THE ABC STATION PACKAGE LIQUOR AND GARAGE STORE

PREPARED UNDER THE DIRECTION OF PROFESSOR CHARLES WAGNER TO SATISFY THE REQUIREMENTS FOR MBA 299

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WAYNE R. PADRONO
The ABC Station Package Liquor and Garage Store was started in 1967, as a combination service station and grocery store. In August of 1973, the liquor store was added. It is located on the fringe of the ghetto area and near a private university. Mr. Jack Jones is the owner and Mr. Al Jones, his son, is the manager of the store. They employ fifteen people, three of which are part-time. It is a proprietorship which uses the Cash Basis Method of Accounting. Al retains a CPA to prepare the company’s income tax returns as well as to prepare operating statements on a quarterly basis. The CPA is having trouble getting the proper figures on a timely basis and as a result operating statements are prepared only once a year on the same date as the income tax return. Since Al doesn’t have a background in accounting, it is difficult for the CPA to explain to Al what he needs and the procedures to use to provide him with the information needed.

The grocery store and the service station are open from 6:00AM - 1:00 AM. The liquor store is open from 10:00 AM - 1:00 AM. Al purchases his liquor every Monday morning to be picked up the following Wednesday. These orders are not subject to any quantity discount. He is a very hard worker putting in 60 - 100 hours per week! For this reason he might consider selling the business in 5 years. He is involved in every operation of the business and virtually makes all the decisions.

Their market is the packing house workers and Negroes who pass by going to work as well as the older people in the vicinity.
They usually purchase no more than they can carry. It is the only store of that type in the area. Al advertises pretty heavily in several local newspapers and on radio stations.

He is quite proud of the speed with which he can pay off his trucks and equipment. His goal for next year is $1,000,000 in sales. He also sees no reason why in the near future both his father and himself cannot earn $30,000 per year, about three times what they are presently drawing as a salary.

On November 29, 1973, Jack contacted the Small Business Administration (the company has a loan with them) requesting help in the area of inventory control. Through the SBA's association with a private university, a counselor was assigned to the company on July 17, 1974, as a fulfillment of one of his requirements for his MBA degree.

From the counselor's initial interview with Al and his father, Jack, then strictly with Al, he realized that Al had more problems than just inventory control. These are enumerated as follows:

1. **Inventory control for the Service Station (Grocery Store).**
   Al marks everything up in this area 40%. He felt that he wasn't making the gross profit that he should. Since he was confident that he didn't have a problem with employee theft, he thought perhaps there might be a problem with shoplifters. Convex mirrors are at the end of each aisle and the more valuable merchandise is secured behind locked glass doors. The merchandise is
stamped with a price and there is a camera pointed at the cashier counter. The whole area can be readily observed by the cashier.

2. **Inventory control for the Liquor Store.**
   Al could tell by looking at the shelf stock and working with it every day whether the inventory level was proper or not and the quantity to order. He realized that he was the only person with this knowledge; therefore, he was concerned with what would happen in his absence.

3. **Future planning for fixed asset repair and replacement.**
The counselor felt that there was also a problem in Al's philosophy concerning the purchase of fixed assets. Al was quite properly concerned about paying off the fixed assets as quickly as possible; however, the counselor felt that there was not enough emphasis given to the question of where will the money come from to repair and replace these assets in the future? The firm is using the Cash Basis method of accounting.

4. **Financial Statements are not received from his accountant on a regular basis.**
   Neither Al nor his employees have the time and/or the capabilities to submit accounting information on a timely basis to his accountant.

5. **If the business continues to grow, the Cash Basis method of accounting may not be the best method of accounting to use.**
As the business grows and gets more complex, the Cash Basis method of accounting may not be sophisticated enough to present the proper financial picture of the company.

6. **Insufficient delegation of authority.**

The counselor felt that the most serious problem was in this area. Al tries to handle too many of the details of running the business himself. As a result, the operation literally falls apart when he is gone for any period of time. The manager of the garage has been with Jack for twenty five years and as a result has a free hand in running it.
TEACHING NOTE

I OBJECTIVES OF THE CASE — To give the student insight into the problems of a small struggling business. They should be able to recommend solutions that fit the resources and for the most part the abilities of the people involved. They must in their recommendations distinguish between an ideal "book" solution and a more practical solution under the circumstances.

II ISSUES OF SIGNIFICANCE --
A. Inventory control for the Service Station (Grocery Store).
B. Inventory control for the Liquor Store.
C. Future planning for fixed asset repairs and replacement.
D. Financial statements are not received from his accountant on a regular basis.
E. If the business continues to grow, the Cash Basis method of accounting may not be the best method of accounting to use.
F. Insufficient delegation of authority. The case should more properly be used in a management course but not at the introductory level.

III STUDENTS PREREQUISITES FOR USING THE CASE EFFECTIVELY --
Introductory courses in management and accounting.

IV REFERENCE MATERIAL -- None
V WORDS TO CLASSIFY AND INDEX SUBJECT MATTER OF CASE —
Small business - typical operation problems.

VI ANALYSIS — The problem of a time consuming inventory system encompassing all of the merchandise vs a procedure of test checks to indicate an inventory problem (if you will, management by exception).

A problem of Al trying to handle too much of the details of running the business himself vs the developing of competent people to do some of the detail work and the willingness of Al to relinquish some of his duties and to trust in other individuals.

VII RECOMMENDATIONS — (Numbers correspond to problem areas under the history of the company)

1. Add signs warning against shoplifting, inventory at retail once a month, have the cashier greet the customers (at least new customers) and instruct employees on a regular basis on what to do when they catch a shoplifter.

(a) Install a couple of signs warning against shoplifting indicating that anyone caught shoplifting will be prosecuted.

(b) Inventory at retail once a month to determine if the gross profit is approximately 40%.

(c) Have the cashier ask, especially an unfamiliar customer, "may I help you?"
(d) Instruct your employees on a regular basis as to what to do when they catch a shoplifter.

2. **Inventory once a week prior to placing an order.**
   Al purchases his liquor every Monday morning to be picked up the following Wednesday. These orders are not subject to any quantity discount. I would recommend that an inventory be taken every Monday morning just prior to the order and recorded on the appropriate sheets, one for each supplier. The column headings for these inventory sheets should be as follows: **Inventory Date**, **Quantity Ordered** **Number**, and **Inventory Date**. Also, record any items backordered from previous orders. I believe the time spent will be well worth the effort, since you are dealing with a relatively small number of items that are of high value. In addition, if Al for some reason would be absent from work on a Monday, there would be sufficient information present for someone else to place the order. The above procedure, however, would not control inventory. Periodically, if the cashier would keep a running record of sales by bottle size, case, brand, etc., then that category could be reconciled at the end of the week to determine if there is an inventory problem.

3. **Allocate a sum of money each month for fixed asset repair and replacement.**
   One of the goals expressed by Al was that of earning a greater salary for himself and his father based on the
increasing profits of the business, which certainly is understandable and quite a legitimate goal. However, I see a danger of increasing ones standard of living based on an increase in profits without adequate planning for the future repair and replacement of the buildings, trucks, equipment, etc. As you may recall the company is on a Cash Basis method of accounting and as a result funds are not "restricted" for repairs and replacement of fixed assets via the depreciation charges. I would strongly suggest that a certain sum of money be set aside each month, perhaps based on a percentage of profits, prior to any determination of salary increases.

4. Al and/or his employees must make the time and acquire the skills to submit to his accountant the information he needs by the date required, otherwise, a bookkeeper should be hired.

For control purposes, it is very important that Al receive financial statements by department monthly, if possible, or at least quarterly. When times are good and sales increase month by month it isn't readily apparent of the necessity to have reports on the financial condition of the business. However, when the business turns around and sales start to drop, at that time the necessity of financial statements becomes apparent, but in many cases it's too late! A company that is operating without any formulated financial reporting system could be compared to a runaway horse with
no one at the reins - out of control! In order for the accountant to submit on a regular basis financial statements by department, it is necessary that someone with the appropriate capabilities take the time and effort to prepare the records needed by him. If no one is available with the time or capabilities to do this I would strongly suggest that a bookkeeper be hired.

5. Al should make himself aware of the advantages of the Accrual method of accounting so that when the time comes the proper decision can be made.
As the business grows and becomes more complicated, Al should be aware that there is a more sophisticated accounting method called the Accrual method of accounting. By using this accounting method you more properly match the costs incurred against the revenues generated to arrive at a more accurate and realistic profit figure.

6. Develop managers for each store.
Al tries to handle too many of the details of running the business himself. He must realize that control can still be maintained after he delegates some of the detailed work to others. It is a problem of education and training the people under him, as well as having the proper checks against which their efforts can be judged. I envision the organization chart as follows:
I believe the garage pretty well runs itself now, so that an individual must be developed to manage the Liquor Store and the Service Station.

Let's take the Service Station (Grocery Store). I am assuming that Al now receives from his accountant a monthly income statement. If the gross profit does not approximate 40% something is wrong and it must be checked out. I'm also assuming that my suggestions concerning inventory control have been implemented, which would allow Al to arrive at a realistic gross profit figure. Furthermore, various financial ratios and expense ratios should be developed to use as guides against which the performance of the manager could be judged.

Insofar as the Liquor Store is concerned, assuming that my suggestions for inventory control were followed, there would be sufficient information available for someone else, other than Al, to place the order. The store is small enough that Al can "eyeball" the stock on hand periodically to determine any inventory problems.
QUESTIONS TO BE GIVEN STUDENTS

1. What practical inventory methods could be utilized for the Service Station (Grocery Store)?

2. What additional precautions could be taken against shoplifters in the Service Station?

3. What practical inventory methods could be utilized for the Liquor Store?

4. Is Al properly providing for the future repair and replacement of the fixed assets?

5. How can the correct financial figures be submitted on a timely basis to Al's CPA?

6. Why would it be better to use the Accrual Basis of accounting if the business continues to grow?

7. What can Al do to relieve himself from some of the details of running his business?

ANSWERS

1. Al could inventory once a month at retail to determine if the Gross Profit approximates 40%. This would be a fast and effective way to handle this problem. Only if the gross profit was substantially different than 40% would Al pursue this problem any farther.

2. The additional precautions are as follows:
   a. Install a couple of signs warning against shoplifting indicating that anyone caught shoplifting would be prosecuted.
b. Have the cashier ask, especially an unfamiliar customer, "May I help you?"

c. Instruct the employees on a regular basis as to what to do when they catch a shoplifter.

3. Al could take an inventory every Monday, just prior to placing an order, on the appropriate inventory sheets for each supplier headed up as follows: Inventory Date, Quantity Ordered Number, and Inventory Date, making sure to indicate any backordered items from previous orders.

4. Al is considering raising his salary as well as his father's based on the expected "extra" cash available because most of the fixed assets have been paid for. To me this is very short sighted. He should deduct an appropriate amount each month from his cash balance which should be reserved for fixed asset repair and replacement before any consideration should be made on salary increases.

5. Al lacks the accounting background necessary in this specialized area to report the correct figures to his CPA on a timely basis. My recommendation would be to hire a bookkeeper.

6. By using the Accrual method of accounting you more properly match the costs incurred against the revenues generated to arrive at a more realistic profit picture. As the business continues to grow this becomes more important from a control standpoint.
7. Al should develop managers for each of his store to relieve himself of some of the details. As long as he has followed my suggestions concerning inventory control, the proper controls exist to judge the actions of his managers. The point that cannot be emphasized too strongly is that the managers of the various stores must be given the freedom to make mistakes - but must learn from them. They may not choose the same methods that you would have chosen, but this is immaterial as long as the goals are reached. They, in fact, may do a better job than you could do simply because they have more time to devote to their individual problems than you would have been able to devote because of your responsibilities to all three store. This would in fact be a way to improve your management capability for to manage is nothing more than getting work done through others.