basis of past figures—and to justify any radical departure from the trends revealed by the past—their sales forecasts became amazingly better.

In essence, this was a basic application of management science, without the imposition or suggestion of any detailed, complicated plan. Nothing could have been simpler than the measures we proposed, yet they accomplished almost everything we and the client could have wished. With the product managers no longer guarding their forecasts jealously, every other financial and management situation in the company became easier and more precise. The company's old haphazard attitude of "we can't predict anything in this business" became a more rational approach.

EXHIBIT 4

ABC COMPANY
SIX MONTH FORECAST ANALYSIS

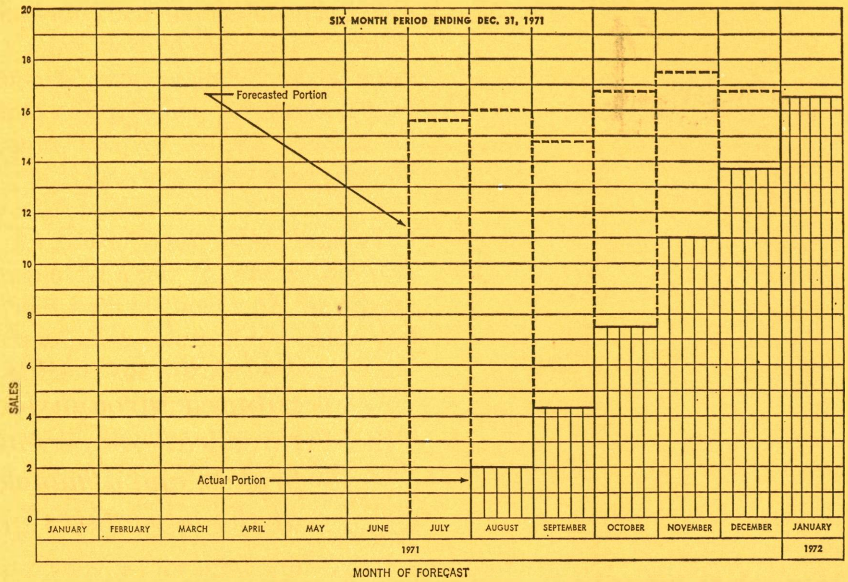


EXHIBIT 5

ABC COMPANY, INC.
ACTUAL vs. FORECASTED SALES