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## THE ECONOMIC REVIEW AND OUTLOOK

M. Dudley Stewart, Jr., Ph. D.

Director  
and  
Associate Professor of Economics and Finance

### The Global Economy

Concern over inflation and slow economic growth continues to prevail in many nations around the world.

Inflation continues at unacceptably high levels while real economic growth rates, although having rebounded substantially from the worldwide recession of 1973-1975, remain somewhat sluggish.

There appears to be increasing pressure for establishing cartels and international trade restrictions in order to protect domestic markets and increase output and employment. Such policies, if established, would only serve to make all nations concerned worse off, not better.

The dollar has declined to historic lows against such currency units as the Japanese yen, the Swiss franc, and the West German mark. There are three major reasons: (1) Differential rates of inflation—that in the United States has, with exceptions, remained relatively higher. (2) The huge U.S. trade deficit caused primarily by importing \$45 billion of crude oil last year and similar amounts in previous years. And (3), the existence of a dirty or managed floating foreign exchange rate system instead of a cleanly floating one.

Finally, the Russian-Cuban adventures in Africa, now most evident in the Horn, and the Middle East give cause for concern about global stability and peace.

### The United States Economy

We see no compelling reason to change out SWAG forecast for the U.S. economy that we prepared last fall.

Real gross national product will grow at a lower average annual rate than the 5.7 percent attained in 1977—approximately four percent. We still do not foresee another recession on the horizon unless the rate of inflation increases substantially, or unless some severe outside shock to the economy occurs.

Inflation, as measured by the consumer price index, will average seven percent, a slightly higher rate than the 6.7 percent experienced in 1977.

The unemployment rate will average approximately seven percent, perhaps slightly thereunder. Thus, we anticipate the rate of 6.4 percent that existed in December, 1977 will worsen.

Short-term interest rates in general will most likely creep upward by another 50 basis points.

### The Texas Economy

The economy of Texas performed well in 1977.

Although the Texas Employment Commission is in the process of revising to a new benchmark, the labor force estimates for all Texas counties, and will release the data at a later date, we have no reason to believe that the unemployment rate did not remain well-below that for the U.S. economy.

Industrial output expanded by approximately eight percent in 1977.

For the construction industry in both Texas and the nation, 1977 was a banner year. The valuation of total construction in the state amounted to an estimated \$6.2 billion—39 percent higher than 1976 and the highest recorded during the last 20 years.

We have every reason to believe that the growth of the Texas economy will continue to substantially exceed that of the nation.

### The Deep East Texas Economy

We believe that our 16-county Deep East Texas economy performed excellently during 1977, even though the data we have are quite limited.



The retail food price indexes for Houston all showed increases during the year. The cost of food in all categories rose 7.4 percent. The food at home index increased 6.7 percent, while that for food away from home climbed 9.8 percent. These indexes are used by us as proxies for food costs in Deep East Texas.

We continue to remain very optimistic about the growth prospects for the Deep East Texas economy during the remainder of the year and beyond.

\* \* \* \* \*

#### Minimizing the Cost of Going Through U.S. Customs

You can more easily make plans to save money on duties by obtaining from your nearest U.S. Customs office two pamphlets: "GSP & the Traveler" and "Know Before You Go."

For example, any gifts that you buy abroad costing less than \$10.00 can be excluded from duties. Simply print, "Unsolicited Gift, Value Under \$10.00" on the packages and mail to the recipients from your foreign address.

Another example: On your customs declaration form, list the items with the highest duties first, so that your \$100 allowance will be applied to them, not to your low duty ones. If family members who live in your household are traveling with you, you can combine their \$100 duty-free allowances with your own.

Consult the two above mentioned pamphlets for further money saving tips.

Source: "Personal Business," Business Week, February 13, 1978, p. 102.

\* \* \* \* \*

#### Do You Want to Buy Manufacturers' Surplus Products?

The Surplus Dealers Directory, published annually by the Institute of Surplus Dealers, 520 Broadway, New York, New York 10012, lists approximately 3,000 individuals who deal in surplus goods. It's cost is \$10.00. Subscribers also receive a monthly bulletin that contains ads from manufacturers desiring to sell various goods and from persons wishing to buy certain ones.

Source: "Action Line," The Houston Post, July 11, 1977, p.m.

TABLE USEF-1

## SIX ECONOMIC FORECASTS FOR THE UNITED STATES ECONOMY: 1978

(In billions of dollars, except as noted)

Forecasting Unit	Month Forecast Made	Nominal GNP <sup>a</sup>	Real GNP <sup>b</sup>	Price Level Increase <sup>c</sup>	Real Growth Rate	Unemployment Rate
CONCENSUS <sup>d</sup>	—	2,094.6	1,393.2	6.2%	4.3%	6.5%
Chase Econometric Associates, Inc.	Jan. 1978	2,078.3	1,389.4	5.8%	3.9%	6.7%
The Conference Board	do	2,098.5	1,398.2	6.2%	4.5%	6.1%
Data Resources, Inc.	do	2,093.2	1,397.3	6.0%	4.5%	6.5%
Kent Econometric Institute	do	2,111.4	1,403.4	6.5%	4.9%	6.4%
MAPCAST (General Electric Co.)	Dec. 1977	2,097.6	1,390.5	6.6%	4.0%	6.6%
Merrill Lynch Economics, Inc.	Jan. 1978	2,088.3	1,390.1	6.3%	3.9%	6.7%

Source: The Conference Board, "The Conference Board Statistical Bulletin," February, 1978, pp. 10-11.

<sup>a</sup>In current dollars.

<sup>b</sup>In constant (1972) dollars.

<sup>c</sup>The forecasted change in the GNP Implicit Price Deflator (1972 = 100).

<sup>d</sup>Calculated by the SFA BEER.

## EQUIPMENT LEASING

Chester L. Allen, D.B.A.  
Associate Professor of Economics and Finance

The value of business assets leased in the United States has grown from \$20 billion in the late 1960s to over \$100 billion today. The types of assets leased have expanded from primarily real estate, computers, office equipment, and transportation equipment to virtually all types of assets from shipping cartons to entire factories. Approximately 20 percent of all new equipment in the U.S. is being leased rather than purchased.

### Why the Growth in Leasing?

The growth in the use of leases is the result of several factors. The first is the increased awareness on the part of business managers that it is the use of an asset that contributes to the productivity, efficiency, and profitability of the firm rather than ownership per se. Thus, leasing is now viewed as an alternative to borrowing and/or using one's funds to acquire the use of assets.

A second reason for the increased attractiveness of leasing is the emergence of the "financial lease". Earlier leasing opportunities were primarily in the form of "operating leases" such as those offered by IBM for its computers and Xerox for its copiers. These leases are generally cancellable at the option of the lessee, require the equipment be maintained by the lessor-manufacturer, and are not fully amortized (i.e., the total payments to the lessor are less than the cost of the equipment), since the term of the lease is considerably less than the expected life of the asset. The financial lease on the other hand is made available by financial institutions or specialized leasing firms. These leases are not cancellable, do not provide for maintenance, and are fully amortized. The financial lease is arranged similarly to borrowing: First, the firm selects the equipment and negotiates the purchase price and other terms with the manufacturer as would be done if the asset was to be purchased. Then the firm arranges with the lessor to purchase the equipment from the manufacturer (rather than extending the funds to purchase to the firm) and executes a lease agreement with the lessor (rather than a note). The lease agreement will specify the term of the lease and the lease payments to be made. The lease contract must be carefully written in a form acceptable to the Internal Revenue Service or it could be deemed a form of installment note rather than a lease. The major requirements are that the term must be for fewer than thirty years, the lease payments must represent a reasonable return to the lessor (usually 8 to 15 percent), and no purchase option be granted to the lessee.

The availability of financial leases provides firms the opportunity to obtain control over a vast array of equipment types without actually buying the assets with borrowed or equity funds, and on terms often more favorable than those offered by operating leases.

The third and perhaps most significant factor leading to the expansion of leasing is the attractiveness of the alternative to both lessors and lessees. If financial institutions and leasing firms and the lessee firms did not find leasing arrangements to be mutually beneficial then the service would be neither offered nor desired. This article focuses on the potential advantages of the firm of leasing versus purchasing.

### The Lease or Buy Decision

The choice between leasing and purchasing is one of the most complex of all financial decisions. The complexity arises from the differences in the amounts and timing of certain cash flows unique to each alternative. It should first be recognized that certain flows will not be affected by the decision: additional sales revenues and operating costs (other than depreciation) are entirely the result of using the asset and will be the same regardless of whether the asset is leased or owned. The purchase of the asset, however, gives rise to certain cash flows which are unique to ownership: a cash outflow to purchase the equipment, and, if the firm is borrowing to support the purchase, a cash inflow in the amount borrowed and cash outflows to pay principle and interest on the note; and a cash inflow when the asset is sold at the end of its usefulness to the firm. Furthermore, a reduction in cash outflows for income tax payments will result as depreciation charges and interest are deducted as business expenses and if the purchase qualifies for an investment tax credit. If the asset is leased, however, the only unique cash flows are the outflows for the lease payments and the reduction in cash outflows for taxes resulting from the deductibility of the lease payments as a business expense.

A simple example will show the pattern of cash flows unique to each alternative: Assume a machine costing \$10,000 is to be acquired. The equipment has a 3-year useful life, as estimated market value at the end of the third year of \$1,000, and, if purchased, will be depreciated by the straight-line method. Furthermore, assume the asset does not qualify for a tax credit, the firm's marginal tax rate is 40 percent, and the firm will borrow \$6,000 for 3 years at 9 percent if the equipment is purchased. Finally, assume the machine can be leased for \$4,000 per year (which, incidentally, provides the lessor with a 9.65 percent return).

The purchase alternative involves an initial outflow of \$10,000 to purchase the equipment which is partially offset by the \$6,000 inflow from the lender. At the end of each of the three years, outflows of \$2370.33 are required to amortize the note. The interest portion of the annual note payments are tax deductible which results in a reduced cash outflow for taxes equal to the product of the firm's tax rate and the interest payment (i.e., 0.40 multiplied by \$540.00, \$375.27, and \$195.72 for years 1, 2, and 3 respectively). In addition, the annual depreciation charges of \$3,000 offer a tax savings of \$1,200 per year. Finally, a \$1,000 inflow will result from the sale of the machine at the end of the third year.

The leasing alternative requires a \$4,000 initial cash outflow for the first lease payment followed by \$4,000 cash outflows at the end of years 1 and 2. The firm's outflow for taxes however will be reduced by \$1,600 because of the deduction of the lease payments. Thus, the net cash outflows unique to the leasing alternative are \$2,400 initially and at the end of years 1 and 2.

The table below summarizes the net cash flows for the two alternatives:

Net Cash Outflows (Inflows) Unique to the Alternative

<u>Alternative</u>	<u>Initial</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>
Purchase	\$4000.	\$ 954.33	\$1020.22	(92.04)
Lease	2400.	2400.00	2400.00	-0-

The purchase alternative offers lower outflows in year 1 and 2 and an inflow in year 3. The lease alternative, however, offers a lower initial outflow. The relative attractiveness of the different cash flow streams depends in part on the opportunities the firm has for the use of the cash conserved in each period. The analysis of the value of the timing of the flows will not be presented here. Interested readers are invited to contact the author for information on this technique.

There are considerations other than the economic analysis of the net cash flow streams that can affect the relative desirability of the alternatives. These factors are discussed below.

Availability of Cash

A firm attempting to conserve cash and unable or unwilling to borrow the full amount needed to purchase the asset will often find leasing an attractive alternative to buying. If the annual lease payments are lower than the cost of the asset less the amount borrowed (if any), the initial cash drain on the firm will be less if it chooses to lease. In the simple example presented earlier, the \$600 lower initial cash outflow associated with the leasing alternative would be attractive to the firm attempting to conserve cash.

Effect on the Firm's Ability to Borrow

Lenders are generally aware that leasing results in a fixed claim on the firm's operating income (as does borrowing) and thereby reduces the firm's ability to service additional debt. Thus the effect of lease or buy decisions on future borrowing capacity depends in part on the before-tax amounts of fixed financial obligations

associated with each alternative. A purchase involving only owner's funds would obviously not involve fixed financial claims and would preserve the firm's borrowing capacity and could, if the asset acquired contributes to profits, increase it. However, if borrowed funds are used, the pre-tax claim on income is equal to the interest payment plus the before-tax amount needed to cover the principle payment with after-tax dollars (i.e., principle payment/(1-tax rate)). The pre-tax claim for leasing alternatives is equal to the annual lease payment. For our simple example, the claims on operating income for the borrow-to-purchase alternative are \$3,590.55, \$3,700.37, and \$3,820.07 in years 1, 2, and 3 respectively versus claims of \$2,400 in years 1 and 2 for the leasing alternative. Thus the borrowing capacity of the firm would be somewhat enhanced in years 1 and 2 and greatly enhanced in year 3 if the asset is leased rather than purchased.

Furthermore, leases will often impose less binding restrictions on further borrowing than will debt agreements. For example, many borrowing arrangements stipulate that future debt must be subordinated. If the corresponding lease contract does not require subordination, future borrowing terms could be more favorable if the firm leased rather than borrowed currently. Also, other restrictions imposed by lenders, such as limitations on dividends, new investments, or the sale of assets, appear less frequently in lease agreements.

#### Conclusions

The availability of the financial lease offers the businessman an alternative to purchase as a means of obtaining control over assets. This author believes that many more financial institutions will be marketing leasing services in the near future and that this increasing competition among the suppliers of leases will yield new forms of leasing and promote even better terms for the lessee.

The analysis of lease versus buy alternatives requires the projections of the net cash flows associated with and unique to each alternative. These cash flow streams are then evaluated relative to reinvestment opportunity rates, the firm's current and desired cash position, and the implications for future borrowing capacity. The analysis is quite complex in most cases but the potential impact of the decision on the firm makes the analysis mandatory. The author can provide references to analytical methods offered in the literature and assistance with the analysis, if contacted. A computer program designed to implement the analysis of the lease-buy decision has been developed by the author and researchers at Texas A & M University and Virginia Polytechnic Institute and State University and is available to interested firms.

A BUSINESSMAN'S GUIDE TO THE CONTROVERSY OVER DEMAND MANAGEMENT POLICIES IN

THE UNITED STATES: THE MONETARISTS VERSUS THE FISCALISTS

M. Dudley Stewart, Jr., Ph.D.

Director  
and  
Associate Professor of Economics and Finance

Introduction

There are two major competing theories with different demand management policies deriving from each.

On the one hand, there are the Keynesians, Neo-Keynesians, or so-called Fiscalists who believe that a capitalist economy is inherently unstable and, thus, requires federal government intervention by the use of countercyclical fiscal and monetary policies to provide for a full employment, noninflationary, growing level of output and income.

On the other hand, there are the Neo-Quantity Theorists or Monetarists who view a capitalist economy as being inherently stable—in the absence of federal government interference. For them, the conventional demand management policies carried out by the federal government are actually procyclical or destabilizing, not countercyclical or stabilizing. Thus, they argue that the federal government is the cause of most of our economic problems, not the cure.

Let us now examine each of these viewpoints in somewhat more detail.

The Fiscalist Position

The fiscalist position dates back to 1936 when the late Lord John Maynard Keynes (1883-1946), the renowned British economist, published his General Theory of Employment, Interest and Money.

The fiscalists argue that during periods of recession, the federal government should run appropriate budget deficits to stimulate aggregate demand in the economy. This, they say, can be accomplished by (1) increasing government expenditures, (2) reducing taxes, or (3) a combination of the two.

In addition, such fiscal policy action should be supplemented by easy money policies carried out by the Federal Reserve System, primarily via open market purchases of United States government securities. This increases the lending and investment capabilities of the commercial banking system that, in turn, expands the supply of bank credit and money. As a result, interest rates decline, thus causing increased investment expenditures by business firms and an increase in aggregate demand.

During periods of inflation, reverse fiscal and monetary policies are called for. The federal government should incur appropriate budgetary surpluses to reduce excess aggregate demand pressures in the economy. This is achieved by (1) reducing government expenditures, (2) increasing taxes, or (3) a combination of the two.

Additionally, such fiscal policy actions should be augmented by tight money policies undertaken by the monetary authorities, primarily by selling U.S. government securities on the open market. This reduces the lending and investment capabilities of the commercial banking system that, in turn, reduces the supply of bank credit and money. Interest rates rise as a result, thus causing business firms to reduce their investment expenditures and decreases aggregate demand pressures.

#### The Monetarist Position

The modern monetarist position dates back to the late 1950's when Dr. Milton Friedman, now retired from his position as Paul Snowden Russell Distinguished Service Professor of Economics at the University of Chicago, resurrected the Quantity Theory of Money in a form that has since received considerable support from within the economics profession. It might be added that he was the recipient of the 1976 Nobel Prize in Economics.

The monetarists argue that fiscal policy by itself, that is, in the absence of an accomodative monetary policy, has little or no net effect on total spending in the economy.

Further, they maintain that in contrast to the prevailing economic wisdom, conventional monetary policy is actually procyclical, not countercyclical as the fiscalists maintain. A major reason is the exceedingly long and variable lags associated with it. Indeed, they argue that monetary policy actions that result in frequent and abrupt changes in the rate of growth of the money supply are the single most important cause of economic instability—inflations and recessions—in our economy.

As to interest rate movements, they admit that they do act in accordance with the Keynesian theory—but only for approximately six months. After that they reverse their



directions because of inflationary expectations associated with easy money policies, and because of deflationary expectations associated with tight money policies.

Finally, the monetarists argue that there results a crowding-out effect when the federal government borrows to cover its massive deficit spending. The crowding-out effect refers to the belief that private borrowers are forced out of the credit markets, thus reducing investment expenditures on, say, new plants and equipment. This, in turn, offsets or even reverses the presumed stimulative effects of deficit spending.

### The Economic Policy Prescriptions of the Monetarists

What economic policy prescriptions do the monetarists propose? They are as follows: (1) Stop using conventional fiscal policy for economic stabilization purposes and balance the budget, preferably at a much lower level, (2) cease using monetary policy for economic stabilization purposes as it is conventionally carried out, (3) allow the free market to determine interest rate levels, and (4) go to an international system of cleanly floating foreign exchange rate, not the so-called dirty or managed float that now exists.

The monetary authorities, given the still relatively inaccurate art and science of economic forecasting, should adopt and adhere to the following fixed rule: Expand the money stock at a constant rate equal to the long run growth rate of real gross national product, say, between three and four percent a year—adjusted for long run changes in the income velocity of money. A rate greater than that would be inflationary. A rate less than that would be stagnating to deflationary.

### Conclusions

Of the two positions, this author believes that the monetarist view is the more correct one.

Although it is by no means perfect, it would appear that if their policies were followed, after a period of between three to five years, the economy would completely resume its noninflationary, long run growth path.

An important additional advantage would be that businessmen and consumers would be able to make their economic decisions under conditions of greater certainty.

Finally, although economic fluctuations would not be entirely eliminated, it is reasonable to believe that their number would be reduced and that their magnitudes and durations would be considerably lessened.

## THE COLLECTION OF DEBTS BY COURT ACTION

BY

Don A. Evans, J. D.  
Associate Professor of Administrative Services

When other debt collection methods fail, the final resort is the civil lawsuit. It isn't a very efficient collection medium—it's time-consuming and costly. Furthermore, success in court does not guarantee collection.

Solid proof of the existence of an account receivable will be required before a court will lend its assistance in the collection effort. A written contract signed by the creditor and by the debtor is useful. In cases where creditor and debtor have no written contract the creditor's books of account will be good evidence of the existence of the account, provided that these records are kept in a systematic manner. In any event, sound record-keeping is essential.

Certain types of contracts may not be enforced unless they are in writing and signed by "the party to be charged," that is, the debtor. Among these are contracts for the sale of land or an interest therein, contracts for the sale of goods for \$500 or more, contracts for the sale of securities, and contracts giving a creditor a security interest in personal property.

The average suit to collect a commercial claim is filed and heard in a state court. Suits to collect amounts of up to \$199.99 are filed in Justice of the Peace Courts. Suits to collect amounts of between \$200 and \$499.99 are filed in County Courts. In counties with County Courts at Law—including Nacogdoches and Angelina Counties—suits involving amounts of between \$500 and \$4999.99 may be filed in either the County Court at Law or the District Court. In counties with constitutional County Courts, such as San Augustine County Court may not hear cases involving more than \$999.99. Cases involving more than the maximum jurisdiction of the local County Court must be filed in District Court. If the object of the suit is repossession of property upon which the creditor has a security interest and the value of the property to be repossessed is more than \$500, the case must be filed in District Court.

The assistance of an attorney is mandatory in all but the smallest commercial collection cases, and is advisable in even the smallest. Payment arrangements must be worked out with the attorney. He may take the case on a contingent fee basis, in which his fee will be a percentage of the recovery, or he may wish to handle the matter on an hourly or flat-fee basis, in which case his fee must be paid even if there is no recovery. Most Texas commercial claims may, however, be filed as suits on sworn accounts. A plaintiff in such a suit may ask for a reasonable attorney fee as a part of his claim against defendant. If he prevails and is able to collect his judgment, the defendant will end up paying plaintiff's attorney.

The lawsuit begins with the filing of a complaint with the clerk of the court that will hear the case. The complaint must state the name and address of the defendant, a statement of the facts giving rise to plaintiff's claim against defendant, and a statement of the remedy plaintiff desires that the court award, which is monetary damages in the average commercial case.

When the claim qualifies as a suit on a sworn account—as most suits to collect accounts receivable do—the complaint should contain a sworn affidavit by the plaintiff that debtor truly owes the debt, and that he's been asked in writing to pay at least 30-days before the filing of suit, and that debtor hasn't paid.

When the objective of the suit is repossession of property upon which plaintiff holds a security interest, plaintiff must also file an application for a Writ of Sequestration with the court clerk. No repossession of goods which are located inside a building may take place without the reposessor having such a writ if defendant won't voluntarily give up the property.

The complaint must also be filed in a proper county. A commercial claim may be sued on either in the county where defendant resides, or in the county where the contract giving rise to the claim was made—it's plaintiff's choice.

The next step is the service of citation upon the defendant. An effort must be made to accomplish this in one of two ways: (1) a sheriff or constable may take the papers to defendant's residence and serve them upon defendant in person, or (2) the officer may mail the papers to defendant's residence by registered or certified mail to be delivered only to addressee. If neither of these methods results in good service, application may be made to the court for substituted service—service in such other way as the court feels will be successful. There must be successful service of citation, otherwise the court will have no jurisdiction over the person of the defendant and will have no power to hand down a binding judgment against him.

When defendant is a corporation, service may be made upon the corporate president, and corporate vice-president, or upon the registered agent which every corporation incorporated in or doing business in this state must appoint. Should service upon these persons be impossible, court permission may be obtained to serve the Texas Secretary of State.

If the defendant resides outside the state of Texas, he may be served out-of-state if the claim against him arises out of a contract made in Texas. If the claim against the out-of-state defendant arises out of a contract made outside the state of Texas, it will be impossible to sue him in a Texas state court under normal circumstances.

Once the defendant is served with citation, he must respond to it within a very limited time period. If the case is filed in District or County Court, the defendant must

respond by 10:00 AM on the first Monday, 20-days after service of the citation. If the case is filed in JP Court, he must respond by 10:00 AM on the first Monday, 10-days after service of citation.

Should the defendant not respond to the citation before the deadline expires, the plaintiff may move for a default judgment in his favor. The court schedules a hearing on this motion, which must be at least 10 days after the filing of the motion. At the hearing plaintiff must prove that he is entitled to default judgment. In suits on sworn accounts, where the complaint has been accompanied by the required affidavit and documentary proof of existence of the claim, the documents themselves prove the validity of the claim and the plaintiff need only prove proper citation and lack of response by defendant. If the suit does not qualify as a suit on a sworn account, the plaintiff must also prove the validity of his claim at the hearing.

The result of the hearing will be a default judgment against the defendant which will be very difficult for him to escape. Such a judgment may be overturned only if the court handing it down had no jurisdiction over the subject matter of the case, or if the citation was improperly served upon the defendant.

The defendant's response to the citation may take one of several forms—but ultimately, if he wished to defend himself, he must file an answer to the complaint, stating why he doesn't owe the debt plaintiff seeks to collect.

As a part of the answer, the defendant may file a counterclaim against the plaintiff, in which he claims that plaintiff has wronged him and entitled him to recovery of damages. The commercial counterclaim may be one or more of several contentions—that plaintiff violated the Federal Consumer Credit Protection Act or Texas Consumer Credit Code with respect to financial disclosures in the contract between the parties, or that the plaintiff has charged usurious interest, or that the plaintiff has committed deceptive trade practices against the defendant, or that the plaintiff is guilty of breach of warranty with respect to the goods sold, or the like.

Almost always, the answer will establish that disagreements as to the facts of the case exist between the parties, so that a trial will be necessary to resolve matters. This will be so, for instance, if the defendant says that he did not sign any contract with the plaintiff, or if he says the account is already paid.

On the other hand, if the parties agree upon the facts but only disagree upon how the law applies to the facts, a trial will not be necessary—the judge may dispose of the case by handing down a summary judgment. This can occur when the only issue between the plaintiff and the defendant is the legality of a contract provision, for instance.

In sequestration cases the procedure is a bit different. The court holds a hearing upon the application for a Writ of Sequestration soon after it has been filed. At this hearing, the plaintiff must show the court that he is entitled to repossess the property

in question under Writ of Sequestration. If the judge is convinced, he will issue the writ which must describe the property to be sequestered. The writ will require the plaintiff to post a bond in the amount determined by the court, to protect defendant against a wrongful sequestration. It will also state how much of a replevy bond the defendant must post should he desire to get the property back. The writ must also state on its face that the defendant is entitled to contest the validity of the writ by filing a motion to dissolve it with the court.

A copy of the writ is given to the sheriff or constable, who will then serve it upon defendant. The defendant must then either give up the property or post the replevy bond in the amount stated in the writ. If he gives up the property he may file his motion to dissolve the writ and get the property back.

Should he file a motion to dissolve the writ, a hearing will be held at which he may make his argument that the writ is unlawful. If he prevails he gets his property back; if he fails the sequestration stands.

When a trial is necessary the case is set for trial on the court calendar. It will come up quickly in JP Court, more slowly in County Court, and probably still more slowly in District Court. It will normally come up more quickly in small counties than it will in large counties.

The trial will be held before a jury if one of the parties requests a jury; there is no jury only if both parties don't want one. Use of a jury will, of course, make the costs of the trial greater. In District Court the jury will consist of 12 persons; in County Court and JP Court it will consist of 6 persons.

In the normal commercial collection case the trial, if one is needed, will be relatively short. The plaintiff must, of course, have the evidence at hand to establish the validity of his claim. Properly kept records and the contract signed by the parties should accomplish that. The plaintiff will know in advance the nature of the defendant's defense, and he should of course be prepared with evidence to refute it. If the defendant has made a counterclaim, the plaintiff will know the nature of it and should be prepared to refute it.

Ultimately the jury will resolve the disputed issues of fact. Ten of the 12 District Court jurors must agree to arrive at a verdict. Five of the six JP or County Court jurors must agree to arrive at a verdict.

Once the verdict is in and the judge has entered judgment upon the verdict, the judgment will become final unless one of the parties asks the trial court for a new trial, or unless one of the parties appeals.

Appeal from the JP Court lies to the County Court in any case involving \$20 or more. A new trial of the matter will be held in the County Court.

Appeal from County Court or District Court lies to the Court of Civil Appeals. Here the appellate procedure is quite elaborate and quite expensive. Such appeals must be based upon questions of law; one may not appeal from a District Court decision because the jury decided the facts improperly. One must appeal upon arguments such as that the judge wrongfully refused to accept evidence which should have been accepted, or that the judge wrongfully admitted evidence which should have been excluded. Perfecting such appeals requires many man-hours of work by an attorney and his staff, and it may also require the transcription by the court reporter of his notes on all that transpired at the trial, a task requiring many more man-hours of work.

Since under our judicial system the ultimate loser of a lawsuit is required to pay court costs, one must carefully consider the possibility of an appeal being in vain. The making of a frivolous appeal can be a most expensive sport.

A judgment becomes final either when the highest court which has jurisdiction to decide a case decides it, or when a lower court hands down a decision upon which the deadline for appeal has expired. A victorious plaintiff is not entitled to collect a judgment until it has become final.

If the defendant pays voluntarily, the matter ends at this point. If the plaintiff has been victorious in a suit on a sworn account, the defendant must pay plaintiff the amount of his claim, plus the fee awarded to the plaintiff's attorney by the court, plus the court costs, plus the fee of his own attorney. If the suit was not on a sworn account, the plaintiff must pay his attorney out of the proceeds of his recovery.

If defendant was victorious, plaintiff will collect nothing from defendant and will find himself saddled with the obligations of paying the court costs plus, possibly, the obligation of paying a fee to his attorney. (If the plaintiff's attorney handled the case on a contingent fee basis, however, he just won't get paid for his effort on this case.)

If the defendant made a counterclaim and was victorious upon it, the plaintiff might find himself owing a judgment to the defendant.

The defendant may make life difficult for the plaintiff by refusing to pay the judgment. Since a judgment is not self-executing, the courts acting alone will not force defendant to pay. The plaintiff and his attorney must do the hard work of forcing the reluctant defendant to pay up.

The plaintiff may deploy several weapons against the defendant to accomplish this. The law provides several ways in which the plaintiff may question defendant about the nature and whereabouts of his assets. Once assets are found, defendant may be compelled to produce them in court, where the sheriff may seize them under Writ of Execution and later sell them.

If the defendant has disposed of assets to third parties in order to put them out of the reach of creditors such as the plaintiff, the plaintiff may file suit against the third parties to recover such assets. If the third party paid a fair price for the assets, this can't be done unless the plaintiff can prove that the third party knew or should have known what defendant was up to. If the third party did not pay a fair price, though, the assets may be recovered.

If diligent detective work uncovers no assets that plaintiff can get to, the plaintiff must just sit and wait. He may file an Abstract of Judgment in the public records of every county in which defendant owns real estate, which will damage defendant's credit rating and prevent him from selling clear title to the property, but no more may be done. And, even this won't prevent defendant from selling clear title to his residence, if his residence is his homestead. In such circumstances plaintiff may take such comfort as he can from the fact that a Texas judgment is good for ten years, and may be renewed for subsequent ten-year periods.

The defendant's weapons for frustrating the plaintiff are two in number. First is that numerous assets of a Texas debtor may not be taken by his judgment creditors. Among these exempt assets are:

1. The debtor's paycheck, if he is an employee.
2. The debtor's welfare-state income, if any: Social Security benefits, unemployment compensation, welfare benefits, Workers Compensation benefits, and the like.
3. The debtor's homestead:

If he lives in the country, 200-acres of land with all buildings thereon.

If he lives in town, a lot worth up to \$10,000, not counting value of any buildings thereon, plus all of the buildings.

4. Up to \$15,000 worth of exempt personal property of a single debtor, and up to \$30,000 worth of said property for a married debtor, this including:
  - a. One automobile
  - b. One truck
  - c. Wearing apparel (including jewelry)
  - d. Furniture (including valuable antiques)
  - e. Tools of a trade or profession
  - f. Varying numbers of various domestic animals.

Note, then, that plaintiff must collect his claim out of debtor's non-exempt assets. These would include items such as bank accounts, accounts receivable, investment real estate, investment securities, second automobiles and trucks, and normally exempt property which debtor owns over and above the statutory exemption limits. (Thus, if he's single and owns \$100,000 worth of furniture, at least \$85,000 worth of it would be fair game.)

Defendant's ultimate weapon is the filing of bankruptcy. Space limitations do not permit going into detail about bankruptcy law and procedure. It suffices for the purposes of this article to point out that judgments for most commercial claims are dischargeable in bankruptcy. The major exception to this is the judgment for a debt which the debtor incurred by defrauding his creditor. It's also worthy of notice that when a businessman bankrupt is proven to have incurred even one debt by defrauding a creditor, he may be denied a discharge from all of his debts.

This very basic summary of the law of collection of claims in the courts has served its purpose if it convinces the reader that the civil lawsuit is a rather clumsy, time-consuming, and expensive method of collection. It will have a beneficial psychological effect upon the unsophisticated debtor, but the sophisticated debtor knows how to use the rules to frustrate his creditor. The two basic requirements for success in the use of this collection method are careful record-keeping and competent legal assistance. In hard cases, generous helpings of patience, persistence, the talents of a detective, and plain old luck till also help.

Ultimately, the best guarantee of collectibility of accounts is care in the granting of credit, and great care in performance of all legal obligations.

\* \* \* \* \*

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Source: "Money Management," Medical Economics, January 9, 1978, p. 67.



## THE VALUATION OF A RETAIL BUSINESS

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### Introduction

When an existing business comes up for sale, chances are that neither the seller nor the prospective buyer(s) has more than a vague idea of what a reasonable market value for it should be. One writer maintains that valuing a business is more than difficult; it is a kind of sophisticated guesswork. The purpose of this article is to aid the prospective small businessman with this problem.

### An Overview of the Valuation Problem

Regarding the purchase (or sale) of a going retail concern, what, basically, is being bought (or sold)? In essence it is (1) a definite group of assets and (2) a potential stream of earnings. Looking at the asset aspect of the acquisition, two problems face the buyer. First, he must somehow determine a value for those assets which he is considering acquiring. Second, he must account for whatever additional outlays may be required: Financing related to the ownership transition period, additional inventory and/or accounts receivable requirements, new signs and stationery, and the like are frequently needed. These must be considered a very real addition to whatever basic value has been established for the business in question.

### Acquisition of Assets

Assets can generally be classified as current or fixed. Current assets are those which are expected to be sold, depleted, or replaced within some fiscal time period, usually one year. Fixed assets are those having an expected life longer than one year. Generally, the majority of the assets involved in a typical retail situation are of the current type.

Current assets can be further broken down into such accounts as cash, marketable securities, accounts receivable, inventory, and various kinds of prepaid expenses. These are the accounts which will be of most importance to the buyer or seller of the typical small- to medium-sized retail store. However, the valuation problem is most likely to center on only two of these accounts, namely accounts receivable and inventory.

### Valuing Accounts Receivable

Basically, there are two objective methods available for establishing the quality of the accounts receivable that are to be sold with the firm. The first technique is the "aging" approach. This technique suggests that the interested party should note what kind of credit terms have been in effect. For example, the present owner might indicate that all accounts are 30-day accounts. The prospective buyer should then examine each account and "age" it. From this process, the prospective buyer can determine those accounts (both the total number and the dollar amounts) that are past due and how far past due they are. Usually some discount percentage is applied to each category reflecting varying degrees of risk of non-payment so that some risk-adjusted value can be determined. For example, a buyer might apply the following discounts:

5%	to those accounts	0-30	days of age
12%	to those accounts	30-60	days of age
20%	to those accounts	60-90	days of age
33%	to those accounts	90-120	days of age
50%	to those accounts	over 120	days of age

The above discount percentages are offered for purposes of example and do not represent hard and fast rules. Indeed, no such rules exist to our knowledge. The point is that some adjustment in the form of discounting should be made for the likelihood that some accounts will not be collected.

The second technique which is often used in helping establish the quality of a firm's accounts receivable involves computing the accounts receivable turnover for the firm. The objective of such a calculation is to determine, on average the number of times per year that the firm "turns over" its accounts. Presumably, the more rapid the turnover, the less risky are the firm's accounts. The calculation for accounts receivable turnover entails dividing the firm's total credit sales for the year by the average dollar amount of the firm's accounts receivable. For example, if last year's credit sales amounted to \$250,000 and the average dollar amount of accounts receivable was \$50,000, then the accounts receivable turnover would be five—five times per year ( $\$250,000 \div \$50,000$ ).

By itself, the accounts receivable turnover rate, five in this example, can provide only one bit of information. It can be used to indicate, on average, the number of days' accounts remaining outstanding for this firm. Simply divide five into 365 days per year. The indication is that, on average, the accounts in this hypothetical firm remain outstanding for 73 days ( $365 \div 5$ ). This, of course, can be useful in itself. If all the accounts are supposed to be 30-day ones, then it is obvious that many of the firm's accounts are past due.

The accounts receivable turnover rate can also be compared to the industry average. A number of publications are available that indicate what the "normal" accounts receivable turnover rate should be for the specific kind and size of retail outlet in question. This kind of comparison should give the buyer and seller additional insight into the quality of the accounts receivable associated with the firm.

### Valuing Inventory

Unless circumstances dictate otherwise, the usual approach for valuing inventory for going concern involves determining its current market value (replacement cost at wholesale). The assumption underlying this approach is that all inventory is fresh and salable. In those cases where the inventory has questionable value, the prospective buyer may need to obtain assistance from someone in the retail field who should know what the inventory is worth. Since merchandise varies so greatly and because any two cases are rarely alike, no "cut-and-dried" rules exist for valuing suspect inventory. The decision, unfortunately, is largely subjective.

One important consideration has to do with inventory levels. If a business changes hands near the end of the year, it may be that inventory levels are low because of seasonal selling and/or paring of inventories in anticipation of the annual property tax valuation process. In such a case, the buyer should keep in mind that the inventory he is buying will soon need to be supplemented if past sales levels are to be attained. Further, if the buyer plans to increase sales levels, then additional inventories will be necessary to support the higher sales levels. In either instance, the prospective buyer must account for an immediate need for working capital or external financing for purposes of building inventories and accounts receivable. Failure to account for such working capital requirements can result in the failure of the business before the new owner can get settled in.

### Valuing Fixed Assets

As indicated earlier, acquiring the typical small- to medium-sized retail business usually does not involve fixed assets to any great degree. Certain tangible fixed assets no doubt will be acquired such as store fixtures, cash registers, and, perhaps, even some sort of delivery vehicles. In such cases, it is necessary to subjectively evaluate the value of these assets, possibly bringing in an "outside expert" if the valuation process becomes difficult. A banker, for example, should be helpful in determining the current market value of delivery vehicles. Most bankers gladly offer assistance in such cases. Unfortunately, few going concerns are on the market for the value of their tangible fixed and current assets. Intangible assets include such items as goodwill, the value of the location, and whatever franchise(s) the seller may have generally establish substantial portion of the "value."

Goodwill involves whatever favorable image the seller has been able to develop over the life of the business. Undoubtedly, some retailers develop more goodwill than others; but, will it follow the store after ownership changes?

Sometimes the main thing going for a retail outlet is its location. A prospective buyer may expect to pay a premium for a business just because the location is currently very good or soon to be advantageous because of property re-zoning, new traffic flows, and so forth. Again, location is an intangible item, but nevertheless should be considered.

The same holds true for franchises which are to be transferred with the business to the new owner. Franchises, generally speaking, are those exclusive arrangements between some supplier and a retailer guaranteeing the retailer that he alone will have the selling rights to a particular branded product or service within some stipulated geographical area. If the product or service is generally well-received by the public, then such a franchise may command some premium over the basic selling price of the retail outlet.

A central problem associated with accounting for intangible assets is that much depends on what the new owner is able to do with them. The innovative new owner may parlay these intangibles into early and long-term profits, whereas a less-creative owner may never reach the potential afforded him. Because of the problem of valuing intangibles most firms must be valued on the basis of some expected level. Determination of this expected level of earnings requires an analysis of earnings, both past and present. Such analysis is named cash-flow analysis and involves both past and projected (pro forma) income statements.

The suggested cash flow analysis "earnings" approach is essentially when few or no tangible assets are involved, or if it is necessary to somehow account for certain intangible assets which are expected to accrue to the prospective buyer. With cash flow analysis, the prospective buyer treats the business in question as a "black box" into which cash must occasionally be deposited and out of which comes some net income. The valuation of this box becomes a matter of noting historically how much cash had to be spent versus the amount of cash returned. Furthermore, such expenditures and receipts must be predicted by the prospective buyer, for it is the retail outlet's future prospects which determine its value. The historical analysis is useful only as a guide.

A simplified income statement is shown in Figure 1. The basic accounts depicted in it will aid in valuing a business on an "earnings" basis.

FIGURE 1

INCOME STATEMENT FORMAT

Retailer "A"  
 Income Statement  
 Year Ending December 31, 1977

Sales

less Cost of Goods Sold

Gross Profit

less Operating Expenses (including owner salary but  
 excluding depreciation)

less Depreciation Expense

Operating Income

less Interest Expense (if any)

Earnings Before Taxes

In order to implement strict cash flow analysis for the firm, an adjustment to the income statement is required. Any depreciation expense is included as an expense for tax purposes, but does not actually reflect on out-of-pocket expenditure during the time period covered by the income statement. Thus, for a truer picture of what before tax cash-flows really are, the dollar amount of depreciation expense should be added back to the earnings before taxes number. The result is referred to as the before tax cash inflow. It is the projection of this figure that helps determine the value of the retail outlet when the cash-flow "earnings" approach is being used.

Once the before-tax cash-flow projections are made, all that is required is the application of some capitalization rate. This rate represents a discount factor that is used to determine the present-value of some stream of inflows across some specified time period. In other words, given an estimate of annual revenues (the firm's cash flows), the maximum price that the buyer should be willing to pay for those revenues is simply the function of the return required on that investment and the time frame of the revenue projection.

To illustrate this let us assume that the projected cash flows for a given firm are \$10,000 the first year, \$11,000 the second year, and \$12,000 in the third year, and that the prospective purchaser of the firm desires a 10 percent annual return on his investment. (This 10 percent required return is his capitalization rate). The appropriate valuation formula is  $V = R(1/1+c)^n$  where  $V$  = the maximum price he would be willing to pay,  $R$  = the annual cash flow projection,  $c$  = the capitalization rate, and  $n$  = the year in which a given  $R$  is to materialize. Application of the formula yields a maximum purchase price of  $10,000(1/1.10)^1 + 11,000(1/1.10)^2 + 12,000(1/1.10)^3 = \$27,188$ . It is important to note that although the projected cash flows total \$33,000, the maximum that the prospective buyer can pay is only \$27,188 if he is to achieve his required return of 10%.

It can be argued that the capitalization rate should reflect the degree of operating risk inherent to the business being evaluated. If the above firm were deemed very risky, a capitalization rate of, say 20 percent might be selected. The result would be a valuation of \$22,915 instead of \$27,188. The lower valuation has resulted due to accounting for risk in the selection of the capitalization rate.

The selection of a capitalization rate again represents considerable subjectivity. Sometimes it is helpful to use the returns available from other investment vehicles as a guide to the kind of capitalization rate appropriate for the valuation of a particular business. No two businesses are alike. And, no two investments are exactly alike. But to note that a prospective seller has set a price (for a risky business) such that the capitalization rate is implied to be 10 percent at a time when General Motors common stock is yielding 12 percent says something about the asking price for this risky business.

In most cases, the determination of an appropriate capitalization rate for the valuation of a small business is considerably less difficult than for a larger firm which draws its financing from a large group of equity owners. As long as the prospective purchaser is an individual, a partnership, or even a corporation in which the participants all plan to be active in the firm, the required rate of return and thus the appropriate capitalization rate is equal to the before-tax cost of available debt financing to the prospective purchaser. Although the financial academician might choose to belabor this contention as theoretically incorrect, the authors feel that within the restricted framework of this article it is easily defensible.

Justification of this position stems from the fact that as long as the purchaser is active in the business, his return is in the form of the salary requirements that he places on the business. The issue of determining the appropriate capitalization rate for an investment by a corporation funded by a group of absentee owners is complicated by the necessity of satisfying the demands of those owners by producing a rate of return sufficient to provide an acceptable level of dividends and/or earnings sufficient to promote growth in the per share price. This element is not a consideration for the small business where the owner(s) withdraws a salary from the firm. The dollar amount of his salary

requirements is simply determined and incorporated into the cash flow projection as an expense of the firm. As a consequence, the resultant net cash flow need only be sufficient to cover the requirements of whatever debt is employed or if no debt is employed, the benchmark would become the borrowing rate available to the firm if debt funds were to be obtained.

Furthermore, the maturity available to the small firm for such financing effectively establishes the other necessary factor in the valuation computation, namely the number of years over which cash flows must be projected. By using the number of years that sources of debt financing would commit funds to the firm or its purchasers as the time frame for the valuation computation the prospective purchaser avoids the assumption that projected cash flows can be accurately made into infinity.

The typical prospective buyer of a small business is interested in providing his basic salary requirements and being able to own the business debt free at the end of the loan period. Accordingly, it seems more than logical for him to value that business with those objectives in mind.

#### Valuation Checklist

By way of summary, the prospective purchaser of a small business should follow the checklist below in valuing the firm in question:

1. Establish a fair market value for the firm's inventory. Be sure to estimate additional or restocking requirements that will require you to invest money beyond the purchase price.
2. Develop a cash flow projection using past financial statements or tax return as a guide. Be sure to include your salary requirements in the expense section.
3. Determine the sources of debt capital available to you and the terms at which it is available. The rate of interest is your capitalization rate and the length of the maturity available becomes "n" in the valuation equation.
4. Discount the projected cash flow at the capitalization rate over the time frame established in step three. The resultant valuation is the maximum price you should be willing to pay for the firm.
5. Compare the valuation obtained in step four with the asking price after the latter has been adjusted for any additional capital requirements (i.e. additional inventories, etc.). If the valuation thus produced exceeds the asking price you have found a bargain. In the event that no asking price has been established, the valuation thus produced is of course the basis for your offering price and subsequent negotiations.

## SMALL BUSINESS INSTITUTE UP-DATE

Janelle C. Ashley, Ph. D.

Director of the Small Business Institute  
and  
Professor and Acting Head, Department of Management and Marketing

With only nineteen cases needed to complete the Small Business Administration contract for 1977-78, both student and business client interest have caused the Small Business Institute (SBI) case load to reach 27 for the Spring Semester, 1978. Over 100 students are participating in the traditional format, i.e., three to five students working as a team with an individual business under the guidance of a full-time faculty member. Three clients are working with larger student groups from classes in Advertising and Marketing Policy.

At this point in our program, we step back to reflect—to reflect on the need for the program and its effectiveness. These questions can be viewed from a client, a student-consultant, University, and/or faculty point of view. The SBI program, of course, was originally designed to provide new learning opportunities for students and faculty while making available to small businesses consulting services designed to their unique specifications. Through the SBI the University found a chance to extend its "public service" activities beyond the traditional academic boundaries. The Small Business Administration, all the while, saw the program as a further way to lever its scarce resources and thereby provide more and better advisory services. That the original needs still exist is quite evident. To answer the question of "effectiveness," however, we turn to those who are actively involved as participants.

SFA students participating in the SBI program as student consultants are much like their counterparts in this innovative program all across the U.S.A. They strongly endorse the value of the program. Over ninety percent of the students would recommend the program to other small businesses. They see a definite need for expansion of the SBI concept and certainly consider it a positive use of SBA resources. Students point to the benefit of learning about small business problems and the whole area of small business ownership and operation. Not only do they gain information enabling them to make more perceptive career choices, but they will know what to expect should they decide to become small business owners themselves.

SFA student opinions are often quite personal in nature. They see their efforts as a "real world" test providing positive reinforcement of the value of their entire business education. They cite more self confidence as a result of their SBI work. And an added benefit to the students is the experience of working with fellow students in a team approach to problem solving.



Business clients too support the hypothesis that the SBI approach at SFA is a viable and rewarding program. They recommend the experience for other small business owners, indicate their willingness to repeat the process, and profess satisfaction with the level of help provided by the students. SFA students have encountered problems in virtually all areas: accounting, finance, management, management information and marketing. Clients express confidence in their student consultants by their very willingness to reveal confidential details of their operations. This is followed by a high receptivity to implementing suggestions. In terms of impact, clients see the largest impact on operations, i.e., less immediate influence on sales, profit, or employment.

Other surveys on the impact of the SBI program generally agree that the approach is particularly beneficial to new businesses. That this is also true of the SFA program is evidenced by the following excerpts from two unsolicited letters following Fall, 1977 SBI team assignments.

"The SBI team assigned to help me for the fall semester 1977 was outstanding . . . They (the student team) spent many hours with me discussing options and making plans. With my limited funds, we were not able to incorporate many well thought-out options. Even with these financial restrictions, I have learned a good deal about business and advertising from the SBI team."

"They had a personalized, professional attitude and seemed to be genuinely concerned with helping the business. This professional attitude impressed me most. I feel their motivation was more than just taking a course and completing the requirements and their professionalism was carried through in their report . . ."

Another satisfied client writes:

"The service of setting up a bookkeeping system for our business turned out to be even more beneficial than we had expected . . ."

"The team was courteous at all times, were willing to listen to our difficulties, were not afraid to say they did not know the answer if they did not know it, and were quick to seek the answer to a question when they could not answer it."

"The report the team wrote was factual, accurate, and unbiased."

"We were very happy with the association we had with your SBI team. We will not hesitate to seek your help in the future when a need arises nor will we fail to recommend your services to anyone who needs help. You are providing the community of Nacogdoches with a very valuable service, as well as providing your students with valuable experience . . ."

Faculty members volunteer additional support for the SBI approach. They say:

"Not only my students, but I, learn a great deal from my work with the SBI program."

"I feel much more in touch today than ever with the business environment—more sympathetic to the real problems these practicing managers face."

"The reputation is growing each semester and more and more students are asking to be involved."

The step back to reflect, you can see, presents us a most positive image. There is a continuing need for the SBI program at SFA, and all who participate—students, clients, and faculty—stand to gain from the experience.

If you are interested in participating as a business client or learning more about the SBI program, please contact:

Dr. Janelle C. Ashley, Director  
Small Business Institute  
P. O. Box 9070; SFA Station  
Nacogdoches, Texas 75962  
Telephone: 713/559-3102  
713/569-4301

\* \* \* \* \*

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\* \* \* \* \*

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DEEP EAST TEXAS DATA



TABLE DET-1

VALUE OF BUILDING PERMITS FOR SIXTEEN COUNTIES IN DEEP EAST TEXAS:  
BY COUNTY SEAT AND LARGEST CITY

(In dollars)

County Seat and Largest City	Dec. 1977	1977	1976
Anderson Palestine	638,200	8,303,505	2,679,991
Angelina Lufkin	1,122,180	13,612,803	13,250,937
Cherokee Rusk	nil	na	867,900
Jacksonville	80,000	5,462,674	2,977,302
Houston Crockett	162,500	2,207,813	4,368,569
Jasper Jasper	825,500	2,603,305	na
Nacogdoches Nacogdoches	1,554,700	15,669,700	9,904,880
Newton Newton	na	na	na
Panola Carthage	100,000	1,961,280	1,577,850
Polk Livingston	44,750	na	4,575,831

Source: Bureau of Business Research. The University of Texas at Austin, Building Construction in Texas, Various issues.

na Not available

TABLE DET-1 (continued)

County Seat and Largest City	Dec. 1977	1977	1976
Rusk			
Henderson	382,500	na	5,715,541
Sabine			
Hemphill	na	na	na
Pineland	na	na	na
San Augustine			
San Augustine	68,000	155,900	100,600
San Jacinto			
Coldspring	na	na	na
Shepherd	na	na	na
Shelby			
Center	41,000	na	na
Trinity			
Groveton	na	na	na
Trinity	nil	581,824	na
Tyler			
Woodville	na	na	na

See source and footnote at the beginning of the table.

TABLE DET-2

## LABOR FORCE AND EMPLOYMENT ESTIMATES FOR SIXTEEN COUNTIES IN DEEP EAST TEXAS

(In persons)

County	Jan. 1978		Jan. 1978		1977		1976	
	Labor Force	Employment	Labor Force	Employment	Labor Force	Employment	Labor Force	Employment
Anderson	10,982	10,352	na	na	na	na	11,221	10,412
Angelina	22,487	21,502	na	na	na	na	22,413	21,320
Cherokee	14,557	14,039	na	na	na	na	14,174	13,454
Houston	6,722	6,497	na	na	na	na	6,787	6,515
Jasper	10,619	9,842	na	na	na	na	10,162	9,509
Nacogdoches	17,208	16,719	na	na	na	na	16,052	15,646
Newton	3,818	3,523	na	na	na	na	3,771	3,519
Panola	7,041	6,636	na	na	na	na	6,996	6,620
Polk	6,151	5,806	na	na	na	na	6,041	5,682
Rusk	17,566	16,835	na	na	na	na	16,465	15,691
Sabine	2,465	2,197	na	na	na	na	2,487	2,261
San Augustine	2,505	2,336	na	na	na	na	2,532	2,349
San Jacinto	2,224	2,073	na	na	na	na	2,256	2,130
Shelby	8,340	7,879	na	na	na	na	8,179	7,733
Trinity	2,783	2,693	na	na	na	na	2,837	2,725
Tyler	4,763	4,419	na	na	na	na	5,058	4,794

Sources: Texas Employment Commission, "Special Monthly Labor Market Information--Annual," n.d., various pages, U.S. Department of Labor, Bureau of Labor Statistics, Region Six, "Historical Report on Labor Force and Employment: Texas, February 17, 1977, n. pp., and Texas Employment Commission, "Labor Force Estimates for Texas Counties," various issues.

na not available

Note: These estimates are in the process of being revised to a new benchmark.

TABLE DET-3

## UNEMPLOYMENT ESTIMATES FOR SIXTEEN COUNTIES IN DEEP EAST TEXAS

(In persons, except as noted)

County	Jan. 1978		Jan. 1977		1977		Unemploy- ment	Unemploy- ment rate
	Unemploy- ment	Unemploy- ment rate	Unemploy- ment	Unemploy- ment rate	Unemploy- ment	Unemploy- ment rate		
Anderson	630	5.7	na	na	na	na	809	7.2
Angelina	985	4.4	na	na	na	na	1,093	4.9
Cherokee	518	3.6	na	na	na	na	720	5.1
Houston	225	3.3	na	na	na	na	272	4.0
Jasper	777	7.3	na	na	na	na	653	6.4
Nacogdoches	489	2.8	na	na	na	na	501	3.1
Newton	295	7.7	na	na	na	na	252	6.7
Panola	405	5.8	na	na	na	na	376	5.4
Polk	345	5.6	na	na	na	na	359	5.9
Rusk	731	4.2	na	na	na	na	774	4.7
Sabine	268	10.9	na	na	na	na	226	9.1
San Augustine	169	6.7	na	na	na	na	183	7.2
San Jacinto	151	6.8	na	na	na	na	126	5.6
Shelby	461	5.5	na	na	na	na	446	5.5
Trinity	90	3.2	na	na	na	na	112	3.9
Tyler	344	7.2	na	na	na	na	264	5.2

Sources: Texas Employment Commission, "Special Monthly Labor Market Information—Annual," n.d., various pages, U.S. Department of Labor, Bureau of Labor Statistics, Region Six, "Historical Report on Labor Force and Employment: Texas," February 17, 1977, n. pp., and Texas Employment Commission, "Labor Force Estimates for Texas Counties," various issues.

na not available

Note: These estimates are in the process of being revised to a new benchmark.



TABLE DET-4

RETAIL FOOD PRICE INDEX FOR HOUSTON: AUGUST, 1977<sup>a</sup>

(1967 = 100)

Category	Index Jan. 1978	Percent Change to January from:		
		Dec. 1977	Oct. 1977	Jan. 1977
FOOD	204.9	1.1	2.5	7.4
Food at home	197.1	1.2	2.6	6.7
Cereal and bakery products	189.5	1.9	6.2	7.0
Meats, poultry, and fish	191.1	1.8	1.3	6.6
Dairy products	190.2	0.4	3.8	4.7
Fruits and vegetables	199.9	0.2	3.9	5.5
Other food at home	212.5	1.2	0.9	8.4
Food away from home	232.2	0.8	2.1	9.8

Source: Bureau of Labor Statistics, Region Six, "Consumer Prices: January, 1978, p. 3.

<sup>a</sup>Used as a proxy for the cost of food in Deep East Texas.

TABLE DET-5

BUSINESS LOANS APPROVED UNDER ALL PROGRAMS, EXCEPT DISASTER, BY THE  
U.S. SMALL BUSINESS ADMINISTRATION FOR SIXTEEN COUNTIES IN DEEP  
EAST TEXAS, BY COUNTY SEAT AND LARGEST CITY: FISCAL YEAR 1976

(In thousands of dollars, except as noted)

County Seat and Largest City	Number	Total	Highest	Lowest	Average <sup>a</sup>
TOTAL <sup>b</sup>	70	5,439	375	5	77.7
Anderson Palestine	3	103	65	13	34.3
Angelina Lufkin	24	1,527	350	7	63.6
Cherokee Rusk	1	75	—	—	75.0
Jacksonville	1	76	—	—	76.0
Houston Crockett	7	723	250	13	103.3
Jasper Jasper	6	581	325	18	96.8
Nacogdoches Nacogdoches	8	722	251	13	90.3
Newton Newton	nil	—	—	—	—
Panola Carthage	2	360	310	50	180.0

Source: U.S. Small Business Administration, 1976 Annual Report, Vol. II: (Washington, D. C.: Government Printing Office, 1977), various pages.

<sup>a</sup>Rounded to the nearest \$100. Calculated by the SFA BBER.

<sup>b</sup>Calculated by the SFA BBER.

TABLE DET-5 (continued)

County Seat and Largest City	Number	Total	Highest	Lowest	Average <sup>a</sup>
Polk Livingston	2	175	175	70	122.5
Rusk Henderson	7	480	375	5	68.6
Sabine Hemphill	4	290	110	30	72.5
Pineland	1	40	—	—	40.0
San Augustine San Augustine	1	30	—	—	30.0
San Jacinto Coldspring	nil	—	—	—	—
Shepherd	1	35	—	—	35.0
Shelby Center	1	82	—	—	82.0
Trinity Groveton	nil	—	—	—	—
Trinity	1	70	—	—	70.0
Tyler Woodville	nil	—	—	—	—

See source and footnote at the beginning of the table.



TABLE T-1

## SELECTED INDICATORS OF TEXAS BUSINESS ACTIVITY

(Seasonally adjusted, 1967 = 100)

Index	Nov. P 1977	Oct. P 1977	Nov. r 1976	Year-to-Date 1977	Average 1976
Industrial Production	na	141.2	130.8	na	131.8
Electric Power Use	206.8	215.9	185.6	205.8	185.1
Urban Building Permits Issued	329.0	345.0	239.6	319.4	234.3
Commercial Bank Loans Outstanding	219.6	215.2	193.1	205.4	180.6
Nonagricultural Employment	151.5	150.7	146.2	148.9	143.9
Average Weekly Hours - Mfg.	99.2	98.9	98.0	97.2	98.4
Average Weekly Earnings - Mfg.	208.1	206.1	187.7	196.5	182.4

Source: Bureau of Business Research, The University of Texas at Austin, Texas Business Review, February, 1978, p. 49.

P Preliminary.

r Revised.

na not available.

TABLE T-2

## EMPLOYMENT ESTIMATES FOR TEXAS

(In persons, except as noted)

Item	Jan. 1978	Jan. 1977	1977	1976
Labor Force	5,904,900	na	na	5,535,000
Employed	5,580,200	na	na	5,217,000
Unemployed	324,700	na	na	318,000
Unemployment Rate	5.5%	na	na	5.7%

Sources: Texas Employment Commission, "Special Monthly Labor Market Information—Annual," n.d., p. 1, U.S. Department of Labor, Bureau of Labor Statistics, Region Six, "Historical Report on Labor Force and Employment: Texas," February 17, 1977, n. pp., and Texas Employment Commission, "Labor Force Estimates for Texas Counties," various issues.

na not available

Note: These estimates are in the process of being revised to a new benchmark.

TABLE T-3

PERSONAL INCOME IN TEXAS AND THE UNITED STATES:

December, 1976-77

TABLE T-3

PERSONAL INCOME IN TEXAS AND THE UNITED STATES:  
December, 1976-77

(In millions of dollars, except as noted)

Entity	Dec. 1977 <sup>P</sup>	Dec. 1976	Percent Change	Year To-Date	Percent Change
Texas	7,818	6,949	12.5	86,059	11.1
The United States	136,085	122,252	11.3	1,529,989	11.4

Source: Business Week, April 3, 1978, p. 100.

<sup>P</sup>Preliminary.

UNITED STATES DOMESTIC AND INTERNATIONAL DATA

Year	Domestic	International	Total
1977	1.11	0.12	1.23
1978	1.15	0.15	1.30
1979	1.20	0.18	1.38
1980	1.25	0.20	1.45
1981	1.30	0.22	1.52
1982	1.35	0.25	1.60
1983	1.40	0.28	1.68
1984	1.45	0.30	1.75
1985	1.50	0.32	1.82
1986	1.55	0.35	1.90
1987	1.60	0.38	1.98
1988	1.65	0.40	2.05
1989	1.70	0.42	2.12
1990	1.75	0.45	2.20
1991	1.80	0.48	2.28
1992	1.85	0.50	2.35
1993	1.90	0.52	2.42
1994	1.95	0.55	2.50
1995	2.00	0.58	2.58
1996	2.05	0.60	2.65
1997	2.10	0.62	2.72
1998	2.15	0.65	2.80
1999	2.20	0.68	2.88
2000	2.25	0.70	2.95
2001	2.30	0.72	3.02
2002	2.35	0.75	3.10
2003	2.40	0.78	3.18
2004	2.45	0.80	3.25
2005	2.50	0.82	3.32
2006	2.55	0.85	3.40
2007	2.60	0.88	3.48
2008	2.65	0.90	3.55
2009	2.70	0.92	3.62
2010	2.75	0.95	3.70
2011	2.80	0.98	3.78
2012	2.85	1.00	3.85
2013	2.90	1.02	3.92
2014	2.95	1.05	4.00
2015	3.00	1.08	4.08
2016	3.05	1.10	4.15
2017	3.10	1.12	4.22
2018	3.15	1.15	4.30
2019	3.20	1.18	4.38
2020	3.25	1.20	4.45
2021	3.30	1.22	4.52
2022	3.35	1.25	4.60
2023	3.40	1.28	4.68
2024	3.45	1.30	4.75
2025	3.50	1.32	4.82
2026	3.55	1.35	4.90
2027	3.60	1.38	4.98
2028	3.65	1.40	5.05
2029	3.70	1.42	5.12
2030	3.75	1.45	5.20



TABLE USD-1

## AGGREGATE DEMAND AND SUPPLY

(In billions of dollars)

Item	1977 <sup>P</sup>	1976	1975
Gross National Product in Current Dollars	1,890.4	1,706.5	1,528.8
Gross National Product in Constant (1972) Dollars	1,337.6	1,274.7	1,202.1

Source: The Federal Reserve Board of Governors, Federal Reserve Bulletin, February, 1978, p. A52.

<sup>P</sup>Preliminary

TABLE USD-2

## INDUSTRIAL PRODUCTION

(Monthly data seasonally adjusted, 1967 = 100)

Item	Jan. <sup>P</sup> 1978	Jan. 1977	1977 <sup>P</sup>	1976	1975
Federal Reserve Board Index of Industrial Production	138.6	132.0	137.0	129.8	117.8

Source: The Federal Reserve Board of Governors, Federal Reserve Bulletin, February, 1978, p. A46.

<sup>P</sup>Preliminary

TABLE USD-3

## MONETARY AGGREGATES

(Seasonally adjusted, in billions of dollars)

Item	Dec. 1977	Dec. 1976	Dec. 1975
Money Stock ( $M_1$ ) <sup>a</sup>	335.4	312.4	294.8
Money Stock ( $M_2$ ) <sup>b</sup>	806.5	740.3	664.3
Monetary Base <sup>c,d</sup>	140.0	115.5	108.5

Source: The Federal Reserve Board of Governors, Federal Reserve Bulletin, February, 1978, pp. A14 and A15.

<sup>a</sup>Demand deposits, plus currency and coin in circulation.

<sup>b</sup> $M_1$  plus savings and time deposits in commercial banks other than negotiable CDs of \$100,000 and larger.

<sup>c</sup>Total reserves of member banks plus currency and coin in circulation.

<sup>d</sup>Calculated by the SFA BBER.

TABLE USD-4

## STOCK MARKETS

Item	Dec. 1977	Dec. 1976	1977	1976	1975
New York Stock Exchange Index (Dec. 31, 1965 = 50)	51.83	56.34	53.67	54.45	45.73
Average Daily Volume (Thousands of shares)	21,475	23,621	20,936	21,189	18,568
American Stock Exchange Index (Aug. 31, 1973 = 100)	124.88	104.06	116.18	101.63	83.15
Average Daily Volume (Thousands of shares)	3,008	3,095	2,514	2,565	2,150
Standard & Poor's Corp. Composite Index of 500 Stocks (1941-43 = 10)	93.82	104.66	98.18	102.01	85.17

Source: The Federal Reserve Board of Governors, Federal Reserve Bulletin, February, 1978, p. A28.

TABLE USD-5

## EMPLOYMENT

(In thousands of persons, except as noted)

Item	Dec. 1977 <sup>a</sup>	Dec. 1976 <sup>a</sup>	1977 <sup>b</sup>	1976	1975
Civilian Labor Force	98,919	95,960	97,359	94,773	92,613
Employed	92,609	88,441	90,565	87,485	84,783
Unemployed	6,310	7,519	6,794	7,288	7,830
Unemployment Rate	6.4%	7.8%	7.0%	7.7%	8.5%

Source: The Federal Reserve Board of Governors, Federal Reserve Bulletin, February 1978, p. A47.

<sup>a</sup>Seasonally adjusted.

<sup>b</sup>Calculated by the SFA BBER.

TABLE USD-6

## PRICE INDICATORS

(1967 = 100)

Index	Dec. 1977	Dec. 1976	1977 <sup>P</sup>	1976	1975
Consumer Price Index	186.1	174.3	181.6	170.5	161.2
Wholesale Price Index	198.2	187.1	194.2	182.9	174.1

Sources: Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, February 1978, p. A46.

<sup>P</sup>Preliminary.

TABLE USD-7

## PURCHASING POWER OF THE DOLLAR

(Values rounded to nearest cent)

Index	Dec. 1977	Dec. 1976	1977	1976	1975
Consumer Price Index (1967 = \$1.00)	\$0.51	\$0.53	\$0.52	\$0.59	\$0.62

Calculated by the SFA BEER from Board of Governors, of the Federal Reserve System, Federal Reserve Bulletin, February 1978, p. A46.

TABLE USD-8

## INTEREST RATES AND YIELDS

Item	Dec. 1977	Dec. 1976	1977	1976	1975
Federal Funds Rate	6.56	4.65	5.54	5.05	5.82
U.S. Treasury Bills (3-mos.)	6.07	4.35	5.27	4.98	5.80
U.S. Government Bonds (10-yrs.)	7.69	6.87	7.42	7.61	7.99
Corporate Bonds	8.54	8.47	8.43	9.01	9.57
Conventional New Homes Mortgages					
Contract Rate	8.87	8.87	8.80 <sup>a</sup>	8.76	8.75
Fees and Charges	1.30	1.38	1.33 <sup>a</sup>	1.44	1.54

Sources: The Federal Reserve Board of Governors, Federal Reserve Bulletin, February, 1978, pp. A27 and A40.

<sup>a</sup>Calculated by the SFA BBER.

TABLE USI-1

## U.S. INTERNATIONAL TRANSACTIONS

(In millions of dollars)

Item	1977	1976	1975
Merchandise Exports	na	114,700	107,088
Merchandise Imports	na	123,917	98,043
Merchandise Trade Balance	na	-9,217	9,045
U.S. Direct Investments Abroad (net)	na	-4,596	-6,264
Foreign Direct Investments in the United States (net)	na	2,176	1,414

Source: The Federal Reserve Board of Governors, Federal Reserve Bulletin, February, 1978, p. A54.

na not available.

TABLE USI-2

## FOREIGN EXCHANGE RATES

(In dollars per unit of foreign exchange rounded to nearest cent or fraction thereof)

Currency Unit	Dec. 1977	Dec. 1976	1977	1976	1975
British Pound	1.85	1.68	1.74	1.80	2.22
Canadian Dollar	0.91	0.98	0.94	1.01	0.98
French Franc	0.21	0.20	0.20	0.21	0.23
German Deutsche Mark	0.46	0.42	0.43	0.40	0.41
Japanese Yen	0.004	0.003	0.004	0.003	0.003
Mexican Peso	0.04	0.05	0.04	0.07	0.08
Swiss Franc	0.48	0.41	0.42	0.40	0.39

Source: The Federal Reserve Board of Governors, Federal Reserve Bulletin, February, 1978, p. A68.



\* \* \* \* \*

Federal Regulation Costly to Families and Individuals

According to a recent study, Public and Private Expenditures for Federal Regulation of Business, by Washington University of St. Louis, Missouri, an average family of four had to spend over \$1,200 in 1976 to meet the cost of federal regulation.

The study examined six broad categories and only a limited number of federal regulatory activities. The compliance costs amounted to \$65 billion or 3.6 percent of the Gross National Product.

Data that would add billions of dollars more to such costs were not available for many of the major federal government regulatory activities.

Although the study discovered only the tip of the iceberg, it does apparently indicate clearly the adverse effects of such regulation on the economy.

Source: "Money Matters," The Houston Post, February 4, 1978, p. 1C.

\* \* \* \* \*

Fiedler's Basic Principle When Presenting a Forecast:

"Give them a number or give them a date, but never both."

\* \* \* \* \*

Martha's Maxim:

"If God had meant for us to travel tourist class, He would have made us narrower."

\* \* \* \* \*

\* \* \* \* \*

Dietz's Law of Ego: "The Fury engendered by the misspelling of a name in a column is in direct ratio to the obscurity of the person mentioned."

\* \* \* \* \*

The 1977-1978 Directory of Texas Manufacturers, a two volume set, may be purchased for \$40.00 (Texas residents add five percent sales tax) from:

Bureau of Business Research  
The University of Texas at Austin  
Austin, TX 78712

Telephone: 512/471-1616

\* \* \* \* \*

Van Nortwick's Law of Ego: "When your name appears in public print, the persons you would like to see it are out of town or do not read the paper that day."

\* \* \* \* \*

#### Federal Income Tax Returns Audited in 1976

In 1976, the Internal Revenue Service audited 1,887,521 returns, collecting \$1.3 billion.

The average assessment for the United States was \$704 and ranged from a low of \$317 in Vermont to a high of \$1,902 in Wyoming. For Texas, the average amount was \$826.

Source: Internal Revenue Service as cited in Medical Economics, January 23, 1978, p. 236.

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