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A Case Study of Combination of Closely Held Vending Corporations in Transition to Public Ownership.

James Leroy Caldwell

Louisiana State University and Agricultural & Mechanical College

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A CASE STUDY OF COMBINATION OF CLOSELY HELD VENDING CORPORATIONS IN TRANSITION TO PUBLIC OWNERSHIP

A Dissertation

Submitted to the Graduate Faculty of the Louisiana State University and Agricultural and Mechanical College in partial fulfillment of the requirements for the degree of Doctor of Philosophy in

The College of Business Administration

by

James LeRoy Caldwell
B.S., Louisiana Polytechnic Institute, 1951
M.B.A., Louisiana State University, 1953
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ABSTRACT

This study traces the early phases of evolution of Venda-Craft, a corporation created as a holding company to exchange its common stock for all the stock of four industrial vending groups consisting of nine corporations. Emphasis is given to the managerial structure of the holding company, its operational problems, and its financial planning.

Venda-Craft was created as a stage in the transition from private to public ownership of the operating companies. The transition is sought by the promoters for liquidity of investment and stock market profits.

Economies of operation are also sought although the desire for maintaining maximum autonomy of the operating units influenced the development of a highly decentralized structure for the holding company. The structure of each operating unit reflects the strong leadership of the promoter who developed it and is now combining it with others through the holding company.

An immediate offering of common stock of Venda-Craft was anticipated by the promoters. The stock market slump in 1962 and the lack of clearly defined plans for the use of proceeds of the proposed sale caused the issue to be postponed indefinitely.
Forces other than promoters' objectives had a part in determining the form of Venda-Craft. The experience and background of the promoters as practical businessmen, and their personal traits of leadership are reflected in the organizational structure. Recommendations by consulting specialists, and conscious application of management, financial, and accounting theory contributed to the solutions of many problems. In some instances, leadership of other established vending companies was used as a guide but techniques and policies of other companies were modified for application to Venda-Craft. In determination of pricing policy, creative innovation was used. External factors such as the stock market and both state and Federal tax policy influenced the form and policies of the holding company.

In order to develop a basis for comparison, operating data were collected on six leading vending companies. Although the sample was limited, the range of sales volume, age, and previous history implies a broad look at representatives of the national vending industry. Despite their diversity of scope, similarities in operating figures indicate the presence of industry characteristics. Similarities were found in the proportion of debt to equity, the relationship between current assets and fixed assets,
the margin of profit after taxes to net sales, the typical current ratio, the price earnings ratio at which vending stocks sell on the market, and the ratio of market price of stocks to their book value. Present structure and operations of Venda-Craft were compared with the norms developed from statistics of the six companies.

With plans for the stock offering postponed, financial emphasis is shifted to improving operating results. A four year plan was developed to bring the operating results of Venda-Craft into closer alignment with results shown by the industry leaders. The ability to improve results is essential for the eventual transition to public ownership at a price acceptable to the promoters. Successful operation must be demonstrated by the holding company before the final objectives of the promoters can be attained.

This study traced the development of one company as a study in the applications of contemporary management theory and practice. The results obtained are not universal in their application but indicate techniques and an approach for analysis of the development and operation of other firms.
CHAPTER I

INTRODUCTION

The creation of a business enterprise is a complex activity requiring the successful uniting of the diverse functions of production, sales and finance into a properly balanced entity. It is a time-consuming process requiring careful consideration of the items to be included and the manner in which these items are combined to create the firm. From the original conception of the idea, the entrepreneur must progress along an orderly path, accomplishing by a progression the various phases of activity which lead to an operating enterprise. The path is not always the entrepreneur's own choosing. Trade custom, legal requirements, and tradition influence decisions. The failure to recognize problems or the failure to provide for their sound solutions is a major cause of the heavy mortality rate among business firms. In reporting on 17,075 firms which failed in 1961, Dun and Bradstreet cited lack of managerial experience as a major contributing factor in 17.2% of the failures. Managerial incompetence caused the failure of an additional 44.4%.

It is true that sometimes a business can be successful despite a lack of planning, but such cases are rare. They depend to a large extent on outside conditions giving them a windfall advantage or success being attained by laws of chance. The entrepreneur is not a gambler who is willing to entrust his funds simply to fate or luck. He is willing to take risks when he believes that he can minimize these risks by use of controlled conditions and to this end, he acts to eliminate difficulties and provide solutions for problems.

The first five years constitute the most crucial period during which the plans of the entrepreneur, and his solutions to problems, must prove to be effective. Out of the 17,075 companies reported by Dun and Bradstreet as having ceased operations in 1961 because of business failure:

- 19.8% were two years old or less
- 36.8% were three years old or less
- 56.2% were five years old or less

During this critical period when organizational structures are being solidified and operating policies are being formulated, the entrepreneur must find much of this guidance from outside the firm. The lack of direct experience with the firm forces him to rely on his own experience in other firms and his knowledge of the principles and applications of management theory.

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2 Dun and Bradstreet, op. cit., pp. 10-11.
Increasing probability of success requires careful planning. A statement of the objectives of the firms, a decision as to the type of organization to be employed, an estimate of the capital requirements, an exploration of sources for obtaining the needed capital, an evaluation of the market for the particular product or service being offered, an estimate of the cost of operations, and an estimate of expected profit comprise a basic planning program. As a final check, the expected profit should be weighed against the probability of failure to ascertain if the risk factor justifies the investment. Most of required information is based on predictions in which some margin for error must be allowed. Even though the investigation requires much subjective judgment by the entrepreneur, the effort to quantify forces him to consider the factors in concrete rather than abstract terms and increases the probability of success.

**Statement of the Problem**

This is the study of one stage of the transition of a group of closely held corporations to public ownership. The organizational device used to effect the change of ownership is a holding company which will acquire all stock of the operating units. The objectives sought through the combination, the
reasons for the selection of the holding company as the device of transition, and the problems encountered in preparing for the transition will be explored. Major emphasis will be on financial and organizational problems in an effort to evaluate their solutions when viewed in the light of established practice or sound management theory.

Scope of the Problem

A concrete discussion of the process of creating a business concern cannot delve into the specific problems or organization without discussing a specific firm. The evolution of each company is different because it transpires at a different place, at a different time, with different factors of physical assets and people, and for different objectives. The firm which emerges is the result of custom building rather than coming from an assembly line process. Yet even with this diversity of nature, the basic rudiments are quite similar. This rudimentary nature will be illustrated through birth and evolution of a business corporation, using the illustration as a case study from which parallels may be drawn and applied to other companies. The study will attempt to show the basic objectives to be gained, the major problems encountered in reaching these objectives,
and the solutions to the problems. To this extent the study will be descriptive. But it will also be analytical. Alternative actions will be studied and an attempt will be made to show that final actions rest solidly upon theoretical concepts of management and represent application of these concepts to an actual situation. The legal and social forces affecting the corporation will be studied to determine how they affected the final form of the emerging company.

The company used to illustrate the process of development is a Georgia chartered corporation created as a holding company to effect the combination and integration of activity of a group of operating vending corporations through complete ownership of their stock. In order to protect the companies against disclosure of information of a confidential nature which was made available to the writer for use in the study, the names of all companies involved in the venture are fictitious.

The events which are described are factual and have already occurred up to and including the chartering of Venda-Craft. The events and forces which shaped the final form of the company are described and analyzed. As the company begins operation, programs are being developed and additional plans are being made.
As a part of this planning, the writer compiled data on expected future operations of Venda-Craft, determined the effect which these plans would have on future financial needs, and developed a financial program which the company should seek to accomplish by the end of fiscal 1965. The validity of the goals was checked against operating statistics compiled from a group of national vending companies. It is gratifying to the writer that the promoters of Venda-Craft have reacted favorably toward the comparison and the established goals and are using them as a part of the company's financial planning.

Premises Used in the Study

The following basic conditions are stated as being present:

1. The individual operating companies are too small individually to market a public stock issue.

2. The companies involved are closely held but the owners desire to create a wider market for their securities.

3. There is a desire by the present owners to maintain autonomy of operations but still reduce unnecessary duplication of business activities.

These premises are definitely understood by all of the promoters as being the most basic foundation upon which agreement can be reached as to the need for combination and as to the type of combination which should be utilized.
**Delimitation**

This is a study of the creation of a holding company as a device for effecting the transition from private ownership to public ownership of the combining units. No presumption is made that the technique selected by the promoters is the only suitable technique or that it is the most desirable for all companies. The study will not explore comparatively the effectiveness of all devices or forms which might be used under all circumstances but will be restricted to the holding company as a form for simultaneously overcoming the obstacles and meeting the objectives of the entrepreneurs in their decision to prepare their companies for eventual public ownership. It will, however, include comparative analysis of the holding company with other forms to indicate the special advantages which the holding company has in attaining the objectives sought specifically by these companies in their combination.

**Approach to the Problem**

This study rejects the broad generalizations of the earlier Universalists who sought verities of organization which were equally applicable to all businesses without regard to size, environment, or type. Instead, it relies upon contemporary
writers who are seeking specific concepts even if their application becomes more restricted. Ernest Dale, a proponent of specific application, suggests that concepts of organization have greatest meaning when cases to which they are applied are grouped both by type and size of company, and more importantly, by objectives. On this basis, successful executives have:

... ordered their resources so as to be able to reach their objectives within the framework of the law and existing social, human, and public conventions... 

They did not regard the division of work and work assignment as predetermined, but rather as dependent on their objectives. For them, organization was like a road to market or a tool with which to build.

They treated organization as an art rather than as a science. True, they tended to classify types of work and to postulate hypotheses or "criteria" of organization. But their classifications and hypotheses were based on the technology of the industry, on the environment of the company, and especially on the changing personalities of top management. Their hypotheses are approximations and guides, applied with flexibility, rather than universal principles enforced regardless of circumstances and objectives. They are frameworks designed to meet change and in practice were continually modified.3

Expressing a similar view of the function of organizational planning, Koch says:

To the forward thinking practitioner of organization and control, it is not so important to adhere strictly to universal traditions, nor to achieve rigorously the logical positivism of the behavioral scientists. What is important is to face up to and solve the organizational problems of growth in response to change. 4

The development of a system of organization for use in a new and dynamic business does not rest so much upon traditional concepts of an "ideal" structure as it rests upon a conscious effort to meet objectives. It is a plan for grouping activities and securing the cooperation of the personnel who will undertake them. Barnard states:

The persistence of cooperation depends upon two conditions: (a) its effectiveness; and (b) its efficiency. Effectiveness relates to the accomplishment of the cooperative purpose, which is social and non-personal in character. Efficiency relates to the satisfaction of individual motives, and is personal in character. The test of effectiveness is the accomplishment of a common purpose or purposes; effectiveness can be measured. The test of efficiency is the eliciting of sufficient individual wills to cooperate. 5


Going further than the Universalist theories, organization is concerned with answering the following important questions:

1. What are the strategic parts of the system?
2. What is the nature of their mutual dependency?
3. What are the main processes in the system which link the parts together and facilitate their adjustment to each other?
4. What are the goals sought by the systems?\(^6\)

Koch indicates three approaches taken by contemporary literature in viewing the problem of organization:

1. As a field of action for improvement of organization and management practice.
2. As a search for management principles as a result of comparative study of successful business organizations.
3. As a theory of organization which draws heavily on the behavioral sciences.\(^7\)

However, by drawing from the second approach, principles may be extracted by comparative study of existing businesses and then using the principles so derived for the purpose of appraising the structure of a particular business concern being studied. The principles may not be applied dogmatically as statements of absolute right or wrong but they can be applied as a guide with allowances for variations in objectives, environment, and


\(^7\)Koch, op. cit., p. 32.
even personalities. This is being undertaken in this study. The emerging Venda-Craft will be viewed against the background of current trade practice of similar companies, but in every comparison, the individuality of the company will be maintained.

**Objectives of Combination**

The creation of a new corporation, Venda-Craft, through the uniting of four independent operating groups is being undertaken as a stage in transition from private ownership to public ownership. The holding company was selected as the vehicle which would be most useful in effecting a combination to meet the diverse objectives of the contributing stockholders. The objectives for combination fall within the major headings of (1) seeking a public market for their holdings in common stock, and (2) seeking economies of joint operation. At the time when the idea of combination originated, the market oriented objectives were dominant. Inability to effect an immediate market issue has forced more emphasis on present operating advantages as a preliminary step to eventual public sale of stock.

The present owners of the privately held operating companies cite five advantages to be gained by establishing a trading market for the securities which they hold:
1. Wider availability of capital sources

   The ability to draw from the collected savings of the public provides a much broader base for funds acquisition and increases the amount available for further expansion and growth.

2. Liquidity of investment

   The inability of the owner to convert his claim of ownership into cash may impose a serious disadvantage. Even more difficult is the prospect of converting merely a portion of his claim of ownership into cash because there is no established market for the stock. Should he, through his own efforts, locate a prospective buyer, the amount which this buyer would be willing to pay will be reduced by his anticipation of difficulties which he might encounter should he desire to dispose of the stock at some later time. The assistance of an underwriter in providing a wide base of stock ownership and the continued participation of a dealer who stands ready to buy and sell will facilitate the creation of a market where transactions can take place with the minimum of friction.

3. Valuation

   Public ownership of a corporation regularly traded through an established market provides a convenient means
of evaluating the shares of ownership in the corporation. This is especially useful in dealing with fractional interests of the total business. Although there is no exact way of determining a definite figure which may be universally accepted as the value, the presence of quoted ranges at which a buyer stands ready to pay and a seller stands ready to accept provides the most effective measuring device. Although capitalization of earnings is frequently utilized to estimate going concern value for a closely held company, the inexactitudes of both reasonable expectations of earnings and a realistic rate of capitalization increase difficulties of sound valuation. The market value of a widely traded stock includes the opinion of aggregate buyers and sellers as to the proper rate of return and expected earnings, as expressed through price earnings ratios, as well as including any other factors which would have a bearing upon subjective evaluation. In a closely held organization, the only methods of disposing of the company as a going concern are through sale to a buyer interested in entering the business or to a competitor. Both probably understate the value which could be obtained from a wider market. Public ownership then offers the dual advantages of providing a more suit-
able standard for measurement of the value of the company in total or in part, and being able to obtain this value in a fairly negotiated transaction.

4. Estate planning

With the large increase in tax rates dating from the World War II period, much greater consideration has been given to planning ways in which to legally avoid these levies and to prepare to pay those which are due. The successful entrepreneur must consider the effects on his heirs of leaving them a large estate whose valuation is subject to question and whose assets are in a non-liquid form which is relatively indivisible. Public ownership and trading can facilitate in establishing the value and if necessary provide for the payment of the tax burden through the sale of a portion of the stock.

5. Appreciation of stock prices

The post World War II bull market has seen the price of common stocks rise as a result of investment optimism to levels where the price per share multiplied by the number of shares outstanding far exceeds the
possible selling price of the firm as a going concern to another entrepreneur interested in purchasing it for its income producing potential. This allows the entrepreneur or his heirs to sell an interest in the company through the public market at a price far in excess of the amount which could be obtained for the same fractional interest in a privately placed sale negotiated in the absence of a public market.

Operational objectives are those coming as a result of elimination of duplication of activities, and economies of scale. They are:

1. More effective use of excess equipment.
2. Greater exchange of information about common operating problems.
3. Use of expert technicians and staff consultants.
5. Economies of large scale purchasing of merchandise.
7. Centralization of planning.
Problems of Transition

In undertaking the desired transition from the privately held corporation to the publicly held corporation, various internal and external obstacles must be overcome. The external obstacles pertain to the relationship between the firm and the individuals and institutions in the marketing process. The internal obstacles deal with necessary changes and adjustments in the structure and management of the firm resulting from the change in ownership or from its increased size. External obstacles are:

1. Size of issue

This will need to be large enough to attract an underwriter, and thus place enough shares on the market and have them spread over a sufficiently wide base of ownership to provide frequent trading. The ability to prorate the costs of issuance over a large number of shares is also important since a heavy portion of the costs are relatively fixed.

2. Timing

A study of the market is needed to provide information on pricing and favorable market movements.

3. Registration

Compliance with the regulations of the Securities and Exchange Commission requires careful handling, time delays, and expense.
4. Pricing of the issue

Careful gauging of the current investment market is necessary to obtain a fair price for the initial issue. The absence of past experience in this field forces heavy reliance upon comparison with other similar organizations which are presently being traded. It is desirable to place the offering price low enough to assure its public acceptance but not at the expense of excessive dilution of equity of existing stockholders.

5. Arranging a satisfactory underwriting agreement

As the intermediary between the company and the public, the underwriter can give valuable assistance but it must be remembered that his counsel may not be entirely without bias. His desire for a "hot" issue which will take an immediate price rise may cause initial underpricing which results in lower net proceeds to the corporation. Furthermore, underwriting firms vary in the type and amount of service which they render and in the fees which they charge.

The internal obstacles present the greatest challenge to solution and require careful adherence to principles of management as well as critical analysis and evaluation of the problem. The
paradox of solutions which solve one problem but create additional ones is frequent. Some of these internal obstacles are:

1. Determining the capital structure of the new company

   This problem involves forecasting operating results and interpreting the effect of these results on investor objectives to create a structure which will fit present needs of the company, provide flexibility for future growth, and at the same time be marketable to the investing public.

2. Allocation of securities

   Although closely tied in with determining the form and amounts of the basic securities to be issued, the problem becomes more acute when these securities are allocated to existing stockholders in exchange for their present shares and issued to outside investors. Conflicts in objectives will be frequent here and require skill in negotiation as well as the willingness of existing holders to sublimate some of their personal desires.

3. Changes in control

   Combination necessarily means a sharing of control with outside investors or with other parties in the combining companies. The ability to effect gains through
Combination will rely to a large extent upon the ability to centralize operation. The loss of autonomy is one of the prices to be paid for the advantages to be derived from combination but the extent of the change is subject to many different interpretations. Compromises must be reached in the conflicting desires to retain control and acquire advantages of combination.

4. Developing an organizational structure

The physical combining of two or more organizations poses difficult problems in meshing two different units into a smoothly operating single concern. Duplication of activities should be avoided wherever possible. Systems must be modified to conform to other systems or to fill different needs. Both of these will have a major effect on personnel, both of executive stature and at the various operating levels. Frequently the problem is greater for personnel at upper executive levels than lower levels where jobs can be substituted with greater ease. Where the corporate officers are also the major corporate stockholders, the problem involves greater conflicts. The broader scope of operations may also create gaps in staffing which must be recognized.
and filled from outside sources. All of this needs to be done with as little upheaval to the employee as is possible.

5. Combining operations

The companies must bring together in a physical sense their operation so that product mix and volume, selling, financing, and research flow truly as that of a single company.

6. Providing adequate reporting and control procedures

This provides for comparison of expected performance with actual developments and is an important measure of how effectively the combination has been carried out.

7. Relationships with creditors

The security position of creditors must be protected. Clearly understood arrangements with them assist the new concern in developing its own credit position and are especially important to effect a transfer of liability to the new company.

8. Settlement with dissenting stockholders

For stockholders who oppose combination or the securities offered in exchange, arrangements must be made to remove their objections. This may be through
further negotiations, resulting usually in a cash purchase price agreement, or eventually have it resolved by the courts. These processes may be both time consuming and expensive for the company and may have a detrimental effect on its working capital position.

The solution of previously mentioned internal and external problems require careful planning to effect a successful combination. Contradictions and conflicts must be compromised. This can be done only through a complete understanding of the long-run objectives sought by the combination and a thorough study of the avenues which are available to bring them about.
CHAPTER II

BACKGROUND ON VENDING INDUSTRY

The earliest known reference to a coin activated merchandising device was made by the Greek mathematician, Hero, in a work entitled *Pneumatika* which appeared in 215 B.C. He illustrated and described a device used for vending sacrificial water in Egyptian temples by measuring out a specified amount when a coin was dropped into the slot. However, there is no indication that the device was widely used. What appears to be the first patent issued for a vending machine was issued in England to Simeon Denham in 1857 for a device to vend stamps. The first United States patent for a vending machine went to W. H. Fruen in 1884 for an "Automatic Drawing Device" (U.S. Patent No. 309, 219), which was designed to dispense a liquid by a process which bears a close resemblance to the device by Hero. Very few of these machines were ever produced. The real beginning of practical vending in the United States came in 1888 when Thomas Adams introduced machines on the elevated railway platforms of New York to sell chewing gum.

In 1925, cigarette venders were introduced and represented the first serious attempt to sell items costing in excess of a nickel
by a completely automatic means. Initial attempts met with derision from traditional tobacco companies, especially when it was learned that cigarettes would be sold through the machines for 15 cents as compared with a usual price of 11 or 12 cents at traditional outlets. Nevertheless, the machines became an immediate success, establishing cigarettes as a major vending machine item, as they remain today.

During the 1920's the present pattern began to take shape with operating companies owning and servicing the machines and paying a commission to the outlets where they are placed. The first trade association for the industry, the National Merchandising Association, was created as the result of a meeting in New York on September 14, 1936.

Following World War II, dramatic changes and explosive growth took place in all phases of the vending industry. In 1946, Rudd-Milikian led the way in the field of hot food vending with the first successful machine to dispense hot coffee. In the same year, Eastern Electric introduced the first electrically-actuated console machine for vending cigarettes. Change makers were introduced, first as service machines, then built in as part of the machine itself. It was not until 1960 that machines
were commercially available which would accept, identify, and make change for paper currency. Vendo expects to have a machine on the market within a year which will accept credit cards and properly bill the transaction.

Total sales volume has increased rapidly. In 1946, the total volume amounted to $600 million but by 1961 had risen to $2.7 billion in merchandise sold through approximately four million vending machines located throughout the United States. Cigarettes lead in popularity of sales with one of every six packages being sold through machines. Cigarettes contributed approximately 43% of the industry's 1961 total revenue. Second in importance was the sale of soft drinks in both bottles and cups which provided another 18% of the sales volume. Approximately 150 vending machine manufacturers are located in the United States, although many of these products.

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approximately 3,500 in 1946 to a peak of approximately 6,300 in 1959 and began a decline so that the total is now estimated at 6,200. This decline in number of operating firms is due to the wave of business combination which swept through the industry beginning in late 1959 and continuing throughout 1960 and most of 1961. Late in that year, the trend appeared to slow as the newly emerged national companies paused to weld their many acquisitions into solid, effectively managed corporations. Taking cognizance of the movement, I.H. Houston, manager of vending sales department of National Biscuit Corporation commented before the Texas Merchandise Vending Association meeting in Dallas on September 17, 1960:

Number 1 on our list of clearly visible trends is that toward bigness and national coverage. Ours is still an industry of small owner-operator businesses, but with the formation of new publicly financed companies and the almost daily announcements of acquisitions and mergers, we are following a typical and wholly progressive American pattern.

Despite the trend toward larger operating units, the typical vending operation is still essentially a small business. The typical operator has a capital investment of about $30,000 involving about

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4I.H. Houston, "The Trend to Bigness," Vend, XIV (October, 1960), 60.
100 machines and two or three employees. Sales volume averages close to $2,000 per machine for in-plant sites. Gross profit runs around $800 per machine. Net profit before taxes runs about 4% of sales or about 2½% after taxes for the typical company. Since the typical company has annual sales of about $200,000, profit after taxes (and owner's salary) averages $5,000. Larger companies show about the same average sales volume per machine but the wider base for spreading fixed costs results in more economical operation, hence, the net return after taxes and owner's salary would tend to run between 3% and 5% of sales.⁵

A study by Boris Pari of the School of Business, Northwestern University, undertaken for Vend magazine also emphasized the small size of the typical operator. A profile was taken of 650 companies deemed to be representative as to geographic location, sales volume, and product mix. Of this group:

- 458 (71%) engaged in vending as a full time occupation.
- 192 (29%) supplemented another major line with some vending.
- 78 (12%) were founded prior to 1945, the oldest having been founded in 1908.
- 572 (88%) were founded in 1945 or after.
- 305 (47%) are owned by sole proprietors.
- 98 (15%) are partnerships.
- 247 (38%) are corporations.

25% had no employees.
9% had 1 part time employee.
34% had 1 to 3 employees (the median for all companies was 2).
13% had 4 to 6 employees.
5% had 7 to 10 employees.
14% had 11 or more employees.

It is significant that in 1960, only 11% of the operating companies had eleven or more employees, as compared with 14% in 1961. Diversification is also more widespread in 1961 than in 1960:

<table>
<thead>
<tr>
<th>Year</th>
<th>1 type machine</th>
<th>2 types</th>
<th>3 types</th>
<th>4 or more types</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>21%</td>
<td>17%</td>
<td>12%</td>
<td>50%</td>
</tr>
<tr>
<td>1961</td>
<td>18%</td>
<td>12%</td>
<td>10%</td>
<td>60%</td>
</tr>
</tbody>
</table>

(Separate types of machines are those selling different classes of merchandise such as cigarette machines, soft drink machines, hot coffee dispensers, etc.)

The combination movement of 1960 resulted in larger companies seeking joint efforts for financing and for developing future growth. Regular trading markets were established for the stock of several companies such as ABC Vending, Vendo, and Automatic Canteen on the New York Stock Exchange and others such as Interstate Vending and Automatic Retailers are being traded over the counter. The new trading markets were commented on by Thomas Donahue, President of the National Automatic Merchandising

Association, in the President's Address of the association meeting in Miami Beach on October 28, 1960:

In 1960 our industry caught the public eye in a most spectacular way. It 'went public' in many more ways than in the stockbroker's concept of the term. This year we saw the emergence and consolidation of several large, well-organized national operating companies. We saw the building of strong and well diversified manufacturing companies through absorption of smaller long established and more specialized equipment producers. We saw further efforts by suppliers of vendible products to produce merchandise especially adapted to vending, as well as efforts to improve existing products and to render new services in financing, in employee training, and especially in merchandising. . . . In 1960 we saw the man-in-the-street buying a share of those vending companies which were or because publicly owned. 7

With the movement toward larger companies and the technological advances, the vending industry is preparing itself to assume a much larger role in United States merchandising. The hot food market has just been opened by the introduction of machines which will keep a complete meal frozen until a set time and will then defrost and warm it for serving. A major trend at this time is installation of complete automatic in-plant feeding for factories, office buildings, schools, and other high density areas where quick and inexpensive food is desired. The future potential of vending was explored by vending pioneer

K. Cyrus Milikian, board chairman of Rudd-Milikian, Inc., in an address to the Financial Analysts Association of Philadelphia in May, 1962. After predicting retail sales of $6.6 billion within a decade, he gave seven reasons for this expected expansion:

1. Industry is moving to suburban areas where traditional feeding and shopping facilities are not as readily available.

2. Rising costs of operation of manual cafeterias in small and medium sized manufacturing plants are making losses too great to be borne by the company.


4. Specific acceptance of certain products already vended—20% of all candy, 16% of cigarettes, 25% of soft drinks.

5. Convenience of service at all times.


7. Emergence of national operating companies, and consolidation of manufacturers, allow issuance of securities to the public and provide leadership and funds for meeting this expansion need.  

With the belief in this potential for growth, all phases of the industry are moving to secure their position and improve their

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competitive advantage. The most potent force now at work in the operating companies is the trend toward combination. However, the simple act of formation of a super-company with its acquisitions of smaller companies that are diversified geographically and in type of operation, will not in itself lead to the successful future. Unless operating units can be coordinated into a meaningful system, there is little chance for long-run success. The problem of uniting them is essentially a problem of management.
CHAPTER III

THE COMPANIES COMPRISING VENDA-CRAFT

Four distinct ownership groups are participating in the organization of Venda-Craft but these groups are divided into eight separate and legally chartered corporations. All have developed around a central owner-manager who exerts great power in the operation of his company even though other stockholders share in the ownership. Without exception, the organizational structure, the operating policies, and the financial position are reflections of the personality and background of the owner-manager.

In this chapter, the development and present structure of each company group will be reviewed. Its strong points, weaknesses, contribution to the new Venda-Craft system, and its influence on the structure of the Venda-Craft system will be explored.

Southern Sales Group

Southern Sales began in 1947 as a one man operation which was engaged in placing and filling vending machines in factories and institutions and in "street" locations, mainly automobile
service stations, grills, and restaurants. Expansion of routes and sales volume resulted in additional employees being hired. Major structural revisions took place in 1955 and 1957 in an effort to provide operating efficiency. In 1959, the company expanded into Georgia with the creation of a new wholly owned subsidiary corporation. The company sold out entirely its "street" locations and moved completely to the newer field of in-plant feeding.

At this time, the legal structure of the Southern Sales System consists of four operating companies. Two are located in South Carolina and two are in Georgia.

1. Southern Sales, Inc., was chartered in perpetuity by the State of South Carolina on April 7, 1950. Capital stock consists of 1,500 shares of common stock at $10 par, 20,000 shares of common stock at no par, and 600 shares of preferred stock at $100 par. All stock is owned by five individuals.

2. The Colony, Inc., was chartered in perpetuity by the State of South Carolina on October 15, 1948. Capital stock consists of 150 shares of common stock at $100 par. All stock is owned by Southern Sales, Inc.
3. Southern Sales of Georgia, Inc., was chartered by the State of Georgia on February 13, 1959, for a period of thirty-five years with renewal rights. Capital stock consists of 10,000 shares of common stock with a par value of $5 and 250 shares of preferred stock with a par value of $100. All stock is owned by Southern Sales, Inc.

4. Rebel Sales of Georgia, Inc., was chartered by the State of Georgia on October 30, 1961, for a period of thirty-five years with renewal rights. Capital stock consists of 10,000 shares of common stock with a par value of $5 and 250 shares of preferred stock with a par value of $100. All stock is owned by Southern Sales, Inc.

The two South Carolina corporations operate exclusively in that state and the two Georgia corporations operate exclusively in Georgia, having been chartered when it was found advisable to expand the geographic area of operation. Separate corporations were established instead of branches or divisions to facilitate operations as domestic companies and to insulate the parent company from risk in the event that expanded operations should prove to be a failure.
The use of two separate corporations in each state is the result of wording of the sales tax statutes in each state. In Georgia, a sales tax is imposed using a bracket system which required collection of a tax from the retail customer beginning with 1c on each sale of at least 11c but less than 36c where the 2c tax bracket begins. The seller then remits to the state an amount equal to 3% of his net sales. However, sales through vending machines of items of 10c and under do not allow the tax to be passed on to the consumer. In order to provide for some tax relief, an Executive Order was issued by the Honorable Ernest Vandiver, Governor of Georgia, stating:

WHEREAS, it has been administratively determined that all of the sales of merchandise by vending machine operators of ten cents or less are single sales, and that such operators have no opportunity of grouping such sales so as to collect any part of the sales tax from his customers, and that the same is also generally true under existing business practices and regulations in respect to other persons exclusively engaged in selling tangible personal property for ten cents or less; ...it is ORDERED that said tax be levied and collected, based upon the cost price of the tangible personal property to vending machine operators exclusively engaged in dispensing tangible personal property for ten cents or less and other persons exclusively engaged in the sale of tangible personal property for ten cents or less. All said taxes are to be remitted by said persons to the State Revenue Department.¹

¹Executive Order No. 61-4 of the State Revenue Commission, State of Georgia, March 30, 1961.
Since the method of sales tax payment with its favorable provision provided for in this order is applicable only to companies which sell items EXCLUSIVELY for 10¢ and under, it was necessary to separate these activities by placing all machines on which the savings would be allowed into a separate corporation. Thus, Rebel Sales was established to own and operate all machines which sell items for 10¢ and under, leaving Southern Sales of Georgia to own and operate all machines which sell items for above 10¢. A similar situation in South Carolina causes the same division in products to be made there. Southern Sales handles all items for 10¢ and under and the Colony handles all items of higher price.

The organizational structure consists of General Officers who are considered officers of the entire system and Divisional Officers who are considered employees of the South Carolina Division (two companies) or the Georgia Division.

General Officers

General Manager

The executive officer of the system is the general manager. He is responsible for the success of the business through all operations at all locations. He reports directly to the Board of Directors who have given him total authority and responsibility
for fulfilling the objectives of the firm. It is significant in this instance that the general manager is the founder of the system and one of its five stockholders. In the legal organization of the four companies which comprise the system, he holds the title of president of Southern Sales and The Colony and the title of secretary-treasurer of Southern Sales of Georgia and Rebel Sales.

Personnel Manager

His responsibility is hiring employees, developing standards for hiring and promotion, developing and supervising the employee training program, and the maintaining of company-wide morale. This officer is directly responsible to the general manager and is authorized to look into any areas of the business that he feels would affect the accomplishment of his objectives. He does not, however, have the authority to change procedures or policies. He does have the capacity to make recommendations. If the line supervisor does not agree with the recommendation it will be referred to the general manager for decision. The August 8, 1962, directive appointing the current personnel manager expresses clearly the feeling of the general manager:
It should be pointed out that the recommendation of the Personnel Manager will be very seriously considered because he is given the responsibility of achieving the personnel objectives. One could not rightly expect that the Personnel Manager be responsible for achieving objectives if recommendations were not seriously considered.

Supervisor of Special Projects

A company "trouble-shooter", this officer is available to give staff assistance to any division which is having problems. He is the representative of the general manager to work closely with any division head in solving problems or stimulating endeavor in special promotional activities.

Controller

He is responsible for accurate accounting, creative analysis, and financial planning for the system. His position on the organizational chart is unusual in that the various clerks who perform the actual record keeping are under the jurisdiction of the office manager who reports directly to the South Carolina operations manager. The controller has no direct subordinates because he is a part time employee. He is a Certified Public Accountant who maintains a practice in a South Carolina city and is an accounting professor at a college in South Carolina.
Divisional Officers

Sales Manager

He reports directly to the general manager and is responsible for the obtaining of new locations, the retaining of present locations, and the increase of sales volume within his area. He co-ordinates his activities with those of the operations manager who is in charge of servicing all the routes obtained by the sales manager. At this time, the Georgia sales manager is also acting as South Carolina sales manager although the positions are still considered separate and shown separately on the organizational chart. Because this sales manager has had more formal training in business than the operations manager in each state, his function has been broadened to include consulting in a staff capacity with the operations manager. The present sales manager has the title of president in the legal organization of both Southern Sales of Georgia and Rebel Sales.

Operations Manager

He has three main activities under his jurisdiction. His primary responsibility is the direction of the filling and servicing of vending machines. In this line function, he controls the supervision of all route salesmen and branch managers within his state. His other activities include keeping the machines in working order and running an orderly office. The Maintenance
Department, under the direction of the maintenance engineer, and the Office Department, under the direction of the office manager, perform these functions. The functions of the South Carolina operations manager are somewhat broader than those of the Georgia operations manager. Because the home office of the system is in South Carolina some of his subordinates perform activities for the entire system. In both divisions, the operations manager reports directly to the general manager and has the entire responsibility for operations within his state with the exception of sales activities.

Maintenance Engineer

He has the responsibility of running the Maintenance Department, keeping the machines operating on the routes, and doing the repair work on the machines. In both states, he reports directly to the operations manager. The South Carolina Maintenance Department does all major repair and modification work for the entire system.

Office Manager

This officer reports directly to the operations manager of his state. He has the responsibility of keeping all records correct which pertain to the operations within his state, and aiding in the interpretation of them for the operations manager. The South Carolina office manager performs much of the physical
record-keeping for the entire system. All payrolls are prepared in this office and most disbursements for merchandise originate here. The records of transactions are sent directly to the controller who prepares the statements but the actual work by the clerks is under the direct supervision of the office manager who reports directly to the South Carolina operations manager.

Route Instructor

He supervises the routemen operating out of the South Carolina office in the same way that the route master supervises the routemen operating out of the Georgia office. In addition, he works with the personnel manager in the training of route salesmen for the entire system.

Branch Managers

Both the Georgia and South Carolina divisions utilize branch managers in locations where the concentration of accounts to be serviced and the distance from the home office allow less expensive operation by this method. Out of state operations are currently being handled in this fashion also. An office in Charleston acts as home office to a newly established North Carolina branch and an office in Atlanta acts as home office to a new Florida branch.
Resident Managers

In Georgia, the resident manager is a route salesman who has been promoted to full time attendance at a single large in-plant feeding installation. He is actually an operative employee who reports to the route master. As additional large installations are developed, the use of resident managers will be increased. If installations become large enough to warrant more than one employee on full-time duty at a given location, the resident manager will be responsible for their performance.

Evaluation of the Southern Sales Structure

The structure of the Southern Sales organization is the most completely formed of the group which will comprise Venda-Craft. Although it has some weaknesses, the management of Southern Sales is more clearly aware of the problems of organization than the management of the other units and has made more attempts to develop and adapt a workable structure. It is the only unit which has an organizational manual which indicates employment positions, spells out the duties, and indicates their relationship both vertically and laterally with other positions. It is also the only company which has on exhibit in the company office a large organization chart. It is significant in the thinking of the
ORGANIZATIONAL STRUCTURE
SOUTHERN SALES SYSTEM
top management that this chart has a metal background upon which the blocks representing job positions adhere by magnets. Thus in a discussion of relationships, experimental maneuvers can be worked out.

The basic philosophy of the existing management is that the organization should reflect both the objectives sought and the capabilities of members of the organization. It is significant that the structure has been frequently modified and if it is still not ideal, it has at least avoided the rigidities which have been typical of the other firms who have failed to modify formal relationships as changing size and conditions created problems.

Nevertheless, the present organizational structure exhibits some rather unusual characteristics. First, there is a distinct difference between the legal organization of the component companies and the managerial organization. Officer titles as used for legal purposes do not carry with them the usual authority relationships. For legal purposes, there are four separate companies but for managerial purposes, there is only one system. Authority is delegated on the basis of system title rather than legal corporation title. This makes for unusual although clearly understood relationships. The president of Southern Sales of Georgia has none of the authority usually assumed to go along
with this title and reports directly to the General Manager of the entire system. The giving of this legal title to the Sales Manager is attributed to creating for him prestige in the eyes of the local business community which facilitates his gaining access to executives of prospective client companies. This facilitates accomplishing his clearly defined duties as sales manager for the Georgia Division.

Employees may be component company employees or system employees. Only officers of the first echelon who report directly to the general manager are considered system employees. The Colony in South Carolina and Rebel Sales in Georgia are legally separate companies but their existence has little effect in the managerial organization. Officers required by law are filled by duplicating the staffing of officers in the other company operating in the same state.

The presence of four companies, each with its own officers, would make coordination and centralization difficult in such small companies. Each component is not large enough to need or able financially to afford full staffing in the usual sense with its prevalent layers of superiors and subordinates. For that reason, it was decided to disregard completely corporate identities in establishing formal managerial relationships. The arrangement is effective in that specialization of duties may be employed system-wide.
In addition to having the most completely developed organizational structure, Southern Sales has the widest span of management reporting directly to the president. Seven officers, representing both line and staff functions, report directly to the president. This exceeds the frequently quoted rule of three to six direct subordinates at the top level but falls well within usual practice. A study conducted by the American Management Associations of 100 large companies and 41 smaller companies showed that in practice the theoretical rule was not strictly utilized. Half the large companies studied had nine or more subordinates reporting directly to the president. In the smaller companies, 25 presidents supervised seven or more. The median for the entire group showed eight subordinates supervised.

In the American Management Association study of 100 companies, there were 94 companies in which the production manager (comparable in Southern Sales to the operations manager) reported to the president, 88 companies in which the sales manager reported to the president, 46 companies in which the controller reported to the president, and three in which a special assignments officer reported to the president.\(^2\) These results show that both the number and type

of subordinates reporting to the president of Southern Sales are in keeping with common practice.

In viewing the formal organizational chart, two aberrations from usual practice require special attention. First is the lack of direct authority which the controller exercises over the accounting clerks. A more usual arrangement would place the accounting department directly under the controller. Although operations of the controller's department vary from one company to another because of differences in company operation, unplanned evolution, and differences in interpretations of the limits of the controller's functions, it will commonly include routine accounting operations, systems and internal audit, taxes and other legal reporting, and budgets and analysis. There is frequent overlap between the activities to be assigned to the controller and those assigned to the office manager. In some instances, the functions of the controller are viewed broadly enough to include activities of the office manager and his subordinates as a part of the function of controllership and make the office manager a direct subordinate of the controller. A more frequent application will assign to the office manager certain duties which have to do with controllership and let the office department perform them as a service function.3

In Southern Sales, the situation is unusual in that the controller has no power to command anyone involved in any accounting activities. Theoretically, the controller is a staff officer who makes recommendations to the office manager who is responsible for the physical preparation of all accounting records. In practice, the clerks look directly to the controller for direction. Although there has been no formal delegation of functional authority, the controller has assumed authority which is not recognized in the formal corporate organization. Nevertheless the lack of clear expression of authority is viewed as a weakness in the structure.

Unplanned evolution is the cause of this strange situation. The controller started with the company as a part-time outside accountant keeping the records himself. As the company expanded, he assumed more responsibility in financial decision but did less of the actual work of record keeping. It was shifted to full time clerical personnel in the office department. The size of the company would justify the employment of a full time controller who would take direct charge of the record keeping activities but the owners feel that such a change would result in the loss of a valuable officer who has assisted the system in development and who understands the problems because of his long and close association.
A less defensible weakness is the co-equal relationship in each geographical division between the sales manager and the operations manager. The two officers are supposed to share authority for providing good service to customers. Although the change has not been shown in the chart, the current use of the same sales manager for both divisions enhances his status somewhat and may be a preliminary step to clarifying his position. The sales manager is in charge of establishing routes and increasing sales but the operations manager is in charge of all physical aspects of servicing the routes. This is a merchandising company which is sales oriented but in many actual situations, it requires mutual agreement to accomplish company goals. This is illustrated by the situations in which the operations manager makes a call with the sales manager in attempt to pacify a customer who is dissatisfied with the service which he is receiving. The sales manager does not have the authority to authorize a change in the mode of operation to provide better service for the customer. This joint authority has worked out in practice with surprisingly little friction. However, its success depends upon the capacity of these two personalities to overcome this recognized structural weakness and to provide mutual cooperation. It also places a heavy responsibility on the
general manager who is their immediate superior. The relationship between the two officers is not clearly spelled out. It has been left to an informal working out of problems between the men involved.

The use of a plural executive is a legitimate organizational device although its use is best restricted to policy making over broad areas in which many departments are affected.

Dale affirms the use of plural executive action but believes that its use should be restricted to situations that can be handled better by groups than by individuals. Even though the two men communicate effectively and cooperate informally, there is no evidence that a proper assignment of responsibilities would result in an area of concentration too broad for one man to handle. A potential area of confusion under the present arrangement is in the responsibility for customer relations. The sales manager acts at one time as a consultant to the operations manager and at other times as a co-equal executive. In the solution of a particular problem, the overlap could easily lead to confusion as to the capacity in which the sales manager is acting. The arrangement between the sales manager and the operations manager is viewed as one of the major weaknesses of the structure of Southern Sales.

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Despite the imperfections in the organizational structure, Southern Sales is the dominant corporate group going into VendaCraft. Like the other company groups, Southern Sales has developed around its central leader but in its development has avoided some of the rigidities of structure which characterizes the other combining groups. As company growth made old patterns obsolete, they were abandoned in favor of new patterns which were established to meet new objectives or adapted to changed conditions. The company also stresses management education for its officers and supervisors. Academic courses in business administration in nearby colleges, special management short courses, and individual study using current publications are used. The result is a knowledge of management theory which is unusual by so many employees in such a small company. The emphasis on management education is directly related to the background and education of the president of Southern Sales who taught management courses at one time in a southern college. His breadth of knowledge and the management education which is emphasized in his company will be a valuable addition to the holding company as it attempts integration of the separate companies. A major contribution to the success of the holding company is the understanding of organizational relationships
and a willingness to modify existing relationships as conditions change. Southern Sales is providing the example (even though the example is imperfect) for development of the other companies. This contribution is as vital as the sales volume which Southern Sales is contributing to the system.

Mid-Georgia Candy, Inc.

This single entity located in central Georgia, was chartered by the State of Georgia on July 19, 1955, for a period of 35 years with renewal rights. Capital stock consists of 1,665 shares of common stock with a $30 par value.

This company was created by the owner and operator of a wholesale candy company who established Mid-Georgia Candy as an outlet for his products on a nearby military installation. As a result of the mutual ownership of the two companies and their close operational relationship, the formal organization of Mid-Georgia Candy has been kept at a minimum. There is no formal organizational chart nor a corporate manual defining relationships between employees. All accounting activities are undertaken by the larger affiliated company with a charge for this service being allocated as an overhead cost. The highly localized area in which the machines operate keep requirements for
routemen as low as two to four men with an additional two to four men providing the back-up operations of maintenance and stocking of merchandise. Normal employment consists of five men, all of whom report directly to the president.

The entire decision and policy making activities are undertaken by the president. No effort has been made to expand into new locations or create any sales generation activity other than keeping operational machines in the present location and replacing existing machines with improved models. The location was obtained through a government bid to provide the specified service to the base. The rather static conditions of operation in the restricted market and the small number of personnel involved in the operation allow a single executive to utilize only a single operative level beneath him.

Since the president of Mid-Georgia Candy is also the president of the affiliated company, the subordinates actually reporting to him include the operative employees of Mid-Georgia Candy plus a minimum of three middle level officers of the affiliated company. The highly routine nature of Mid-Georgia Candy's operations reduces the required direct supervision and the close working arrangements with the affiliated company allow a portion of the required direction and checking to be done in that company. The evolution of an informal arrangement for
handling many routine problems reduces drastically the necessity for action from the upper level. An example of this has to do with ordering merchandise. Because practically all the merchandise sold through the vending outlets is purchased through the affiliated company, records are maintained by that company and when additional merchandise is needed, it is provided by the issuance of a requisition. The small size and limited scope of selling activities reduce the complexity of the organization required to meet the objectives of the company. Organization here consists mainly of division of work activities and checking the performance against established sales quotas. In such a small company where the operative employees report directly to the single executive of the company and the span of control is not increased beyond reasonable limits, the arrangement offers the particular advantage of keeping the executive closely in touch with the operation of the business. Communication is simplified by a short vertical channel both for giving directions and for receiving prompt and accurate reporting of results.

One complicating factor in an otherwise simple structure is the unusual reliance on the affiliated wholesale candy company. Through the establishment of norms of operation including reorder points for merchandise to stock the machines, officers and
clerical personnel of the affiliated company are actually exercising functional authority delegated to them by the president of Mid-Georgia Candy. Functional authority is the voluntary surrendering of authority to make decisions in certain restricted areas by an executive and transferring this authority to another person. It is frequently given to a staff assistant with the result that orders may be given by the assistant without first clearing through the line executive. But the application in Mid-Georgia Candy goes beyond the usual range and establishes such authority with executives and clerical personnel in an entirely separate company.

The exception principle is used by the affiliated company officers to determine when a question is to be referred to the president. A problem whose solution is not covered by stated instructions or by trade custom and practice is referred to the president. When such a question arises, the operative employee of Mid-Georgia may be referred directly to the president or the affiliated company officer may take the question to the president personally and return the answer to the operative employee.

The decision to enter Mid-Georgia Candy in the Venda-Craft system is, in effect, a decision to spin it off from its close

dependence on the affiliate. Major organizational changes will be required to effectively integrate it into the system.

Joining the Venda-Craft system will require a greater independence on the part of Mid-Georgia Candy. Furthermore, the more dynamic leadership of Venda-Craft will be unsatisfied to hold the company in its status quo even if it is making a profit. One of the advantages of including Mid-Georgia in the Venda-Craft venture is its location in central Georgia where none of the other companies have any installations. It can serve as an office for expanding operations into plants as well as other military bases in northern Florida, central Georgia, and eastern Alabama. The candy company affiliated with Mid-Georgia Candy Company through joint ownership is also a prospective source of supply for tobacco and candy items.

Canteen Group

This group consists of a pure holding company and two operating companies engaged in vending in South Carolina. Evolution of the legal structure is complex but represents the leadership of one man.

In 1948, a partnership called Dixie Distributing Company was formed by three men. Each held an equal interest in the
business although one of them was managing partner and the driving force behind the growth and expansion of the business. On June 15, 1954, a charter was issued by South Carolina to the same operators for a corporation called Canteen Company. The new company was composed of 50 shares of common stock with a par value of $100, all of which were owned by the Dixie Distributing partners. Although the partnership continued in operation, the sale of all items which sold for 11c and over was transferred to the new corporation. The purpose of the separation of activities and legal entities was to take advantage of the state tax break on collection and remittance of sales tax.

A year later a group of vending machine operations in South Carolina entered into a consolidation agreement. The resulting company was a new corporation named Dixie Distributing Company, Inc., which was chartered on July 1, 1955, by South Carolina. The new corporation absorbed five vending companies, including the previous partnership with the same name. It took over the trucks, inventories, and cash of the various companies and issued stock for these items. However, the owners of the combining companies retained ownership of the vending machines
and entered into a contract to rent them to Dixie Distributing Company, Inc., for a period of seven years.

Because Canteen Company reflected the exact proportionate equity of the former Dixie Distributing partnership, the three former partners transferred ownership of all partnership machines to Canteen Company and let the rent flow to the corporation instead of directly to the individuals.

After a year and a half of operation in this fashion, the management of Dixie Distributing determined that the rent being paid to the various machine owners was excessive. A second arrangement was negotiated in which Dixie Distributing agreed to purchase all machines through a stock issue to the machine owners. Capital stock was increased to 8,507 shares of common stock with a par value of $25. All machines of Canteen Company, including those selling items above 10¢, were turned over to Dixie Distributing in exchange for stock, leaving Canteen Company as a pure holding company. Because it had such a large holding of machines, Canteen Company received 51.6% of the stock of Dixie Distributing Company. Thirty-seven individuals, representing ownership of the combined companies, hold the balance of the stock. One man holds 14.9%. The remaining thirty-six people
have holdings ranging from ten to 317 shares. Only nine of these people hold as many as 100 shares.

The transfer of all Canteen Company machines resulted in Canteen Company acquiring a controlling interest in Dixie Distributing Company, but it also destroyed the sales tax advantage by re-grouping machines selling items above and below the tax break point of 11¢. On March 3, 1957, Industrial Distributing Company, Inc., a new wholly owned subsidiary of Dixie Distributing Company was established in South Carolina with 25,000 shares of common stock with a par value of $1. It vends items of 10¢ and under, exclusively.

Throughout this developmental phase, the president of Dixie Distributing, as one of the three originating partners, was the main force behind the previously described transactions. With the compliance of the other two original partners, who were inactive in the actual operation of the business, he held power which was almost absolute. With the Canteen Company as a dormant entity, and the two operating companies closely allied in operation, the president exercised close control with a minimum of formal organization. Although the company has been profitable and has established a good reputation in its field, the organizational structure is the weakest of the four units comprising Venda-Craft.
When he was no longer able to handle directly all of his employees, a second-in-command executive was created to handle the overflow. This second executive was both an employee and a minor stockholder of the firm. Even now, he has no title but is a de facto executive vice-president. Acting without any clearly defined duties, he handles much of the day to day operations of the system. The carrying out of policy and the follow-up to check results are broadly his major responsibilities. Although he frequently participates in the making of policy in a staff capacity, the actual decision usually rests with the president. The second officer has also performed as a liaison man between the president and other minority stockholders who have objected to the forceful and arbitrary manner used by the president in running the company. The relationship between these two top officers has been cordial and close. It is this expression of an informal organization which has allowed them to work as a team and to keep the companies running smoothly without formal delegation of duties.

An outside accountant handles the actual preparation of statements using data gathered and processed by the office manager's staff. He is on a retainer basis and is available
for consultation with the two top executives in all matters pertaining to financial operation of the business.

An office force reports to an office manager who reports mainly to the second officer although both the office manager and his staff may receive direct orders from the president.

A maintenance department is under the jurisdiction of a maintenance supervisor who reports mainly to the second officer. Here, also, the president may issue direct orders.

Three supervisors handle the routine operation of the route salesmen. Their main function is relaying directions from the two top officers to the salesmen and checking to see that these directions are properly carried out. Poor results requiring a change in directions would usually be referred to the second officer.

Formal organization of the entire Canteen system is weak, authority relationships are not well-defined, and communication is vague. Even though the companies do not have a large body of officers and clerical personnel, a lack of effective communication is evident in its operation.

As a standard for a communications system conducive to good management policy, the work of Barnard is recommended. He suggests seven characteristics for an effective communications system. These are:
1. Channels of communication should be definitely known.

2. Objective authority requires a definite formal channel of communication to every member of an organization.

3. The lines of communication must be direct or short as possible.

4. The complete line of communication should usually be used.

5. The competence of the persons serving as communication centers, that is, officers, supervisory heads, must be adequate.

6. The line of communication should not be interrupted during time when the organization is to function.

7. Every communication should be authenticated, that is, it should be known that the person giving the direction is acting within the scope of his authority in giving the order.

The laxity of formal organization causes frequent violation of several of the items of Barnard's list. Closely related with the poor communication is the inability or unwillingness of the founder-president to delegate authority. Even after recognizing that he could not be a part of every routine decision of operation, and creating a position for a second major executive, the president is unwilling to designate certain areas of exclusive authority over ordinary affairs. This means that channels of communication are not definitely known, violating Barnard's

first principle. The route master, office manager, or maintenance supervisor may present a problem to either of the two executives without knowing which one has time to handle the problem or has the needed information available. If the question is presented to the second officer, there is no way of being sure that he can decide without discussing it first with the president. Even if the second officer should act without consulting the president, the subordinate may wonder with justification if the directions given are definitely within the second officer's scope of authority or will be countermanded by the president. Barnard's seventh principle is completely violated.

By custom and practice, and in violation of Barnard's fourth principle, either of the two ranking officers may give directions to the route master, office manager, or maintenance supervisor as well as by-passing them completely and delivering orders personally to a clerk, route salesman, or maintenance worker. The argument is given that it is a small organization where everyone knows everyone else and they are all working together to get a job done. Although there is some validity to the argument, as a matter of policy, formal channels should be established and used as far as possible. The situation is
conducive to problems and personal conflicts. The lack of difficulties at this time owes much to the personal tact and diplomacy of the second officer who handles his somewhat ambiguous position with aplomb.

A recent change of stockholder control of Canteen Company will result in significant changes in the organizational structure of its subsidiary companies. A dissatisfied stockholder of Dixie Distributing Company quietly negotiated the purchase of the stock of Canteen Company which was held by the two inactive stockholders. Because Canteen Company owns a controlling interest of Dixie Distributing Company, the new stockholder who bought two-thirds of the Canteen Company stock is in a position to control the entire system.

The repercussions of the change in control are as yet undetermined. Although the president of Dixie Distributing has a contract which has another year to run, it has been indicated that sweeping changes would be desired by the new majority stockholder and that a first step would be a reduction in the authority and activities of the president with a corresponding increase in the position of the second officer. Better co-ordination for the transition from old to new management can be undertaken through him.
There is little indication yet of the feeling of the new majority holder for the Venda-Craft project. As a minority stockholder of Dixie Distributing he was aware of the plans and had voted for the creation of the company and the exchange of stock. But prior to his take-over of the Canteen system, he had not been included in any direct negotiation. The position is made more difficult in that already he held a controlling interest in Street Sales Company*, a vending company placing equipment on "street" locations in South Carolina. Although Street Sales is a well established and profitable operation, in the opinion of the Venda-Craft promoters, it does not have the growth potential of vendors engaged in industrial feeding and had not previously been considered as a desirable addition to the regional company.

Three alternatives seem likely at this point. First, Canteen system might withdraw from the proposed regional system. Second, Street Sales might be merged into one of the Canteen Companies before allowing the system to join Venda-Craft. Or a close corollary to this alternative would be to negotiate the inclusion of Street Sales as one of the units of Venda-Craft. In either instance, the changed size and outlook would require

* A fictitious name is used to protect the anonymity of the company.
reappraisal of the companies and a possible modification in the stock exchange ratio. The third alternative is a possible agreement between the president of Dixie Distributing and the new management in which the president and some other stockholders would withdraw from the organization and have their equity paid off in equipment at operating locations. This would be a splitting of the system into two separate organizations. The split off unit would then join Venda-Craft, leaving the remaining Canteen system in its affiliated position with Street Sales. Although there is no legal basis whereby the president of Dixie Distributing could force the splitting of the Canteen system, it is believed that this would be accepted by the new control group rather than face a stalemate in operation by an uncooperative president or a damaging lawsuit coming from forcing out the president despite his contract of employment. The alternative of splitting the system is an extreme one which would not be used if other amicable arrangements can be worked out. In the present phase of negotiations, it seems unlikely that such a drastic solution will be required.

The main contribution which Canteen system contributes to Venda-Craft is its better-than-average earnings. Operating with about one-third of the assets of the combining companies, Canteen
system generates about one-half of the after tax earnings. Although the other systems uniting to form Venda-Craft have an excellent potential for future earnings, Canteen system has the greatest realized earnings position. Any plans for an immediate stock sale at prices acceptable to the promoters must include the right to realized earnings of Canteen. Canteen's decision to join the holding company is a barter of its present high earnings for a participation in the potentially high future earnings of the other companies of the system.

Much of the credit for the high earnings of the Canteen group goes to the president. His personal drive and constant attention to operation produced results of extraordinary performance. But his unwillingness to delegate authority limits the expansion of the company to approximately its present level because he is physically incapable of taking on expanded operations or activities.

The change of control of Canteen may well contribute to the success of Venda-Craft by bringing in a new management group which is willing to modify and improve existing organizational structure and procedures in such a way as to allow additional growth. Having been dissatisfied with previous operation, the
new majority stockholder is already acting to institute reforms which will make internal coordination more effective. If these changes can be effected and still maintain the present profit position, additional growth and future profits are possible. The personal force of one man will be replaced by the cooperative force of an effectively organized management group. These changes will result in better working relationships with the other Venda-Craft companies and a fresh philosophy of cooperation with them for further unifying developments.

**Piedmont Dairies, Inc.**

The structure of this company is basically a simple one of highly centralized authority. The company operates two milk processing plants, buying and picking up the raw milk from individual dairy farmers. After processing, the milk is packed in individual cartons and multi-gallon containers for sale and distribution to vending companies, or it is sold in bulk to several military installations in the Norfolk area.

As the majority stockholder of the company, the president and general manager uses his position to maintain a close control over all phases of its operation. All questions of policy affecting the entire company are referred here for decision. Any deviation from routine operating procedure of the plants
is cleared with him, at least on an informal basis. Creation of new business, which consists of bidding on government installation sales and negotiations with vending companies, is directly the responsibility of the president.

Each of the two processing plants is under the supervision of a plant manager who reports to the president. Each manager is responsible for providing a supply of milk adequate to fill the delivery contracts negotiated by the president. Hiring operative workers for a plant is left to the manager but reviewed by the president who also determines whether new positions will be created or existing positions will be removed. Promotion to supervisory positions is also upon the recommendation of the manager but subject to ratification by the president.

The controller reports directly to the president and is responsible for collecting data from both processing plants, consolidating it into operating statements for the company, and interpreting the results of these statements for the president. He is called upon to advise the president in a staff capacity on any decision relating to the financial affairs of the company.

Each plant manager places supervisors over control areas. The operative employees in that area report to the supervisor
who reports to the plant manager. The operation is essentially a highly mechanized flow process, with major areas consisting of receiving, pasteurization, bottling, and shipping. A maintenance supervisor is also included who reports to the plant manager.

Departmentation is on a geographic basis for the operating units with the milk processing plants then using a functional basis. The financial and accounting activities are assigned to the controller who exercises functional authority over the employees of the reporting plants who perform the record gathering activities. Organization is simple. Span of management is narrow at the top with only two plant managers and the controller reporting directly to the president. A narrow span is important here because of the frequent conferences with the subordinates regarding operations in the plants. However, the establishment of formalized policies for handling more operating questions could reduce the need for consulting with the president but he resists this approach, feeling that it would cause him to lose direct touch with the business. The narrow span is also made possible here because the president undertakes activities which in many businesses would be done by someone in the second level. The presence of a sales manager or a personnel manager
who might report to the president is removed by the president undertaking these activities himself. In this respect, the narrow span is somewhat of an illusion. Instead of coordinating activities of others, he performs the activities himself. The actual time involved exceeds the time required to coordinate if he could bring himself to allow further delegation of authority.

The president completely dominates the company. Operational affairs of the plants have been delegated but these affairs are closely checked by the president. Barnard develops a concept of authority coming from authority of position and authority of leadership. In the former instance, the willingness of individuals dealing with a leader to accept his advice or direction is based on the leader's advantage of position. In the latter instance, the leader's knowledge, understanding, and technical ability give force to his directions. Where both situations are present in the same man, his influence is vastly increased and efficiency of the organization is increased. In the person of the president of Piedmont Dairies, his authority is drawn from both areas. A capable businessman who is responsible for the beginning and development of the firm and who has been closely involved in each step of its evolution, he commands the respect of all who work in his organization. The

7Barnard, op. cit., p. 173.
main criticism which is made of the organization is the unwillingness of the president to establish clearly defined policies of operation and delegate to subordinates the authority to carry out more of these policies. Expanded operation, particularly as a result of joining Venda-Craft, will make this necessary or result in less effective operation.

Vertical integration is one reason for inclusion of Piedmont Dairies in a vending combination. The company is the prime source of supply for milk sold through the machines of Southern Sales and Canteen Company. A constant source of supply at favorable prices for an important segment of merchandise is assured.

Piedmont Dairies has other contributions to make to the new system. As a supplier of milk products to several large military establishments, Piedmont Dairies has developed a reputation for reliable service. If service could be broadened to include full line vending service by one of the affiliated companies, sales volume -- and hopefully, profits -- could be substantially increased. Piedmont Diaries also serves as a supplier of milk to other vending companies in the Southeast. Such an established connection will provide a source of information on the operations of other vending companies
which will be useful in carrying out the holding company's intention of additional expansion by acquisition of other local vending companies. Piedmont Dairies may also be used as a base for development of processing and manufacturing operations of milk products and other food items to be sold through vending machines.

A special contribution to Venda-Craft is the drive and ability of the president of Piedmont Dairies. He is a promoter who has developed several previous businesses. On the management team of Venda-Craft, he should be an "idea" man, using his experience and insight to discover other opportunities for profitable development. It is conceivable that some potential opportunities may be completely outside the vending area but would be developed as other subsidiary companies of Venda-Craft. Diversification, both present and future, becomes a major contribution of Piedmont Dairies.

Summary

As an overall appraisal, none of the present structures approximate an ideal structure under present operating conditions. Each company is guilty of imprecisely defined relationships and the lack of clear allocation of duties. The common weakness is at least partially the result of another basic characteristic
which they have in common: each company and its organization is a result of evolution under one strong leader. Each company grew as an extension of the personality of that leader. His objectives became the objectives of his company and he ruled as a benevolent czar. Using employees who had less education, experience, or foresight, he directed them in the activities of carrying on a business. He alone was management. The success of this initial stage, when organization was simply allocating certain duties to operative employees, is shown by the growth which occurred. And with growth came more complex problems of organization and greater required delegation of authority. In varying degrees, all four founders show a weakness in the ability to turn over control of segments of their business to others to handle. Dale, elaborating on a statement attributed to Lieutenant Colonel Lyndall Urwick, says that the problem of delegation is in part personal and in part personnel.

On the personal side, the owner-manager may find it extremely difficult to delegate any part of his work. He may feel that nobody can do it as well as he, and he may be right. Nevertheless because his time is limited, he must concentrate on those matters which he alone can handle or which he can handle far better than anyone else ...
The personnel problem facing the owner-manager may also assume serious proportions. Present members of management, such as the foreman and the engineer, may have been hired originally because they were good at carrying out the chief executive's ideas. Now they may expect promotion to higher managerial jobs, because of long service and seniority, even though they are not qualified for them. If there is no policy of promotion-from-within, outsiders with production experience and familiarity with modern management methods may be hired instead. But this may cause friction among the existing personnel. There may also be the problem of rivalry between a new executive and the president, aggravated in cases where there is an overlap of functions--especially where capital has been supplied by the newly arrived executive.

Both elements are experienced in the present structure of all four combining systems.

With the possible exception of the Southern Sales system, the present organization structures exhibit rigidities. The same structure was continued in use where it was no longer applicable as increased size altered departmental and individual relationships. Future growth is constricted as organizational structures are unable to assume expanded operations in an effective manner. The act of uniting in Venda-Craft injects a new and major influence for change into presently rigid structures. Having shattered the concept of status quo through one drastic change,

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8 Dale, Planning and Developing the Company Organization Structure, p. 38.
other less revolutionary changes become more acceptable to top management. The free transfer of information with the other companies, the examples which other companies set, and the wider scope of activities contribute to an over-all re-appraisal of each company and its effectiveness by its own top management. Such re-appraisal becomes an important side effect of combination and will contribute to the growth and success of the entire Venda-Craft system.
Figure 2

Companies comprising Venda-Craft

THE COLONY

SOUTHERN SAVAS

CANDY

PREMIER DAIRIES

DISTRIBUTION

49.4% 51.4%

6.7% 31.5% 31.5%
CHAPTER IV
DEVELOPMENT OF VENDA-CRAFT

The charter for Venda-Craft, Inc., was issued by the Superior Court of Fulton County, Georgia, on August 4, 1961, for a period of 35 years with the right of renewals for like periods. Authorized capital stock was set at 500,000 shares of common stock with a par value of $1. The objectives of the company as set forth in the charter are:

1. To sell prepared food products, confections, beverages, tobacco products and other merchandise through coin-operated machines;

2. To manufacture, produce, purchase, acquire, own, hold, make, sell and otherwise dispose of, and generally to trade and deal in and with, as principal or agent, at wholesale, retail, on commission or otherwise, food products, beverages, goods, wares, merchandise, commodities and property of every kind and description;

3. To engage in, conduct, and carry on a general manufacturing, merchandising, mercantile and trading business;

4. To own, hold, sell, dispose of and otherwise trade or deal in stock and securities of other corporations and other forms of business organization; and

5. To transact any and all of the foregoing business either as owner for its own account, or as agent or for the account of others, or as a partner, joint venturer, or other form of organization or in relation with others.\(^1\)

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\(^1\)Corporate Charter of Venda-Craft, Inc., on file in the office of the Georgia Commissioner of Corporations, State Capitol, Atlanta, Georgia.
Although offices of the company are established in Fulton County (Atlanta) the right is reserved by statement in the charter to establish and operate offices and branches both in other counties of Georgia and outside the state. By express statement in the charter, there is no preemptive right on stock. In accordance with the minimum capital requirements of Georgia, Venda-Craft began operations with a minimum capital contribution of $500 representing the purchase of 100 shares of stock by one of the petitioners for incorporation. This was merely a formality to bring about a corporation which was then in a position to enter into contracts.

**Events Leading To The Creation of Venda-Craft**

During 1960, as the merger movement among vending operators was under way, each of the previously mentioned ownership groups was contacted by one or more of the newly formed or about-to-be-formed national companies. Individually they entered into negotiations and became convinced that their best interests lay in uniting with others if equitable terms of exchange could be agreed upon. During 1960 and early 1961 each group was involved in negotiations with United Servomation which was in the process of formation at that time. Action proceeded to the point where
an option to affiliate with United Servomation was held by each group and could be exercised by the local companies upon the completion of an audit by Price Waterhouse for the purpose of determining the basis for exchange of shares. The results of this audit persuaded these and several other companies in the region that application of the previously developed formula of United Servomation would result in an unfavorable stock exchange ratio and the option was allowed to lapse.

Still believing in the advantages of combination, representatives of companies located in the Southeast began to talk of a regional combination. The first meeting of the group which eventually resulted in Venda-Craft occurred in February, 1961. By May, the prospects for a regional operating company appeared favorable. Participating in these negotiations were eight vending groups located in six southern states with combined annual sales of approximately $8 million. The point of agreement was that such an organization would be desirable but the difficult task of negotiating the terms of combination and creating an organization capable of accomplishing the desired results had yet to be worked out. To lead in this endeavor, the president of Southern Sales Company was named temporary

chairman. At this time, even the objectives of the group were not settled. There was still interest in joining a national group but it was felt that even an informal combination at the regional level would strengthen their bargaining power with another group.

Three different alternatives were under consideration. The first, and most popular at this time, involved affiliating with Automatic Retailers of America, Inc., or some other similar group. The chief advantage of this was the added negotiability of the stock received in such an exchange. A second alternative was a regional organization created with the close cooperation of a local underwriter who would undertake an immediate stock sale and establish a local market. The third alternative was a merger or other combination for mutual benefit in the form of greater stability through mutual strength, better cash flow, wider financing, and expanded growth potential. It was felt that the two previous alternatives provided all of the advantages of the third one plus being able to offer immediate liquidity to the present group of stockholders who sought to diversify their personal holdings and avoid a locked-in position.

It was agreed that the first alternative should be pursued vigorously with an attempt to consummate it before the planned
listing of Automatic Retailers of America on the board of the New York Stock Exchange in order to take advantage of expected price increases when public trading took place. If such a rise did occur, the effect on companies joining the combination at a later date would be a less desirable exchange ratio in the stock swap. The chairman of the Venda-Craft project was empowered by the interested companies to negotiate in their interest with Automatic Retailers although acceptance of terms of exchange was subject to ratification by the stockholders of the individual companies. Flexibility was maintained, with negotiations under way with Automatic Retailers, exploratory talks with an underwriter, and settling of details for a merger going on simultaneously. The ultimate decision would be for the adoption of the course which seemed most advantageous to all.

Much of the initial work toward organization was undertaken by the chairman. The following functions were advanced by the Venda-Craft group as necessary to be performed by him:

1. To establish a central clearing house for communication between the individual operating companies and the rest of the business community, such as the underwriter, the auditors, lawyers, prospective future members of Venda-Craft, and potentially competitive companies.

2. To negotiate for the group in the many decisions that must be made on a daily basis for the group, particularly those involving individuals and organizations mentioned in (1) above.
3. To channel to the proper committees of Venda-Craft those suggestions and questions which the individual operators have.

4. To have a central source to whom prospective companies for Venda-Craft can be referred.

5. To have someone responsible for moving the project along at the greatest possible speed and who has this as his primary responsibility.

6. To have work begun on the shaping of the type of organization that will eventually serve the best needs of the individual operating units and the newly formed company.

When further negotiations with national groups proved to be unsatisfactory, it was concluded that a regional grouping would be undertaken. The first problem required a decision as to the type of organization which would be created. A consolidation with present companies continuing to operate as divisions was considered and abandoned in favor of a holding company.

During the period of negotiation prior to incorporation of Venda-Craft, the chairman, acting as a promoter, traveled extensively in performance of his duties, made contracts with the accountants for necessary auditing of the combining firms and for establishing of books for the new company, dealt with the lawyers who were preparing the incorporation papers, and incurred other organizational expenses. These obligations were paid by his firm, Southern Sales Company, and were recorded on their books as accounts receivable due from Venda-Craft. After
chartering, it was agreed by the participating companies that an initial cash contribution of $25,000 would be made to repay the debts already incurred and provide for initial operating costs. On the basis of the preliminary report of the Evaluation Committee (see Evaluation Section) ownership of Venda-Craft would be held as follows:

38% by Piedmont Dairies
32% by Southern Sales Group
24% by Canteen Group
6% by Mid-Georgia Candy

This, of course, was subject to modification when the final audit and accounting alignment of the companies was completed, but on this basis, the following initial contribution to cover costs was made by each company:

$9,500 by Piedmont Dairies
8,000 by Southern Sales Group
6,000 by Canteen Group
1,500 by Mid-Georgia Candy

Following the issuing of the charter, a set of by-laws was adopted (see Appendix 1). During the planning stage of the corporation, policies were agreed upon informally through meetings of the vendors committee which consisted of at least one representative of each of the combining groups. It should be emphasized here that this group was quite informal and uniform agreement was desired before continuing further with any plans. After the
chartering, the vendors committee met and informally agreed upon the content and wording of the by-laws. Then the sole stockholder who held the 100 shares of the outstanding stock called a formal meeting and voted to accept these by-laws. Directors were then elected in accordance with Article VII which calls for not less than seven nor more than twelve directors selected from the following groups:

a. Two directors from those who were former stockholders or are present officers or directors of Southern Sales, Inc.;

b. Two directors from those who were former stockholders or are present officers or directors of Piedmont Dairies, Inc.;

c. Two directors from those who were former stockholders or are present officers or directors of Dixie Distributing Company, Inc.;

d. One director from those who were former stockholders or are present officers or directors of Mid-Georgia Candy Company, Inc.\(^3\)

The Board of Directors then elected the officers of the corporation. The former chairman became president and the additional positions of two vice presidents, a treasurer, and a secretary

\(^3\) By-laws of Venda-Craft, Inc., Article VII (See appendix).
were filled from executives of the combining companies.

With this phase of the organization completed, operations could now take on a more formal nature. The temporary chairman had become the president of the newly chartered corporation and the board of directors was now composed of representatives of the combining companies in the same way in which the previous planning committee was composed of them so that actions now could come before a board for discussion and official decision. The newly elected board would function as the policy making body for the corporation with the executives to implement these policies. An important step in the transition was hereby accomplished.
CHAPTER V

THE STRUCTURE AND ORGANIZATION OF VENDA-CRAFT

Development of the Legal Organization of Venda-Craft

Very early in the developmental phase of Venda-Craft when negotiations were still in progress with national companies, general considerations for the desired type of management were set up as policy guides. A Long Range Policy Committee submitted a report from which the following excerpts are taken:

The initial management team shall be strong. A planned program should be devised to add further strength to that management team as growth dictates . . .

Local autonomy in action for the local companies should be continued so as to increase initiative in each of the operating companies on a long range basis."

The initial policy of maintaining local autonomy became a deciding factor in determination first the legal structure of Venda-Craft and then the organizational structure of the Venda-Craft system. Outright fusion through consolidation was considered in the early phases with present ownership groups operating as divisions. Consolidation was abandoned in favor

of a holding company because the ease of organization and the less drastic effects on local autonomy made the holding company more attractive.

The general advantages of a holding company over outright fusion have much to recommend it. From the list developed by Bonbright and Means, the following advantages are relevant to Venda-Craft.

1. Ease of organizing the combination.
2. Ease of perpetuating the control in the hands of the organizers.
3. Decentralization of management.
4. Insulation of liabilities to creditors.
5. Ease of divorcing the properties.²

These advantages will be further explored.

Ease of organization

This is the most important advantage. Only a majority of the stock must be acquired to make the control effective and in many cases, working control can be brought about with much less ownership. In both merger and consolidation, some arrangement must be made for settlement with the dissenting stockholders, whereas in the holding company arrangement, minority holders merely continue in their ownership position. This results in a substantial reduction of cash needed to effect the combination since dissenting stockholders do not have to be paid off. Debts

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of the operating companies are also unaffected by the creation of a holding company because the continuing corporate entity remains unchanged. Although it is expected that all stockholders in all the companies will exchange their stock for Venda-Craft it is considered an important advantage of the holding company that it can be formed and can function effectively with merely controlling interest in each subsidiary. Stockholders who do not wish to exchange their stock will be undisturbed and will maintain their minority position in the operating company.

Ease of perpetuating control

The advantage of complete corporate control with less than full stock ownership is a direct financial advantage which may be compounded through the device of pyramiding. Thus, a small investment in stock in a holding company may be expanded through successive layers of operating companies into control of a vast quantity of assets. Venda-Craft is planning to acquire other operating companies in order to expand service in the Southeast.

Decentralized administration

While it is true that the holding company is an important device for bringing several enterprises under common control, it is just as significant as a means to bring about the decentralizing of various branches of a large business system. One
of the merits claimed for the holding company as contrasted with outright fusion is the manner in which it can facilitate this decentralization. Through the maintenance of separate corporations for the various units of a business system, separate staffs of executive officers, and separate systems of accounts for each subsidiary can be established and maintained. All the subsidiaries are tied together under the general control and supervision of the holding company but the more detailed problems of operation, as well as many of the larger questions of policy, may be assigned to the directors and officers of each subsidiary company.

It must be borne in mind that in some instances, subsidiaries have been relegated into mere property owning companies with officers who are simply figureheads. There are also successful companies like General Motors who have achieved marked success in decentralization through branches and divisions without resorting to separate legal entities. The separate companies have legal and psychological advantages for encouraging local responsibility but it is not vital to a program of decentralization. This is probably the most important advantage to Venda-Craft.

Joint advantages are sought but not at the expense of total integration of all activities and the giving up of direct control over their individual operating units by the successful
businessmen who have created them. It is felt that the close contact with the market allows a manager to recognize and react to impending changes. The entire structure is being designed to maintain the right of the entrepreneur to direct the routine operations. Although this could be done with outright fusion, the organizational structure of the holding company lends itself to maintaining this goal. Flexibility is also maintained so that if, at a later time, it becomes desirable to tighten control, this can still be effected with a change of policy without the need to modify the organizational form.

Insulation of liabilities to creditors

Although a holding company may so completely dominate its subsidiaries that all properties are in reality combined into a single system, each subsidiary, nevertheless, maintains its own corporate existence. It is unlikely that this legal separation will be disregarded by the courts if the entities adhere to legal formalities. The chance for creditors to avail themselves of the resources of the parent is slight. In general the courts have been more reluctant to disregard the "corporate fiction" in cases involving the liability of a parent company for the debts of its subsidiary than they have been in disregarding this same corporate function in cases where a separate corporation
has been obviously used as a means of defeating the object of an anti-trust law or a public utility law. However, a court may disregard the nominal distinction between a subsidiary and a parent when it finds that the accounts and other business relations between these two companies have been completely merged in practice. Although this is not a major issue in this case, it is desirable for the other companies coming into the combination not to become directly liable for debts incurred by other organizations prior to the combination.

Ease of divorcing the properties

Almost any combination of enterprises carries with it elements of risk of success. Anticipated savings may not materialize. Threat of anti-trust action may loom. One or more of the companies may prove not to fit into the over-all scheme of organization. A fusion of all the constituent companies into a single corporation makes it extremely hard to break up the system into its component parts. But a combination through stock ownership may be easily reversed, especially in the early stages of the holding company's existence. The stock may be sold to others, or spun off to stockholders, or exchanged again with the original contributors. Although such a reversal of position is not anticipated by Venda-Craft, flexibility is maintained if it should become necessary.
Despite the many advantages which have been previously presented, there are some disadvantages which counter them. If this were not the case, the holding company would become the dominant form of combination, completely replacing the direct forms of fusion. Bonbright and Means suggest the following disadvantages:

1. **Obstacles to a complete integration of the constituent properties arising from the rights of creditors and minority stockholders.**

2. **Costly and top-heavy financial structure.**

3. **Expense of creating and maintaining separate corporate organizations.**

4. **Administrative and managerial difficulties resulting from maintenance of separate corporations.**

5. **Liability to dissolution against the wishes of the controlling interest.**

Obstacles created by creditors and minority stockholders

The rights and interests of minority stockholders, and to a lesser extent, creditors of the subsidiaries, must be considered. The objectives of these groups may be decidedly different from the objectives of the parent organization. An

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3Ibid., p. 44
extreme example would be the situation where a holding company obtains control of a competitor for the purpose of closing it down and thus destroying competition. This same conflict of objectives may be felt to a lesser extent in many situations. By integrating several companies into a system, the objective is to maximize profits for the entire system. This may be done on occasion by depriving some of the constituent companies of a portion of their more profitable business and transferring it to other subsidiaries which are better equipped to serve the purpose of the entire organization. Such a transaction gives rise to claims which creditors or stockholders may enforce in courts of equity. Such litigation is expensive on both parties and the difficulty of proving the alleged mismanagement makes success of the plaintiff extremely doubtful. Nevertheless, it may make total integration of the system impossible while such litigation is outstanding. The conflict of increasing the profit of the system at the expense of one of the operating units is not expected to be present in Venda-Craft at least in the short run because of the careful negotiations which have been effected among all groups in setting up goals and objectives. Furthermore since the subsidiaries are expected to be totally owned by the holding company, all owners will participate on a pro rata basis regardless of the source of these profits.
Costly and top-heavy financial structure

The very ease in establishing a holding company tends to encourage development of a capital structure which may be expedient for the moment but unsound for the long run. The common stock of the subsidiaries forms a base for the common stock, preferred stock, debentures, and collateral trust bonds of the holding company. While such an arrangement may please a management interested in maintaining control through use of the thinnest possible equity base, it shows substantial weakness and will not be utilized by the Venda-Craft management which is more interested in the financial integrity of the system. For this reason, many companies which utilize the holding company device for effecting the initial combination then complete the fusion in order to acquire a simplified financial structure.

Further disadvantage lies in the high cost if securities are issued directly through the operating companies themselves. The issuing costs would be greater if each operating company issued its own debt issues than if a single large issue were handled by one company. Some savings can be effected by having the subsidiary issue debt securities to the parent which will use them as a base for its own collateral trust issue but the poorer standing of this type of bond adds to the interest cost. If the debt is issued directly by the subsidiary, the fact that
it is a liability simply of that one company rather than of the entire system will tend to give this a lower credit rating with its correspondingly higher cost.

Expense of creating and maintaining separate corporate organizations

In separate corporations, each must have a separate set of officers, separate accounts, separate records, and separate stockholders' meetings. Although these might actually be very little more expensive than the cost of operating a division, at least their cost must be considered and compared with the costs of complete fusion. A more significant factor is tax position. Some double taxation will be present if income is provided to the parent company through dividends from the operating companies. Consolidated statements may be filed with a 2% penalty or if separate statements are used, 85% of dividend income is excluded from tax calculation. Venda-Craft is prepared to accept the cost of maintaining separate entities because of the other advantages which separate entities provide.

Administrative difficulties

The creation of a holding company does not provide for decentralized management, *per se*. A complex of firms tied together through a holding company may develop into an unwieldy
organization with little control and an administrative system of bureaucratic indifference. Tight control is more difficult to maintain because of the very sense of separateness of the component firms. But neither does any other form of organization guarantee proper control. Although there may be a greater tendency for poor control to slip into the organization, the awareness of this may in itself be a strength because greater diligence will be exercised to prevent it. The Venda-Craft management believes that careful attention to the form of organization and clear cut understanding of joint goals and objectives achieved by good communication and discussion of the problems can lead to a proper balance. Prevention of poor control is but another facet of the organization problem.

Danger of dissolution

The ease with which a holding company system can be broken up by the wishes of the controlling parties also suggests the danger of its being broken up despite their wishes. Its unstable structure brought about through pyramiding can collapse through the default of one or more component parts. Foreclosure proceedings against a subsidiary can result at best in the loss of that subsidiary, and at worst, in the collapse of the entire system. In the Venda-Craft combination of successful
and well operated businesses and its proposed conservative expansion policy, this disadvantage does not appear threatening. The failure of a major division could be just as damaging to a consolidation.

**Development Of The Management Organization For Venda-Craft**

On March 18, 1961, representatives of the four operating systems met and adopted the stock exchange formula developed by the Evaluation Committee (see p. 112). committed in principle to the development of the holding company, three committees were appointed to further develop the organizational structure in accordance with previously determined broad policies.

First an Operations Committee was appointed. Its objective was to determine, from the point of view of the individual companies, what the relationship to the central company should be. The second committee was the Objectives and Policies Committee whose objective was to decide what the central company's relationship should be with the outside business world and what its relationship should be to the individual companies as it attempts to fulfill the objectives of the central company. A third committee was the Acquisitions Committee. It had the responsibility of negotiating with other prospective companies
who were interested in Venda-Craft and to serve as a channel of communications. It was to make contacts and to make recommendations but did not have authority to decide whether or not to acquire individual companies.

At the next session the Operations Committee made the following recommendations which were unanimously adopted by the vendors group:

1. A decentralized company to the greatest degree possible is desired.

2. Accounting procedures should be uniform, in form similar to the National Association of Machine Accountants chart of accounts.

3. Management personnel within the individual companies should be aided in development by assistance from the central company.

4. Purchasing should be centralized.

5. The central office should provide aid in selling ideas, probably through the direction of the vice president in charge of operations.

6. In the long run, standard operating procedures should evolve from the central office that would aid the individual companies.

7. Present officers of individual companies should have employment contracts to protect the individual companies and the central company.4

A Short Range Planning Committee began the task of undertaking the preparation for the ownership transition for the operating companies. It was recommended that management of the operating companies be undertaken as follows:

1. Initial management be composed of the major stockholders who are currently taking an active part in management.

2. Executives must devote full time to the operation of the company. (Exceptions will be considered and decided on a merit basis).

3. Present officer-stockholders must be prevented from entering into a directly competing business if they terminate employment with the subsidiary.

4. Salary will be proportionate to other key employees and must be comparable to the figure that would be paid for non-stockholders to perform similar duties. A bonus based on net profit before taxes will be paid to both stockholder-executives and non-owner executives.

5. Expense accounts by stockholder executives are to be kept within conservative limits with no luxury items allowed.

6. An employment contract of five years is recommended for present owner-executives in order to maintain safety of their position and to insure continuity of management of the operating companies during early years of the existence of the holding company.\(^5\)

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In view of the definitely stated policy toward decentralization, the Objectives and Policies Committee recommended that the central company assume only those activities which were needed for coordination of the system or which it could do more economically than the individual companies. These were felt to be mainly in the areas of finance and central purchasing (which will be explored in subsequent chapters.)

Policy making in the central company shall be under the authority of the Board of Directors composed of representatives of the present management of the operating companies. The president should make it his responsibility to handle the area of finance. As a by-product of this financial area, it would be expected that uniform accounting for the individual companies would follow. An executive vice president in charge of operations would have the principle job of coordinating the efforts of the various individual companies. Assisting him in the area of central purchasing, a purchasing agent would be appointed to negotiate terms and establish uniform purchasing practices. Individual presidents of the operating companies will report to the executive vice president and will have responsibility for the results of their operations of the companies.  

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BOARD OF DIRECTORS

PRESIDENT

CHIEF ACCOUNTANT

EXECUTIVE VICE PRESIDENT

PURCHASING AGENT

PRESIDENT SOUTHERN SALES
PRESIDENT DIXIE DISTRIBUTING
PRESIDENT MID-GA. CANDY
PRESIDENT PIEDMONT DAIRIES

FIGURE 3
EXECUTIVE ORGANIZATION OF VENDA-CRAFT
The central company will not engage in owning equipment or direct operation. Its function is to serve as a management unit of operating properties, coordinating their activities for the joint benefit of all. Barnard states that:

An organization comes into being when (1) there are persons able to communicate with each other (2) who are willing to contribute action (3) to accomplish a common purpose. The elements of organization are therefore (1) communication; (2) willingness to serve; and (3) common purpose.

The function of the holding company as a communications device becomes its most important activity. Boulding expresses the use of organization for communication as follows:

We have seen that in the simplest machinery, as well as in the most complex organization, the function of the executive is to receive information along one set of channels of communication and to transform this information into "orders" which are sent out along other channels. The powers of the human individual, however, to receive information, to assess its reliability to the role which he is playing, and to interpret the information in the form of orders are very limited. It would be utterly impossible, for instance, for the president of even a small corporation to receive and assimilate all the information which is being received daily by the "receptors" of the business; it would be equally impossible for him to issue orders to all the "effectors" of the business. The hierarchy, therefore, acts as a sieve for information and as an analyzer of orders, preventing unnecessary information from reaching the top, trans-

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forming at each level some information into some orders, and expanding the general orders which come down from the higher levels into particular orders at the levels of execution.

The organizational structure of Venda-Craft, is drawn in part from the uniting of organizational structures of the existing companies and in part from creative planning. In the words of Dale, they are "breaking down broad and overwhelming tasks into manageable size and pinpointing responsibilities and at the same time ensuring coordination of the work." Elaborating on this concise definition, he indicates four basic characteristics:

1. Organization is a planning process. It is concerned with setting up, developing and maintaining a structure or pattern of working relationships of the people within an enterprise. It is carried on continuously as changes in events, personalities, and environment require. Thus organization is dynamic. However, the resulting structure is static--i.e., it reflects the organization only as of a given amount of time.

2. Organization is the determination and assignment of duties to people so as to obtain the advantages of fixing responsibility and specialization through subdivision of work.

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3. Organization is a plan for integrating or coordinating most effectively the activities of each part of the enterprise so that proper relationships are established and maintained among the different work units and so that the total effort of all people in the enterprise will help accomplish its objectives.

4. Organization is a means to an end. Good organization should be one of the tools of accomplishing the company's objectives, but it should not become an objective in itself. 10

As a guide in their task, the promoters are drawing largely on their own past experience. Their emphasis will be "practical" as contrasted with "theoretical" Yet the creation of an effective structure which meets the needs of the combining companies encompasses the principles of organizational theory.

Careful groundwork has been laid both with owner-operators and minority stockholders to keep them informed of developments and to enlist their enthusiasm for the project. Objectives have been broadly defined in those areas in which there is mutual agreement, i.e., larger volume of operations and lower operating costs, but the carefully preserved autonomy of individual operations is to allow present owner-managers maximum latitude in

maintaining their own individual objectives and satisfactions. Such action increases the willingness to cooperate in the more major areas affecting the entire operating system. There has been the inculcation of belief in the real existence of a common purpose. This is essential to organization. Barnard states:

\[\text{Willingness to cooperate, except as a vague feeling or desire for association with others, cannot develop without an objective of cooperation. Unless there is such an objective it cannot be known or anticipated what specific efforts will be required of individuals, nor in many cases what satisfactions to them can be in prospect.}^{11}\]

Although the entire group of executives creating Venda-Craft recognize certain common advantages and benefits, the sum objectives of all the men are not identical. The basic policy of autonomy of operating units and the careful attention to major points of agreement are to gain cooperation through such emphasis. Barnard states:

\[\text{We may say, then, that a purpose can serve as an element of a cooperative system only, so long as the participants do not recognize that there are serious divergences of their understanding of that purpose as the object of cooperation.}^{12}\]

\[\text{^11 Barnard, } \textit{op. cit.}, \text{ p. 86.}\]

\[\text{^12 Ibid., p. 87.}\]
Financial gain alone is insufficient as a purpose for welding together these four systems. Each system is successful in its own area and has been made so by strong and aggressive leaders. Creation of the central company is achieved by a delicate balancing of advantages against the loss of independence of each owner-manager. The retention of corporate entities whose only direct change is a change of ownership is designed to minimize the loss of independence. Even the organizational structure adopted minimizes change by superimposing the central company organization directly above the existing structure of the operating companies. Recommendations will emanate from the central organization in an effort to gradually improve the balance of duties between the presidents of the operating companies and their subordinate officers. Although no provisions are currently being made for a personnel staff at the central company level, its creation would be in keeping with the adopted policy of the combining firms.

The creation of Venda-Craft will impose an additional burden of time consuming duties upon the operating company presidents. Each is a member of the board of directors of Venda-Craft and each is operating head of his former company. The additional time required for coordinating joint activities and planning
advancement for Venda-Craft will reduce the time available to spend in the personal handling of operational details of the operating units. Their focus is being shifted to the larger organization and will require greater delegation of authority to their own subordinates at the operational level. As management by personality of the strong leader declines, management by sound organizational structure must be developed if effective operation is to continue.
CHAPTER VI
THE FINANCIAL PROGRAM OF VENDA-CRAFT

Capitalization of the Holding Company

Capitalization of Venda-Craft was set at $1,500,000 consisting of a simple structure of 150,000 shares of common stock with a par value of $1 and a paid-in surplus of $1,350,000. Combined earnings of the four company groups amounted to approximately $75,000 for fiscal 1961 when adjusted for uniformity of accounting practice. Earnings were capitalized at the rate of 5% (20 times earnings) to arrive at the assumed value of the holding company.

Dewing points out that the rates at which earnings should be capitalized depend on the risk involved; and that risk depends to a large extent upon the relative importance of management.\(^1\) Recognizing the difficulty of selecting and applying a valuation ratio to specific firms, he develops broad categories of risk. The highest class (lowest risk) would be capitalized at 10% or ten times annual earnings. Of the fourth class, he says:

"There are many industrial corporations requiring con­
siderable skill of management, yet neither an exceptional
nor unusually rare type of special knowledge, which show
constant earnings under highly competitive conditions.
They have little help from patents or trademarks, nor is
there a great amount of capital required to enter them.
Such businesses are worth not more than 5 times their
normal earning capacity--a 20% basis."

The description, if not the suggested rate, accurately fits the
vending industry, and especially the developing Venda-Craft.

Although the holding company itself is new, its component
companies have several years of past experience and successful
operation. Under competitive conditions, they have made profits
and grown. Although capital investment for a full service
vending company is large, the relative ease of financing equipment
purchases keeps the effective capital requirement contradicting
Dewing's capital requirement concept.

Dewing recognizes that at times, corporate valuation and
stock prices have exceeded his limits by considerable degrees
but attributes this to abnormal conditions. The 1953 edition
of Financial Policy of Corporations specifically mentions
1928-29 and 1943-46. In the late 1950's ratios were again far
in excess of 10 to 1, especially in the so called "glamour

\[\text{Ibid. p. 389.}\]
industries." Selected examples in the vending industry will illustrate the market position. An article appearing in *Time* Magazine in May, 1960, observes:

Wall Street's newest romance is with the automatic vending machine industry, which is changing the eating and buying habits of America. Shares in vending companies have suddenly been tagged with the magic phrase 'growth stock,' have risen spectacularly in a declining market. In January, the stock of Universal Match, which rings up 40% of its sales in vending equipment, sold for 83, last week closed at 134 3/4. Vendo, the largest maker of automatic vending machines, has jumped from 23 3/4 to 66, while Automatic Canteen, biggest combined food-selling and machine-manufacturing company rose from 21 to 31.3

The 1959 earnings reported for Automatic Canteen (the only one of the three which engages in vending operation) were only 93c per share, resulting in a stock price of 34 times earnings.

Automatic Retailers of America was put together in late 1959 by the combination of several other vending companies with Davidson Automatic Merchandising Company. With combined income for 1959 of $789,000 the company was initially capitalized by the promoters at $3,825,000, resulting in a valuation of approximately 5 times earnings. But when stock was first offered to the public on February 4, 1960, it was sold for $16.625 per share.

Unadjusted earnings for 1959 based on 791,796 shares outstanding amounted to $1 per share, up from $0.73 and $0.55 for the two previous years. Based on 1959 earning only, the stock sold at a price over 16 times earnings.\(^4\)

In 1960, Interstate Vending undertook a recapitalization in which 285,000 additional common shares were publicly sold. Earnings per share for 1959 were $0.51 but the stock was sold at a price of $14.875. Sales price was approximately 29 times earnings.\(^5\)

Macke Vending Company, one of the older companies in the field, issued 105,000 additional shares in 1960 at a price of $10. With 1959 earnings per share amounting to $0.50, there was a price earnings ratio of 20 to 1.\(^6\)

The 20 times earnings capitalization of Venda-Craft is not conservative but at the time it was set, it did not appear unreasonable when compared with the market in general and other vending companies in particular.


\(^5\)Standard and Poor's Over-the-Counter and Regional Exchange Stock Reports, Vol. 28, No. 146, Sec. 17 (December 24, 1963), p. 4269K.

The Apportionment Formula

The division of ownership in the holding company was more significant to the promoters than the capitalized value of the holding company. They were pooling their assets and earning power to create a new firm. Regardless of assumed total values at that time, future profits would be based on the fraction of total ownership allocated to each present stockholder. The apportionment formula consisted of three main areas:

A. Value of Equipment. Each company placed emphasis on the value of its operating equipment. The formula had to accept the fact that no vending operator would be willing to receive less than the fair market for his equipment. A floor price was established using as a base the fair market value of equipment as determined by impartial appraisal. Book values of equipment were not considered at all because older equipment which was still in use but already fully depreciated had a real cash value in the used equipment market, and equipment presently on the books was being depreciated at maximum legal rates for tax deduction purposes without regard to market value. The fair market value was determined by a committee of the operators themselves. Liabilities were subtracted after these assets were evaluated in order to determine what each operator would receive for his equity value.

B. Earnings. It was also important to recognize the contribution which the earnings of each ownership unit would contribute to the holding company. The holding company gave credit in new stock in proportion to the contribution to total earnings.
C. Intangibles. Another major factor in the evaluation of a company is its management, its diversification, its territorial potential and other intangibles which might not be reflected on its books. The third phase of the formula attempted to embrace these various activities and considered them in evaluating the stock to be given each stockholder unit.

Although the general principle of the formula was quickly agreed upon, the actual spelling out of the detail was a long process involving many meetings and frequent compromises. Although it involved great attention to details, the asset evaluation (A) was agreed upon without great difficulty. The final agreement provided that each stockholder unit would receive, dollar for dollar, stock value equal to its net evaluated assets, or excess of assets above liabilities, defined as follows:

1. The audited balance sheet of any given date, mutually agreed upon, adjusted by substituting for book value of vending machines the appraised values as determined by multiplying the number of machines of a particular type, model, and year by the machine valuation agreed to by the Evaluation Committee. (The right was reserved for each operator member to have an opportunity for questioning the Evaluation Committee's evaluation of any given piece of equipment.)

2. Automobiles and trucks valued at original cost with reserves based on a four year straight line depreciation, with 25% salvage value.

3. Office, shop, and warehouse equipment valued at original cost, with reserves based on eight years straight line depreciation, with 10% salvage value.
4. Service equipment, display fronts, stands, waste receptacles, and similar assets itemized and valued on a basis acceptable to the Evaluation Committee. The committee recommended that this value should not exceed 1% of the total value of vending machines.

5. Useable spare parts itemized and valued on a basis acceptable to the Evaluation Committee. The committee recommended that this value should not exceed 1% of the total value of vending machines.

6. Merchandise inventory valued at cost.

7. Accounts receivable and advance commissions taken at book value but guaranteed by each stockholder unit.

8. No intangible value should be included in net assets, and the inclusion or exclusion of uncommon assets should be decided by the committee on an individual basis.

Assets used in operations not directly related to vending operations were not included or considered in this phase of the evaluation. All other operations were valued on an individual, negotiated basis. The committee required a complete description of other operations, including a statement of their relationship to merchandise vending and audited statements showing full detail of departmentalization and cost allocation. The committee concluded that such negotiations should give major considerations to cash flow and profit contribution for determination of value.

After the asset values were subtracted from the proposed capitalization of $1,500,000, the remaining stock was allocated
through an averaging of the results obtained from independent use of parts (B) and (C).

Applying (B), each stockholder-unit would receive an amount of the balance of the holding company's stock in direct proportion to the stockholder-unit's percentage of the total net earnings of the holding company before taxes. Profit and loss statements were adjusted to a standardized accounting basis in the following manner:

1. Vending equipment was depreciated on a straight line basis of 5 years with 10% salvage value.

2. The depreciation rate on other equipment was on a straight line basis of 5 years with 10% salvage value.

3. Interest charges were added back to net earnings before taxes.

4. Commissions to accounts were amounts actually paid to or earned by customers, and all net advance commissions were capitalized as prepaid expenses and added to net earnings, if previously charged to profit and loss. Bonuses paid as considerations for contracts were prorated over the contract term.

5. Extraordinary expenses (such as special donations, excessive maintenance costs, reconditioning and replacement of equipment, and new acquisitions) were negotiated with the committee on an individual basis. A list of unusual situations was required to be furnished immediately to the Evaluation Committee. This list also included non-recurring expenses which might validly be replaced in profit.
The foregoing adjustments were undertaken to place each stockholder-unit in a comparable expense and income position. Thus, if one unit after these adjustments provided 35% of the adjusted income of all units added together (which was assumed to be the income of the holding company), by this calculation the unit was entitled to receive 35% of the remaining stock.

The third phase of the formula also used as a base the stock remaining in the holding company after the subtraction of net equity of the four stockholder-units. The objective of this computation was to assign a value to cash earnings before depreciation and taxes which takes into consideration the subjective factors of management, diversification, and territory potential. Because of their intangible nature and the inability to quantify with exactness, allocation based on subjective factors proved to be one of the most difficult to negotiate. A minimum multiplier of 1.50% of adjusted earnings after taxes was agreed upon as a base to give the company credit for its cash earnings before a reasonable depreciation and taxes. The multiplier was increased by an amount depending upon what the company had to contribute in the following non-book value situations:
1. **Management.**
   a. Capable and will continue with the company .15
   b. Youth and experience .05
   c. Can take over expanded operations .01 to .55

2. **Diversification.**
   a. More than 50% industrial .10
   b. Good product balance .10
   c. No predominant accounts .05

3. **Territorial potential.**
   a. Good available location .10
   b. Above average industrial growth .05
   c. Available independent vendors as a prospect for additional merger .10

The maximum multiplier was 2.75% of adjusted earnings after taxes.

Applying this computation, if a company had cash earnings before depreciation and taxes of $100,000 and was entitled to the maximum multiplier of 2.75, that company would be evaluated at $275,000. After each company had been evaluated in a similar manner, their sums were added to obtain the total assumed value. The percentage of this value contributed by each company would then be applied against the actual stock available for distribution after the allocation on the basis of net assets to arrive at the proper allocation of the holding company's stock. This phase of the formula would improve the valuation of a company which had emphasized the intangible growth factors in its situation but had not made a large contribution to earnings.
It was agreed that the final evaluation would be determined by four steps:

1. Stock equal to net adjusted assets would be distributed to each company (Computation A).

2. The proportion of net adjusted earnings of each company to the sum of all earnings would be computed. Stock remaining after (A) would be allocated to each company in proportion to earnings (Computation B).

3. The proportion of earnings (as adjusted by the multiplier of each company) to the adjusted sum of all earnings would be computed. Stock remaining after (A) would be allocated in this same proportion to each company. (Computation C).

4. A simple average of (B) and (C) would be taken to determine the actual amount of stock remaining after the computation by (A), which would be distributed to each company.\(^7\)

The evaluation formula arrived at by the committee and accepted by the vendor's group has many facets, but it was felt that a formula of this complexity was necessary to give fair representation to all phases of all companies. It was the excessive simplicity of the formula used by the United Servomation group and its deleterious effects on company value which was mainly responsible for the withdrawal from negotiations by members of the Venda-Craft group. Stock in United Servomation would have been allocated primarily in

\(^7\)From the March 3, 1961 report of the Evaluation Committee.
relation to net income (before Federal income tax) for the last three full fiscal years.

In order to simplify the exchange process, adjustments of the accounting records had to be made. Each company submitted to the accountant working with the evaluation committee the following information:

A. A balance sheet as of the end of the last fiscal year and a profit and loss statement for the same period. These statements combined the operating results of all organizations in each group, with appropriate elimination of inter-company transactions and profits in assets.

B. Working trial balances of the accounts for the same period prepared in accordance with the classification suggested in the "Proposed Chart of Accounts for Vending operators" put out by the National Automatic Merchandising Association in 1958.

C. Any additional information for special consideration. In addition to the items previously mentioned in the detailed explanations for adjustment, presentation was made of any abnormalities which the owners felt should be considered in the evaluation process. This would include acquisitions or disposals of operations during the period under consideration, extraordinary costs or income of a non-recurring nature, charges to profit and loss for the write-off of intangible assets, or any other item which would be a factor in evaluation.

Statements as of December 31, 1961, were submitted to the accountant for final computation for the exchange of stock although it was understood that it would be late summer or
early fall before the exchange could be formally completed. Because of changes in operations and different rates of growth which could occur during the intervening months with significant effects on the valuation of any of the component companies, it was agreed that the December figure would be final in terms of stock but adjustments would be made as of the closing date by issuance of promissory notes by the holding company to the operating companies for any new valuation excess.

Although the agreement seemed equitable at the time it was made, there remained the possibility of further delays at the time of closing if demands for re-evaluation were made by any of the component units. By late January, 1962, the participants in the venture consisted of only the four ownership groups previously mentioned. With the adjustments in the financial statements underway, it appeared that final results would place the three larger groups at a closer equality of ownership than had been previously expected. At this point, the president and major stockholder of Piedmont Dairies, the largest of the four components (38% by the previous estimate) suggested that both time and expense could be saved by accepting as a basis of FINAL evaluation the 6% for Mid-Georgia Candy Company, as determined by the preliminary application of the formula, and that the balance of the stock be divided equally
by the three other ownership groups. His proposal was unanimously accepted and the accountants were asked to stop working out further adjustments for evaluation purposes and to begin the next phase of adjusting the company's records for uniformity of operation.

Even though the evaluation formula was not used precisely for final allocation of stock, it served a useful purpose as a broad guide of individual company value. Its preliminary application brought about agreement without the necessity of incurring the expense and delays of precise measurement, and in bringing about an agreement, the formula had served its purpose. The formula was not abandoned because it was considered improper or unsuccessful.

As a guideline of company value, the formula did a commendable job, and its significant feature lies in its consideration of assets and earnings distinctly and separately. Such separation is considered the "scientific" method whose application was generally used as far back as the period of corporate expansion occurring between 1897 and 1903.8

8 *Big Business: Its Growth and Its Place* (New York: Twentieth Century Fund, Inc., pp. 27-28.)
Consideration at that time was usually in the form of preferred stock. Commenting on this in 1910, John Moody states:

"Most of the industrial corporations have been formed within the past ten or fifteen years and the preferred stock in nearly all cases represented at the time of formation the physical value of the plants consolidated, while the common stock generally represented the capitalization of future profits or simply voting power."\(^9\)

The principle of separate consideration of assets and earnings is still asserted, although its separation through different classes of stock is not a necessary factor. The following quotation from Gerstenberg illustrates contemporary thinking on the subject:

"The scientific method of valuation proceeds on the theory that a constituent has two distinct things to contribute to a consolidation, namely, assets and earning power. It entails (1) determining the capitalization of the consolidated company by capitalizing earnings, and (2) distributing the securities among the constituent companies according to a formula for evaluation of assets and earning power...

The scientific plan does not provide a hard and fast division of stock, but merely implies a principle, namely, that some allowance will be made for earning power in common stock. Just what allowance shall be made in any given case is a matter for the parties to negotiate. The reader must remember that there is no one scientific method...

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It is not necessary that both preferred and common stock shall be used. In recent years, the use of common stock alone has been the more common practice. Such a practice avoids burdening the new firm with senior issues so that these can be used for later growth opportunities after the success of the combined companies has been demonstrated.\(^{10}\)

The same point is emphasized by Guthmann and Dougall in *Corporate Financial Policy* in their discussion of reconciliation of earnings and assets.\(^{11}\)

The adjustment of book values of assets to a value realizable through orderly liquidation is a technique which is supported by Arthur Stone Dewing. In *Financial Policy of Corporations*, he supports the proposition of valuation based upon earnings by stating "...the capitalization of earnings is the only means at our disposal for determining the value of a going business."\(^{12}\)

However, he recognizes that a business will not be sold for less than the scrap value of its assets even if the business has negative earnings. This scrap value will be determined by the


assets potential earning power to another business.\textsuperscript{13} The analysis of potential value to another business is exactly the approach used by the Venda-Craft Adjustment Committee in arriving at an asset valuation of each company.

Although the valuation of intangibles not shown on the company books (Part C) is the least precise of the three sections of the evaluation formula, it is useful because it allows consideration of special elements which are characteristic of the vending industry. The rapid expansion in the field of vending, the development of large and highly competitive companies, and movements from street locations to complete industrial feeding service are major forces which require a company to be assessed through a more penetrating analysis than a simple projections of past profit trends. For the young vending company, costs of development of its organization and expenditures undertaken for future business development may reduce present profits and fail to indicate prospects for the future. Business development expenditures are comparable to research expenditures made by the manufacturing firm. The results are unpredictable both in amount of return and time of return, but the expenditures

\textsuperscript{13}Ibid, pp. 281-307.
contribute significantly to the long-run profitability of the firm.

Inclusion of intangibles and non-income items in the evaluation formula further strengthens its reliability as well as making it more acceptable to the operators who feel that their development potential is not adequately reflected by past earnings.

The Plans For Public Offering

An initial objective of the owner-managers of the combining companies was an immediate public offering of Venda-Craft stock and the development of a secondary market for future trading. Several of the operating company stockholders wished to dispose of portions of their ownership in order to obtain funds for the development of other ventures which seemed to offer substantial promotional profits. If a regular trading market could be established while the vending issues were enjoying great popularity with buyers, as they were in 1961, a portion of the promoter's investment could be liquidated at a high profit without losing operating control of the holding company.

A stock sale with proceeds going to the promoters is a device which has been used repeatedly as vending combinations were put together. The following examples are indicative:
A. In 1945, Prophet Company offered 100,000 shares through Smith, Hague and Company of Detroit, and Straus and Blosser of Chicago. Of the total, 86,500 shares were sold publicly at $6.25 per share and 13,500 shares were offered privately to officers and employees at $5.25 per share. None of the proceeds accrued to the company.\textsuperscript{14}

B. In 1945, Automatic Canteen offered 14,963 shares at $33.75 per share through Central Republic Company, Inc., and Hornblower and Weeks to residents of Illinois only. The offering did not represent any company financing.

In 1946, an additional offering of 129,966 shares was offered through the same underwriters at a price of $23.50 per share. Proceeds from only 21,921 shares accrued to the company.\textsuperscript{15}

C. In 1947, ABC Vending offered 145,000 shares at $7.50 per share through Reynolds and Company of New York. Proceeds from 25,000 shares only accrued to the company.

In 1950, 177,028 shares were offered by the same underwriter at a price of $9.275 per share. Proceeds of 147,228 shares accrued to the company.

In 1958, 150,000 shares were offered through the same underwriter at a price of $17.75 per share. This offering did not represent any company financing.\textsuperscript{16}

\textsuperscript{14} Standard and Poor Over the Counter and Regional Exchange Stock Reports, Vol. 29, No. 2, Sec. 21 (January 4, 1963), p. 5028.

\textsuperscript{15} Moody's Industrial Manual, 1956, p. 2107.

An immediate offering of approximately 30% of the holding company stock was anticipated with further disposition of stock occurring through after-market sales by those promoters who wanted additional liquidity. After negotiations with several other underwriters in the Southeast, a Charlotte, North Carolina, investment banker was selected to work with the promoters in creating the holding company and bring out the initial stock offering.

As the project progressed, the objective of immediate liquidity had to be abandoned although it is still to be sought later. A change in market conditions and inadequate financial planning were the major causes for the change in plans.

The Change in Market Conditions

The severe market adjustments of late May and early June, 1962, resulted in sharp price declines in individual stocks and a loss of confidence by the small speculative buyer. At the end of the first quarter of 1963 when the Dow-Jones Industrial average has recovered much of the height lost in last year's declines, the over-the-counter market is still depressed. Commenting on this, the Wall Street Journal says:
"With trading slow, the prices of the OTC stocks also are lagging behind upturns registered on the exchanges. The Dow-Jones industrial average of 30 New York Stock Exchange Stocks since last June has recovered about 75% of the deep decline it suffered in late 1961 and early 1962. . . But the National Quotation Bureau Index of 35 over-the-counter stocks has recovered only 65% of its 1962 decline.

Some analysts think even this index gives too optimistic a picture, since it is made up largely of shares in what, by OTC standards, are large and well-established companies. Shares in hundreds of younger and smaller OTC companies haven't bounced back at all from last year's lows, they say."17

The observation is well founded when applied to vending stocks. Market resistance to new speculative issues is reflected in SEC figures on new corporate stock offerings. For the three months ended January 31, 1963, corporations offered only $157.3 million in new stock, down from $605.3 million for the same period ending in 1962.18 Table II shows market information about six leaders in the vending field, covering both listed and unlisted issues. Without exception, the peak price was reached in 1961, and with the exception of Prophet, the current price is still very close to the 1961 low. Price earnings ratios are also lower. It is unrealistic to believe that Venda-Craft could command a price of 10 to 12 times


earnings like that of the four smaller vending companies shown in Table II. The smallest of these companies has over four times the sales volume of Venda-Craft. They all have larger profit margins. They all have a past record of successful operation under the existing management and they have an already established trading market.

The present Venda-Craft holders are unwilling to relinquish any of their equity at prevailing prices. Adjusted asset values of the combined companies forming Venda-Craft are approximately $1,100,000. With earnings of approximately $75,000, the price earnings ratio would have to exceed 13 to one in order to equal present asset values. The sole validity of such a high evaluation is predicted upon future potential. Although potential for an even higher valuation may be present, there is no tangible evidence which would convince an investor. With the change in market conditions, the underwriter advised that the market would not be receptive to a new issue under terms and prices which would be favorable or acceptable to the present owners.

Inadequate Financial Planning

In accordance with the objectives of immediate liquidity and the taking of stock market profits, the promoters considered
an initial public offering from their own holdings of approximately 50,000 shares at a price of $500,000 or more. After an offering of this size, they would still have 2/3 of the outstanding stock of the company and be assured of control. Then as the assumed price rise took place through the secondary market, additional shares could be placed on the market at still higher prices. Control with less than 50% of the stock could be maintained through new stockholder inactivity and the use of proxies.

It was the opinion of the underwriter that the plan was not sound and should not be undertaken. The amount planned for immediate sale was too small in number of shares to provide for an orderly after market. Furthermore, the underwriter expressed an unwillingness to undertake an issue which would not directly benefit the company by providing some additional financial resources. The underwriter was willing to work toward the preparation of a stock issue but he felt that no more than 12½% of the ownership of the old management should be disposed of in one year. For the new stockholder, such a policy provides assurance that existing management will not dump ownership of business onto the public for high stock
market profits and then abandon the corporation without adequate management being developed. Further investigation with other underwriters found several who were willing to handle an issue disposing of 1/3 of the stock solely for the benefit of the present owners but inability of these underwriters to provide a satisfactory after-market with a continuing relationship satisfactory to the company caused negotiations to be dropped.

The view of the Charlotte investment banker was corroborated by two leading investment bankers in Atlanta. In an interview with a vice-president of one of the Atlanta firms, he indicated that the policy of his company was to avoid new issues unless the company:

1. had minimum sales of $1,500,000 to $2,000,000 and
2. had a minimum of 150,000 shares to be distributed.

His company was also reluctant to undertake an issue which did not result in a substantial portion of the proceeds accruing directly to the company. Furthermore, an issue would not be considered if the present owner-managers disposed of so much stock that continuity of management was threatened. A vice-president of the other Atlanta firm presented approximately the same requirements for consideration of a new issue. He added
that his firm recommended that the total value of the shares offered should be $1,000,000 or more. Both officers were clear in stating that their firms have no definite minimum amounts as requirements for an offering and in special cases they have handled stock offerings of smaller size. Each offering is decided individually although their general recommendation is that an effective after market with regular trading at close margins is unlikely unless the previously mentioned standards are met.

Briefly, consideration was given to a combination offering similar to that used by ABC Vending in 1950 in which the bulk of shares issued would be for capital for the company but would include some personal shares. Inability at that time to provide clearly delimited programs and an estimate of needed funds caused the plan to be held in abeyance.

A technical problem involved the SEC requirement that registration cannot be effected without audited financial statements for the three proceeding operating years. The underwriter felt that even with the substantial adjustments made for fiscal 1961 which produced statements used as a base for determining the stock exchange ratio, the reports would not qualify for an SEC approved prospectus. Additional adjustments to bring the
diverse accounting systems into alignment for the past three years would be time consuming and expensive. By postponing the issue, a practical program of financial needs and acceptable statements taken from joint operations could be developed.

Any reservations which the promoters had pertaining to the advisability of waiting for a public issue was eliminated by the price declines of 1962. At the present time, (Spring, 1963) the company is waiting until conditions are more favorable for the transition to public ownership.

Effect Of The Decision Not To Go Public At This Time

The decision not to go public at this time gives the operators of the combining companies the opportunity to re-appraise their present situation. Basically, it includes a shift of emphasis from quick stock market profit to long range operating gain and then capital gains on sale of stock if they wish at that time to take them. The decision not to go public at this time is actually desirable.

It will focus the attention of the present owner-managers on the continued operation of the operating companies and toward their transition and assimilation into a well-planned and soundly-
managed holding company system. The promoters' present earnings will be directly dependent upon company profitability (as contrasted with windfall profits made by rising levels of stock prices), and their future capital gains will be dependent upon their ability to endow the company with the appearance of a desirable investment so that at some future time stock can be offered. The decision to wait for public ownership will also allow decisions to be made solely on the basis of what is best for the company without regarding how such a decision might affect the position of new stockholders or how the action would be viewed by the market in general. With sound management, Venda-Craft has excellent prospects for continued growth in the next few years. Having survived the first crucial five years, the component companies have developed excellent reputations in the business community, enjoy good credit ratings, and are now finding it easier to obtain bank financing for acquiring new equipment and expanding operations. Inroads have been made in providing food service in individual plants of large multi-plant companies which may be expanded in the next few years.

The planned expansion will increase sales volume and should increase profits more than proportionately. It is anticipated that joint operation will provide economies in purchasing
merchandise and vending equipment which help push up the ab-
normally low profit margin. Elimination of duplication of
some activities and tighter control made possible by having
volume large enough to afford more detailed cost analysis
would be direct advantages brought about by the holding company.
It is believed by company management that the system can increase
profits with almost no increase in fixed or semi-variable cost
through replacing some unprofitable accounts by other in-
stallations which would be profitable. The position of Macke
Vending and Prophet (See Table I) is considered indicative of
the increase in profit margins made possible by increasing
volume. Their growth, which appears to be less than the other
four companies shown, is representative of new business developed
by an existant, continuing company in which volume increases
result in better profit margins. Much of the rapid increase of
volume of the other four companies came as a result of mergers
or purchases of other operating companies. The rapid expansion
brought growth in volume but led to distinct problems of
assimilating the newly acquired firms into a unified profitable
system. According to the planned growth, Venda-Craft’s earnings
per share will be higher when public offering does occur and
total price received for a portion of the business will be more
favorable to the present promoters. The promoters should make more profit on their stock by waiting to sell.

Neither the holding company or any of the operating companies have a pressing need for new financing at this time. The working capital position is not strong but the vending industry operates with a current ratio considerably below the usually stated 2 to 1. (See Table III.) The high current indebtedness is explained by the large investment in vendable merchandise usually bought on open account and the large investment in machines which are normally financed by the bank on a 24 to 36 months basis. 19

Current assets comprising combined totals of inventories amount to $100,000 and trade accounts receivable of Piedmont Dairies amount to an additional $175,000. Combined accounts payable are approximately $300,000 and are owed predominately by Piedmont Dairies which has NO long-term debt but relies exclusively on bank borrowing. A South Carolina bank to whom Rebel and Southern Sales owe $125,000 in short-term notes has expressed a willingness to extend payment if the companies so desire. In general, although working capital margins are slim

for the operating companies, the liberal credit policies of their banks are providing adequate funds at this time. If the proceeds of a large stock sale were immediately available, there would be a problem in finding immediate and profitable utilization of it.

**Plans For The Future**

Providing Assets and Working Capital for the Operating Companies

Current estimate of 1962 sales volume is $5,300,000, up from $5,000,000 in 1961. Although final figures have not yet been compiled for the holding company, the company estimates its profit margin is up slightly, although it is still below 2% of sales. The basis for optimism on the profit margin is that several installations which had been operating at a loss were dropped and replaced by other installations which are showing a profit.

Proposed growth through 1965 is planned to be steady but conservative. Total volume should be $8,500,000 to $10,000,000. Several projects are under development at this time which will lead to the anticipated volume as well as increased needs for financing:
1. Negotiations are underway with a major textile manufacturer to provide in-plant feeding in 18 mills. If this contract is obtained, a new subsidiary will be created to be equally owned by one of the operating companies and the manufacturer. Food service will be added to one plant per month for 18 months. When the installation is completed in early 1965, nearly $1,000,000 will have been added to annual sales volume.

About $500,000 additional investment will be required to provide equipment and operating capital for this installation. Half will be supplied by the manufacturer. A South Carolina bank has indicated a willingness to increase the bank line of credit by $150,000 as it is needed.

2. If negotiations with the textile manufacturer do not result in a contract, an additional salesman will be employed. By 1965, he will be expected to create 6 or 8 new accounts per year, each generating an average of $1,000 per week in sales, or a total of $300,000 annual sales.
3. Negotiations are underway to provide soft drink vending service to a southern university. Approximately $40,000 worth of additional equipment would be added. Sales are estimated to run $60,000 per year. It is hoped that additional vending contracts can be obtained once the company has established itself on the campus.

4. Preliminary talks are underway with both military and industrial users in a southern military and industrial complex.

5. Southern sales obtained a contract within the past year to provide complete vending service, including hot foods, for a major food processor in central Florida. Service was installed in two plants only, but at the present time, negotiations are underway to extend the service to a number of additional facilities.

6. Efforts are being undertaken for expansion of vending facilities on military bases along the eastern seaboard as well as acquisition of contracts for both milk and vending at military bases in states bordering the Gulf of Mexico. Expansion of the existing area and development of the new area may require as much as $300,000 to $500,000 additional investment.
The following comparative balance sheet compares the 1961 position with the projected needs for 1965:

(In thousands)

<table>
<thead>
<tr>
<th>Category</th>
<th>1961</th>
<th>Projected Needs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets</td>
<td>$ 440 (40%)</td>
<td>$1,000 to $1,200 (40%)</td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>660 (60%)</td>
<td>1,500 to 1,800 (60%)</td>
</tr>
<tr>
<td>Total Assets</td>
<td>$1,100 (100%)</td>
<td>$2,500 to $3,500 (100%)</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>500 (45%)</td>
<td>675 to $800 (27%)</td>
</tr>
<tr>
<td>Long Term Liabilities</td>
<td>200 (18%)</td>
<td>825 to 1,000 (33%)</td>
</tr>
<tr>
<td>Equity</td>
<td>400 (37%)</td>
<td>1,000 to 1,200 (40%)</td>
</tr>
<tr>
<td></td>
<td><strong>$1,100 (100%)</strong></td>
<td><strong>$2,500 to 3,000 (100%)</strong></td>
</tr>
</tbody>
</table>

The Carolina bank which has provided short term funds in the past can be expected to increase the line of credit to the needed level as the company expands its assets and increases its sales volume. Even with the increased borrowing, the current ratio will be increased from the present .9 to 1 (See Table III) to a more acceptable 1.5 to 1.

With current profits running at $75,000, and the expectation of doubling sales while increasing margins, an equity increase of $800,000 over the next five years is possible if company plans are carried out successfully. This large and rapid equity
increase is needed to finance growth in assets to the desired level. If earnings do not materialize as expected, stop-gap financing can probably be obtained through increased bank borrowing although this sacrifices the desirable current ratio position. The experience of Automatic Retailers of America and ABC Vending (See Table IV) indicate that a vending company might be able to secure financing with as little as 30% equity but such a large proportion of debt results in an inflexible position for the borrower because of restrictive security covenants with his loans, and his having no further borrowing power to rely on in an emergency. Venda-Craft would prefer to move its equity position into the 40% to 50% range as soon as it is feasible.

The long term debt increase to $1,000,000 will be negotiated by the Charlotte underwriter. The private placement of a term loan through an insurance company seems to offer the best possibility. It is suggested that the amount sought will be regulated by the difference between funds generated internally and funds needed to provide a satisfactory current ratio. The company management does not expect to undertake such a loan for at least a year. Immediate increases needed for expansion can be filled through present banking connections. Until major phases of the
expansion are definite (i.e., the contract for the 18 textile mills or other similar operations) the need for funds will not exceed the bank's willingness to provide them. As such plans develop, the underwriter expects to formally negotiate a loan with one of several potential lenders with whom the underwriter has had previous dealing.

The objectives of the Venda-Craft promoters appear feasible and in keeping with trade practices. The small equity position appears questionable for a highly-competitive business faced with the uncertainty of contract termination at important installations. Yet large debt usage is typical of the industry. (See Table IV) In discussing the proper combination of securities of various types in the financial structure of companies, Guthmann and Dougall make the following observation:

"... the adherence to similar financial standards by major companies in certain industries indicates that they may have hit upon an industry pattern of financing that represents a search for optimum capital structure." 20

20 Guthmann and Dougall, op. cit., p. 235.
The use of debt-heavy structures provides for financial leverage to raise earnings per common share. During the lusty period of growth for the industry during the past 10 years, vending companies have depended heavily upon borrowed money to provide the assets and working capital which made possible expanded operation. Leverage increased earnings per share as sales volume increased. The plow-back of these earnings made possible increased borrowing, thereby creating more leverage. This rapid expansion resulted in the "growth company" image which helped boost vending stock prices in the 1960-61 period. Rapid growth rather than conservatism in structure characterized the booming industry and is reflected in the financial structure of individual companies. On the basis of cash flow generated through rapidly expanding sales volume, lenders, particularly local banks, stood ready to finance equipment purchases and inventory needs for the characteristically small locally-owned vending company. Larger companies created through various forms of combinations still relied upon many local banking connections of the component companies. In many cases, large metropolitan banks made loans to the new systems on recommendations and introductions from smaller correspondent banks who had engaged
in previous lending to one or more of the component companies. The result was a heavy reliance upon bank lending and a heavy reliance on short term financing. Bank loans have also provided a substantial portion of the fixed liabilities of the vending companies by extending term loans (generally three to five years) for the purchase of vending equipment.

A major objective of Venda-Craft should be the shifting of a portion of its debt from the short term category to the long term category. Even for the vending industry, current debt in the amount of 45% of the total structure is excessive. Despite the favorable working arrangement with the bank and the assurances that the debt will be extended, this percentage places the company in a precarious position.

The promoters wish to continue to use debt as much as possible for the leverage effect on earnings per common share. High earnings will be reflected in higher market values when the company undertakes a public stock offering some years hence. But in an effort to gain high earnings per share, risk and the possible effect of negative leverage must be considered. The financial pattern developed by leading companies in the industry suggest guidelines beyond which a new company should not pass without deliberate
consideration of its action and the consequences. Desirable leverage can still be utilized by shifting additional financial arrangements into the long term category until total structure approximates that of other vending companies shown in Table IV. Expansion is not being slowed down by this move but a firmer base is being established.

**Providing Income for the Holding Company**

The question was raised as to the best means of getting income into the parent company, Venda-Craft, in order to absorb the expenses of that corporation. Venda-Craft will simply perform a coordinating and management function for each subsidiary company and will have no direct operating income itself.

One method considered was to transfer some of the income producing assets of the subsidiary companies to the parent company. The most practical assets for Venda-Craft to acquire would be vending machines which would be leased back to the subsidiary companies. Legal counsel was acquired to investigate the rulings on transferring equipment whose depreciated basis was below its current market value. The subsidiary companies hoped to be able to sell the equipment at its fair market value to the parent company and pay tax on its gains at capital gain rates,
while enabling the parent company to take the equipment at a stepped-up basis and depreciate it against current income. After thorough study, the plan was abandoned as not being unfeasible.

Although the sale and purchase of properties of related corporations to obtain a stepped-up basis is not expressly forbidden by statute, there are a number of hindrances to its success. The transfer may be held to be a contribution to capital, particularly where the transferee is a newly created corporation, and therefore the asset would retain its old basis. Furthermore, if a leaseback is attempted in such a situation, both the stepped-up basis and the rental deductions of the subsidiaries may be denied on the ground that a true sale did not occur.

Practical considerations do not favor the transfer of assets as a device for providing rental income to the parent company. It would be necessary to presuppose that the parent corporation would have adequate income to absorb the higher depreciation. Furthermore, the parent company should have income in excess of $25,000 per year. With the corporate tax rate on the first $25,000 at 30%, income below that amount would be taxed at a rate only 5%

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above the capital gains tax paid by the selling company (assuming the selling company to be in the 52% bracket). A 5% difference does not justify paying out a 25% capital gains tax at this time in order to obtain a deduction against a 30% rate in future years. And it must be kept in mind that the Internal Revenue Service will not permit arbitrary juggling of intercorporate profits and losses in the case of parent and subsidiary companies.

The payment of management fees appears to be the most effective means of getting funds to the parent company. The fee might be based on gross sales or net profit of each operating company. As long as the management fees paid were reasonable and bona fide fees, there would seem to be no danger that they would be construed as dividends. As a general proposition, management expenses are deductible business expenses even when the services for which the fees are paid are performed by a related company. \textsuperscript{23} Reasonable management fees paid by a subsidiary to its parent have been held to be deductible expenses. \textsuperscript{24}

Although the transfer of present assets to the parent company was not practical, there is no reason why future equipment could not be bought by the parent company and rented to the subsidiaries.

\textsuperscript{23} United States Federal Income Tax Regulations, Section 1.162, Par. 1.

\textsuperscript{24} Smith-Bridgman and Company 16 TC 287.
Rentals could be used to supplement the management fees and in the long run, if the volume of equipment owned by the parent is large enough, might even replace the fees.

At the present stage of development, the promoters are not planning for Venda-Craft to pay any dividends. Following the example of Automatic Retailers of America and Interstate Vending, earnings of the operating companies will be re-invested for further expansion. The promoters will rely on their salaries as chief executive of one of the operating companies to provide personal remuneration. Eventually, when the stock is publicly held, dividend payments by the parent may be utilized. At that time, dividends from the operating companies to the parent company can be used to provide needed funds at the holding company level if the need is so great that it cannot be provided by fees or rental payments. Consolidated statements will be used to minimize taxable liability for inter-corporate movement of funds.

**Summary**

The financial problems in the creation of Venda-Craft are still far from solution. The change in market conditions required a re-evaluation of objectives on the part of the promoters. It shifted emphasis from an immediate stock sale which would have
met objectives of some of the promoters for immediate liquidity and capital gains but was ill advised from the long range viewpoint of the new stockholders or the remaining promoters. Stock would have been sold on the basis of a market boom and on the popularity of vending stocks as a group rather than on any real potential for profit or growth shown by Venda-Craft as an individual company.

Because of this necessary slow down in transition to public ownership, and the time it affords for re-evaluation and more effective planning, the change in conditions appears to the writer to have been a fortuitous event. The present position of Venda-Craft is weak when compared with selected leading vending companies in the following respects:

1. Profit as a percent of gross sales is low.

2. Working capital is a negative figure.

3. The current ratio is well below the average for the industry.

4. The percentage of equity to total structure is slightly low.

5. The management has no experience as a team, working together.

6. Operations of the individual units have not been coordinated to result in a holding company system in fact as well as in name.
7. Lack of specific plans for the use of any capital funds acquired at this time by a stock sale of a term loan arrangement.

However, points of strength which contribute to future potential are also present. Some of these are:

1. An increasing profit margin as unprofitable accounts are being replaced with new profitable accounts.

2. A moderate position in terms of investment in assets needed to generate $1 in sales.

3. Favorable banking connections and good credit positions established by the component companies.

4. An established connection with an underwriter who is interested in the long range welfare of the company and its stockholders.

5. Favorable connections with established industrial companies and the prospect of expanding vending service to these companies.

6. Recognition of present weaknesses by the management of Venda-Craft and their willingness to work toward overcoming them.

The advantages of the company are much more subjective than its weaknesses. Weaknesses are of the type which would have to be disclosed in a prospectus because they are statements of present fact, but SEC rulings would not permit inclusion in the prospectus of most of the favorable points. As subjective evaluations or expression of hoped-for future developments, they have no place in the prospectus. But by waiting until some of the present weaknesses have been replaced by realizing the
potential of some of the points of strength, a much more favorable offering can be made to the public. In order to realize the potential, financial plans will have to be developed where now they are simply nebulous ideas without form or means of implementation. Developments tending to bring the performance and structure of Venda-Craft more within the guidelines set by leading and established companies of the vending industry will enhance its total value and lead toward more successful long run operation.
## Comparison of Certain Vending Machine Companies

### Table I

<table>
<thead>
<tr>
<th>Where Traded</th>
<th>Automatic Canteen</th>
<th>Automatic Retailers of America</th>
<th>ABC Vending</th>
<th>Interstate Vending</th>
<th>Prophet Co.</th>
<th>Marks Vending</th>
<th>Venda-Craft</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. Shares-1962</td>
<td>NYSE</td>
<td>OTC</td>
<td>NYSE</td>
<td>OTC</td>
<td>ASE</td>
<td>ASE</td>
<td></td>
</tr>
<tr>
<td>6774097</td>
<td>2971335</td>
<td>2711875</td>
<td>2152523</td>
<td>577662</td>
<td>a) 493029</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Far</td>
<td>2.50</td>
<td>.50</td>
<td>1.00</td>
<td>1.00</td>
<td>1.00</td>
<td>1.00</td>
<td>2.5%</td>
</tr>
<tr>
<td>Fiscal year ends</td>
<td>Sept. 30</td>
<td>Sept. 30</td>
<td>Dec. 31</td>
<td>June 30</td>
<td>Dec. 31</td>
<td>Sept. 30</td>
<td>Dec. 31</td>
</tr>
<tr>
<td>1962 Sales (000)</td>
<td>223978</td>
<td>180807(1)</td>
<td>61860(1)</td>
<td>40069</td>
<td>33858</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit after taxes (000)</td>
<td>633</td>
<td>4008</td>
<td>2063</td>
<td>1225</td>
<td>863</td>
<td></td>
<td></td>
</tr>
<tr>
<td>% P.A.T. to sales</td>
<td>0.3%</td>
<td>2.2%</td>
<td>3.3%</td>
<td>3.1%</td>
<td>2.5%</td>
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<tr>
<td>1961 Sales (000)</td>
<td>190949</td>
<td>110925(2)</td>
<td>90250</td>
<td>47874(1)</td>
<td>31876</td>
<td>20450(2)</td>
<td>4984</td>
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<tr>
<td>P.A.T (000)</td>
<td>5024</td>
<td>2238</td>
<td>2640</td>
<td>1485</td>
<td>723</td>
<td>387</td>
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<tr>
<td>X.P.A.T. to Sales</td>
<td>27%</td>
<td>2.0%</td>
<td>2.9%</td>
<td>3.1%</td>
<td>2.3%</td>
<td>1.9%</td>
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<tr>
<td>1960 Sales (000)</td>
<td>173660</td>
<td>37640(2)</td>
<td>79430</td>
<td>28463(2)</td>
<td>29970</td>
<td>14000(2)</td>
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<tr>
<td>P.A.T (000)</td>
<td>6321</td>
<td>1155</td>
<td>2510</td>
<td>1155</td>
<td>905</td>
<td>293</td>
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<tr>
<td>X.P.A.T. to Sales</td>
<td>2.5%</td>
<td>3.1%</td>
<td>3.2%</td>
<td>4.1%</td>
<td>3.0%</td>
<td>2.1%</td>
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<tr>
<td>1959 Sales (000)</td>
<td>140510</td>
<td>24811(3)</td>
<td>66090</td>
<td>24487(2)</td>
<td>24880</td>
<td>12188(3)</td>
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<tr>
<td>P.A.T. (000)</td>
<td>3924</td>
<td>789</td>
<td>2310</td>
<td>758</td>
<td>888</td>
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<tr>
<td>X.P.A.T. to Sales</td>
<td>2.8%</td>
<td>3.2%</td>
<td>3.5%</td>
<td>3.1%</td>
<td>3.6%</td>
<td>1.5%</td>
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</tr>
<tr>
<td>1958 Sales (000)</td>
<td>129056</td>
<td>20214(3)</td>
<td>64600</td>
<td>6930(2)</td>
<td>20600</td>
<td>10028(3)</td>
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<td>P.A.T. (000)</td>
<td>3508</td>
<td>580</td>
<td>1880</td>
<td>230</td>
<td>391</td>
<td>185</td>
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<td>X.P.A.T. to Sales</td>
<td>2.7%</td>
<td>2.9%</td>
<td>3.3%</td>
<td>1.9%</td>
<td>1.6%</td>
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* Class A and Class B are the same except that Class shares have preference to non-cumulative dividends of 35c per annum. Originally issued in 1959, the special position is being removed at the rate of 10% of the issue each December 31 through 1969, at which time the two classes will be identical.

**Sources:**

I Automatic Canteen Company Annual Report for the respective years.


III ABC Vending Company Annual Report for the respective years.


V The Prophet Company Annual Report For the respective years.

<table>
<thead>
<tr>
<th></th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
<th>V</th>
<th>VI</th>
<th>VII</th>
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<tr>
<td>Auto Canteen</td>
<td>1.35(2)</td>
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<td>1.35(2)</td>
<td>1.35(2)</td>
<td>1.35(2)</td>
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<td>Interstate</td>
<td>A</td>
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<td>A</td>
<td>A</td>
<td>A</td>
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<tr>
<td>Prophet Mackee Venda-Graft</td>
<td>2.00(5)</td>
<td>2.00(5)</td>
<td>2.00(5)</td>
<td>2.00(5)</td>
<td>2.00(5)</td>
<td>2.00(5)</td>
<td>2.00(5)</td>
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**Sources:**

I Standard and Poor Listed Stock Reports, Vol. 20, No. 31, Section 5 (February 14, 1963), page 256

II Standard and Poor Over-The-Counter and Regional Exchange Stock Reports, Vol. 20, No. 24, Section 4 (February 27, 1963), page 3183

III Standard and Poor Listed Stock Reports, Vol. 20, No. 2, Section 2 (January 3, 1963), page 10

IV Standard and Poor Over-The-Counter and Regional Exchange Stock Reports, Vol. 28, No. 146, Section 17 (December 24, 1962), page 4269

V Standard and Poor Over-The-Counter and Regional Exchange Stock Reports, Vol. 29, No. 2, Section 21 (January 4, 1963), page 3028

VI Standard and Poor Over-The-Counter and Regional Exchange Stock Reports, Vol. 29, No. 32, Section 20 (March 18, 1963), page 4480
Notes to Table II

1 Adjusted for splits of 2 for 1 in 1959 and 1958, and stock dividends of 5% in 1958-59.

2 Adjusted for 2 for 1 split in 1961.


4 Adjusted for 6 for 1 split in 1960 and 1\% for 1 in 1961.


6 On combined A and B stock.
<table>
<thead>
<tr>
<th>Year</th>
<th>Auto Canteen</th>
<th>A R A</th>
<th>Interstate</th>
<th>Prophet</th>
<th>Macke</th>
<th>Venda-Craft</th>
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<tr>
<td>1962</td>
<td>7.94</td>
<td>949</td>
<td>3.52</td>
<td>6.99</td>
<td>6.37</td>
<td>6.79</td>
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<tr>
<td>1961</td>
<td>10.00</td>
<td>722</td>
<td>4.08</td>
<td>6.37</td>
<td>6.37</td>
<td>6.37</td>
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<tr>
<td>1960</td>
<td>6.27</td>
<td>7.32</td>
<td>6.53</td>
<td>5.50</td>
<td>5.50</td>
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<td>1959</td>
<td>4.98</td>
<td>6.78</td>
<td>5.64</td>
<td>4.48</td>
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<td>4.48</td>
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<td>1958</td>
<td>3.95</td>
<td>6.31</td>
<td>4.80</td>
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<table>
<thead>
<tr>
<th>Year</th>
<th>Net Assets as % of Net (based on High)</th>
</tr>
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<tbody>
<tr>
<td>1962</td>
<td>25.0%</td>
</tr>
<tr>
<td>1961</td>
<td>21.9%</td>
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<tr>
<td>1960</td>
<td>12.0%</td>
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<tr>
<td>1959</td>
<td>17.5%</td>
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<tr>
<td>1958</td>
<td>28.2%</td>
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<table>
<thead>
<tr>
<th>Year</th>
<th>Working Capital (000)</th>
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<tbody>
<tr>
<td>1962</td>
<td>18678</td>
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<tr>
<td>1961</td>
<td>28109 (1103)</td>
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<td>1960</td>
<td>22803</td>
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<tr>
<td>1959</td>
<td>13551</td>
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<tr>
<td>1958</td>
<td>12100</td>
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<table>
<thead>
<tr>
<th>Year</th>
<th>Current Ratio</th>
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<tbody>
<tr>
<td>1962</td>
<td>1.6*1</td>
</tr>
<tr>
<td>1961</td>
<td>2.5*1</td>
</tr>
<tr>
<td>1960</td>
<td>1.5*1</td>
</tr>
<tr>
<td>1959</td>
<td>1.8*1</td>
</tr>
<tr>
<td>1958</td>
<td>1.9*1</td>
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</tbody>
</table>

Sources:
I Automatic Canteen Company Annual Reports for the respective years
II Standard and Poor Over-the-Counter and Regional Exchange Stock Reports, Vol. 29, No. 24, Section 4 (February 27, 1963), page 3183
III ABC Vending Company Annual Report for the respective years
IV Standard and Poor Over-the-Counter and Regional Exchange Stock Reports, Vol. 28, No. 146, Section 17 (December 24, 1962), page 4269K
V The Prophet Company Annual Report for the respective years
VI Standard and Poor Over-the-Counter Regional Exchange Stock Reports, Vol. 29, No. 32, Section 20 (March 18, 1963), page 4480
### Table IV

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<thead>
<tr>
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<th></th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Current Assets</td>
<td>37%</td>
<td>28%</td>
<td>30%</td>
<td>36%</td>
<td>54%</td>
<td>26%</td>
<td>40%</td>
<td>40%</td>
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<tr>
<td>Fixed Assets</td>
<td>63%</td>
<td>72%</td>
<td>70%</td>
<td>64%</td>
<td>16%</td>
<td>74%</td>
<td>60%</td>
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<tr>
<td>Total Assets</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
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</tr>
<tr>
<td>Current Liabilities</td>
<td>15%</td>
<td>22%</td>
<td>32%</td>
<td>22%</td>
<td>39%</td>
<td>24%</td>
<td>45%</td>
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<tr>
<td>Fixed Liabilities</td>
<td>33%</td>
<td>38%</td>
<td>38%</td>
<td>36%</td>
<td>26%</td>
<td>18%</td>
<td>13%</td>
<td>33%</td>
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<td>Preferred Stock</td>
<td>8%</td>
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<td>42%</td>
<td>61%</td>
<td>50%</td>
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<td>Common Equity</td>
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<td>30%</td>
<td>42%</td>
<td>61%</td>
<td>50%</td>
<td>37%</td>
<td>40%</td>
</tr>
</tbody>
</table>

| Investment in assets needed for $1 in sales | 0.67 | 0.44 | 0.38 | 0.64 | 0.20 | 0.54 | 0.44 |
| Investment in assets needed for 1% in sales  | 9%   | 14%  | 13%  | 27%  | 19%  | 16%  | 23%  |

Sources:
CHAPTER VII

OPERATIONAL PROBLEMS IN THE CREATION OF VENDA-CRAFT

The organization of the Venda-Craft system was established to provide maximum autonomy of the operating units. However, if it is to provide mutual advantages to the participants in the venture, operations must be coordinated. Present management of the combining companies believes the greatest gains can be realized in the areas of joint purchasing, joint handling of vending equipment, and standardization of service and pricing.

Joint Purchasing

The role of purchasing is vital to the financial success of a business. In its more traditional concept, purchasing consists of the development of a system for learning of a need, selecting a supplier to fill the need, negotiating the price and other pertinent terms, and following up to insure delivery. Professor Lewis of the Harvard Business School prefers to broaden the concept by the use of the term "procurement" which covers all elements of the previous definition and expands it to cover such additional functions of materials supervision and management as inventory control, receiving,
incoming inspection, and salvage operation. In the establishing of a central purchasing function for Venda-Craft, the broader concept of "procurement" with all its implications of planning, administration, and control is envisioned.

The direct objective is to obtain merchandise and equipment at the lowest cost without unduly sacrificing authority or flexibility of the subsidiaries. In conjunction with the recommendations of an independent purchasing consultant, the company adopted the following functions to be performed by the newly created central purchasing agency:

1. Negotiation of buying agreements with suppliers, on behalf of the group, for items which cost less when bought in larger quantities or which in other ways permit reduced prices or lower transportation or storage costs.

2. Handling re-shipment to local operations of single delivery, truckload or carload shipments.

3. Assisting local purchasing activities to obtain best overall values.

4. Assisting in adjusting inventory imbalances of subsidiaries.

5. In the future, the purchasing clearing point might aid in consolidating truck loads between Venda-Craft and out-side companies and between Venda-Craft operations.  

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2Sam B. Carson, Purchasing Opportunities for Venda-Craft, an unpublished report dated May 17, 1962, and submitted to the company.
Special emphasis on purchasing as a major cost element whose control has a direct bearing on profits is not unique to Venda-Craft. The intensification of competition brought about by larger and better organized vending firms has resulted in more searching inquiries into all elements of cost. Additional information is sought to find ways to reduce costs in order to remain competitive and to protect profit margins. George E. Stringfellow, Senior Vice President of Thomas A. Edison, Inc., has emphasized the important relationship between purchasing costs and total profit with an example. He says that it is not unusual in wholesaling operations for 75¢ of every sales dollar to be taken up in purchasing of inventory and supplies. If we assume that 15¢ would be spread for payment of taxes, selling expenses, labor costs, and administrative overhead, leaving 10¢ as profit, a reduction of 1 1/3% of the 75% purchasing cost would increase profit to 11¢. This is a 10¢ increase over the previously assumed profit of 10¢. To accomplish the same increase in profit, it would require a 6 2/3% reduction of any other costs. 3

In a study of recent profit and loss statements of 15 operating vending companies (see Table V), their purchase

### Table V

<table>
<thead>
<tr>
<th>Company</th>
<th>Purchases expressed as a % of total sales</th>
<th>Profit expressed as a % of total sales</th>
</tr>
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<tbody>
<tr>
<td>Co. A</td>
<td>69.2</td>
<td>2.52</td>
</tr>
<tr>
<td>Co. B</td>
<td>46.6</td>
<td>0.08</td>
</tr>
<tr>
<td>Co. C</td>
<td>70.6</td>
<td>2.94</td>
</tr>
<tr>
<td>Co. D</td>
<td>63.0</td>
<td>4.78</td>
</tr>
<tr>
<td>Co. E</td>
<td>36.2</td>
<td>3.73</td>
</tr>
<tr>
<td>Co. F</td>
<td>57.8</td>
<td>3.92</td>
</tr>
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<td>Co. G</td>
<td>75.5</td>
<td>0.26</td>
</tr>
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<td>Co. H</td>
<td>75.4</td>
<td>1.00</td>
</tr>
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<td>Co. I</td>
<td>64.2</td>
<td>2.98</td>
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<td>Co. J</td>
<td>38.3</td>
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<td>Co. K</td>
<td>49.2</td>
<td>6.15</td>
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<td>Co. L</td>
<td>61.3</td>
<td>7.25</td>
</tr>
<tr>
<td>Co. M</td>
<td>58.7</td>
<td>7.98</td>
</tr>
<tr>
<td>Co. N</td>
<td>53.3</td>
<td>2.74</td>
</tr>
<tr>
<td>Co. O</td>
<td>48.6</td>
<td>2.08</td>
</tr>
<tr>
<td><strong>Aggregate</strong>*</td>
<td><strong>60.5</strong></td>
<td><strong>3.05</strong></td>
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</table>

*Total purchases by all companies divided by total sales of all companies. Total profit after taxes of all companies divided by total sales of all companies.

Relationship of purchases and profit to net sales for 15 Southeastern vending companies for a fiscal year occurring between 1959 and 1961. (Not all companies used the same fiscal year.)
price of goods ranged from 36.2% of sales to 75.5% of sales. A simple average (total purchases divided by total sales) amounts to 60.5% for the entire group. The actual percentage of funds expended through the purchasing function is actually higher because these figures do not take into account purchase of supplies, vending equipment, or delivery equipment. The percentage of net profit after taxes to total sales ranged from 0.08% to 7.98%. The simple average of the entire group (total profit after taxes divided by total sales) amounted to 3.05%. Thus, vending as an industry is at this time suffering from a profit squeeze which offers sizeable rewards in profit percentages if the major expense outlay for merchandise can be reduced by more effective purchasing techniques.

Attention to the problems of procurement are resulting in changes in its traditional role. Professor Lewis sees a role of increasing importance with significant changes in the next ten years:

1. There will be included within a single managerial unit all the planning, directing, controlling and coordinating activities concerned with production inventory requirements from the point of their inception through to their introduction into the manufacturing process.
2. There will be increasingly close coordination and even integration between this supply function itself and the overall company policy. There will be less departmentalization and more integration. This will be achieved both through organizational changes and through the developing methods of communication and control.

3. There will be big changes in dealing with stock, inventory, and order placing responsibilities. This will come about as a result of better top management comprehension of the nature and relationship between these activities, and a greater use of automatic data processing.

4. There will be wider use of various mathematical and statistical techniques for the accumulation and utilization of systematic data as a basis for making administrative and policy decisions.

5. There will be necessarily greater utilization within the procurement area of the services of technical experts in mathematical-statistical methods, and of purely technical advisors in such areas as value analysis.4

The importance of the cost position of purchasing and the magnitude of its effect on profit is recognized by the management group on Venda-Craft. The belief in savings through mutual purchasing was one of the first expected gains of combination. In an effort to implement a policy to provide these savings, the company has used a consultant in an effort to obtain an impartial overlook at the present individual systems

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and effect their combination in such a manner as to avoid duplication of activity, reduce cost, and improve efficiency. In general, his work has been confined to the mechanical processes of acquiring and handling.

Another outside consultant is currently working with the company toward the development of controls for the purchasing function and for the development of entirely new standards for judging its operational effectiveness and cost. An attempt is being made to apply operations research methodology to the problem of determining optimum ordering quantities. In addition to establishing the limits between which inventory levels will fluctuate, an interesting application is being used to establish a standard for the total cost of purchasing operations.

The purchasing standard concept is illustrated by reference to Figure 4. If OC represents the aggregate cost of ordering and CC represents the aggregate of all carrying costs, optimum efficiency occurs at point P. To the left of P, savings in carrying cost will be more than off-set by increased ordering costs. To the right of P, savings in ordering costs will be more than off-set by increased carrying costs.⁵ Therefore,

FIGURE 4
OPTIMUM ORDER QUANTITIES
X quantity is the optimum amount to be purchased at Y cost. For a given period, the total merchandise needed will indicate the number of orders of X quantity which will have to be made. Then the cost standard for most efficient operation of the purchasing department should be that same number of orders multiplied by Y cost. If the cost of operating the purchasing department exceeds the given standard, the indication is readily apparent that the company is deviating from actual application of ordering in most economic order quantities. The application is a simple standard developed from additional utilization of economic order quantity theory.

At this time, the gathering of cost data has just begun and results are inconclusive. The most significant element in the application of this technique is that the company is utilizing advanced tools of theoretical management in the solution of the purchasing problem. Venda-Craft management believes this to be the first application of the technique to vending inventory control problems in the Southeast, and possibly in the United States.

**Joint Handling of Vending Equipment**

The vending industry presents a very special problem in the effect which competition may have on the profitability of a company. Because its costs of distribution are closely tied to
the tremendous number of vending machines which it must buy, it is always extremely vulnerable to competition making these assets idle. Competition can cause the cancellation of a location contract (by standard practice, they are mutually revocable upon 90 days written notice) and create a large number of idle machines. This is especially troublesome to a company like Southern Sales which specializes in complete installations of full line vending machines, including the very expensive (frequently over $1,500 per machine) hot food vendors. Where the machines are set up in matching banks, extensive modification may be necessary to install them in another location. The very threat of competition offering a more favorable location contract can force uneconomic adjustments on the commission rate paid. Even more troublesome is a promise of newer, more attractive machines which will be purchased and installed by an invading competitor. In order to satisfy the customer and retain the contract, it is sometimes necessary to replace the whole installation with newer machines. This requires a substantial capital outlay which generates no more revenue than the old machines and leaves the vendor with surplus used equipment.

Combination of the companies through Venda-Craft offers a tremendous advantage to the operators in the solution to the equipment problem. First, cost savings made possible through
volume operation should reduce operating costs and establish a break even point comparable with anyone in the industry. Second, the larger size can support cost accounting services which would be too expensive for individual operating units. A precise knowledge of costs will facilitate negotiations with location owners and allow the passing of savings to them in the form of higher commissions, thus increasing the competitive position. Third, the larger size with its greater capital resources will be valuable when competitive pressure forces uneconomic commission rates resulting in losses for the short run period.

Fourth, the problem of excess used equipment will be minimized by pooling arrangements. It has been agreed that all future equipment purchases will have standardized face plates resulting in uniformity of appearance. Present equipment will be standardized in the same way whenever it is refinished for a new installation. A scale of prices based on type of equipment adjusted for age will be prepared. Inventories of excess equipment will be maintained by the holding company. Before new equipment is purchased by any unit, management of the operating company will first check with the holding company to ascertain if the needed equipment is available in one of the other units. If it is available, the equipment will be purchased for the amount set forth in the previously prepared price scale. It is expected that this will mitigate somewhat
the excess equipment problem and result in financial savings to all the companies.

Fifth, the added size through combination opens prospects for foreign expansion which none of the individual units were large enough to undertake. Consideration is now being given to machine installations at military bases in Bermuda, Cuba, Puerto Rico, and West Germany. They would serve as outlets for used machines which are still useful but because of the introduction of new models have very little sales appeal for domestic installations.

**Standardizing Service**

The need for uniformity in service and pricing is present even though the operating companies maintain separate legal entities and much of their operating autonomy. The most obvious reason for this is geographical. Some of the operating units are located where they could compete with each other for customer accounts. Co-ordination through the holding company is necessary to determine the type of service to be provided, the price to be charged, and the actual operating unit best suited to render the service. Although it is desirable to be able to provide any kind of service which will provide a satisfactory profit without in-
curring undue risk, it is not necessary that each operating unit should be able to provide every type of service. Allocation of contracts becomes a strong advantage of the combination in that it can allow for specialization by operating units.

Decisions for expansion by more intensive cultivation of the present market area or movement into new areas would be a matter of policy by the holding company. As a part of a policy decision to enter new territories or to introduce new products would come a decision as to which of the operating units could best carry out the project.

Even in providing service in present locations, techniques for providing customer satisfaction at the lowest cost should be studied and uniformly applied whenever possible. Sales effort must be pointed in the most profitable direction and unproductive effort eliminated. Although actual operations will be left to the individual operating units, it is important that operating policy be developed through the holding company acting as a communications and co-ordination unit. In so far as possible, standards must be developed by the holding company for the measurement of distribution performance and costs in the operating companies.
The companies are well aware that all distribution activity cannot be standardized such as predicting the exact results for a dollar expended for advertising or direct sales effort when going into a new territory or introducing a new product. But it would be equally foolish to assume that standards cannot be applied to any areas of distribution activity. The development and application of standards provide the key element of control to be exercised by the holding company over its operating subsidiaries.

In an effort to develop standards to assure control and measure performance both of operating units and the individuals who comprise them, a five step program is presently in use by Southern Sales. It will be carried over for installation in the other units as an early phase of coordination efforts. The program consists of the following steps:

1. Classification of costs according to functions and activities expressive of individual responsibility. For example, the routeman who performs a delivery has additional duties for routine maintenance of the machine and clerical duties in taking and recording the inventory of his various machines. These major functions in the use of his time are broken down and classified.
2. Selection of units or bases of measurement through which the standards can be expressed. Such units or bases vary with the type of measurement which is to be applied. The measurement may apply to effort used, to cost, to results achieved, or to the relationship of these factors.

3. Thorough analysis of past experience relative to the cost of the functions and specific activities involved with a view of selecting the best experience and indicators of the best procedure.

4. Consideration of the cost effect of expected external changes. For example, if competition is increasing, it will have an effect on such costs as direct selling and advertising.

5. Summarize the judgment of those executives, division heads, department heads, and salesmen whose experience and training qualify them to judge the measures of satisfactory performance. It must be borne in mind that frequently different standards must be set for different territories, products, and classes of customers where different conditions prevail.
The application of these steps has led to some basic measures of general performance. As used in Southern Sales, these are:

1. Standards of general performance
   a. Cost per dollar of net sales
   b. Cost per dollar of gross profit
   c. Cost per unit sold
   d. Cost per sales transaction
   e. Cost per contract signed
   f. Cost per invoice sent

2. Standards for physical distribution expense
   a. Total delivery cost per dollar of sale
   b. Total delivery cost per customer, or machine served
   c. Total truck operating cost per week
   d. Mileage—truck operating cost per mile

3. Standards for warehousing and handling costs
   a. Cost per physical unit of goods handled
   b. Cost per order filled
   c. Cost per order delivered
   d. Cost per item handled
   e. Cost per sales transaction
   f. Cost per dollar of gross sales
   g. Cost per dollar of goods sold
   h. Cost per dollar of average inventory

The attempt at setting up such a program of standards was an ambitious undertaking for a small firm. There was little available information from other firms. The past experience of this firm, as well as most of its competitors, was marked by acknowledged groping for solutions to problems in an industry that was new and rapidly changing. The attempt to establish
detailed standards was ambitious also because of the limited funds available for a full investigation of facts and the lack of an analysis section in the accounting department. In fact, there was not even a formal cost accounting section.

Much of the program was developed by the president of Southern Sales working closely with the controller. Admittedly, the standards that have been developed have many shortcomings. The standards are not presumed to be a complete system but their use serves to locate many trouble areas which are costing the firm too much money. In many cases, the development of the standard is based on somewhat questionable or imprecise data. Still the attempt at quantification is better than relying solely on the manager's intuition. As a further limit to their effectiveness, the indicated standards are not uniformly applied. Spot checks are used or the standards are applied in instances where management feels that performance is falling and efforts are being made to locate precisely where the difficulty lies and what is causing it.

With the operations combined throughout the Venda-Craft system these standards will have more significance. Pooling of information will allow present criteria to be checked out against performance in other companies. Increased size and financial resources will make possible effective use of joint
accounting techniques and staffs, including cost accounting and analysis sections. Importance of adequate standards will also be increased because of the increased responsibilities and further separation of the present founder-presidents from their operating units. If the Venda-Craft system is successful and has favorable growth, the increased volume of business will further strain the ability of these founder-presidents to keep close contact with the operating units. Greater delegation of authority to subordinates will be necessary. Development of standards provides the best way of judging performance of these subordinates and the units which they supervise.

**Standardization of Pricing**

In the vending industry, pricing means two different things and must be considered from both standpoints. First, it is the question of the price at which the commodities themselves will be sold, e.g., will coffee be vended for five cents or ten cents. But the real customer of the vending machine firm is not the ultimate consumer but the person who allows the machines to be placed in his institution or place of business. It is with this customer that the second, and central pricing problem is met. It is here that the vending machine operator tells the contracting customer how much commission will be paid to him for allowing the
vendor to place a machine at a given location. Industry practice is that commissions are figured as a percentage of gross sales volume. In some cases, particularly in smaller firms which do not keep accurate cost records, the percentage bid is a crude guess set at the lowest figure which the vendor thinks the client will consider. Increased competition with the development of larger and better organized vending companies have increased pressure for more exact techniques in bidding.

Another method of bidding is the sliding scale method. This takes into consideration that a firm makes more profit as it increases in volume and that there are fixed and variable costs which must be overcome by sales volume before the vendor can afford to pay any commission. When this level is met, commissions based on a percentage of gross sales are said. As volume increases, the commission percentage is also increased. This approach is used by both ABC Vending Corporation and the Canteen Corporation of American and is generally being adopted by the larger regional companies. However, there are some serious weaknesses in this sort of pricing. One, it is based on total volume of sales rather than on any specific type of sales. It does not take into consideration that the percentage of profits on coffee and soft drinks is greater than the percentage of profits on cigarettes, hot foods, and milk. Therefore, the character of the volume is important,
and because type of sales varies conspicuously from location to location, there is a real weakness in the pricing structure. Neither does it take into consideration that some vending machines can be bought as cheaply as $100 or as expensively as $1,600. The amount of investment in a given location could be much greater than the investment at another location doing the same volume of business and paying the same commission rate.

Southern Sales has a unique pricing process designed in connection with its accountant which recognizes specifically the role of fixed and variable costs by types of product and the price of the machine from which the product is sold. The company utilizes sliding scales based on the type of product and the type of machine. This is set up in tabular form as a part of the contract. The scale is set up for each product classification and the average volume per month attained on a per machine basis becomes the basis for figuring the quarterly commission payment. (An adjusted sample scale is included in the contract in the appendix). If two candy machines sell a total of $132 in one month, the commission rate is 5%, providing a rent of $6.60 to the location owner. However, if only one machine had been used to attain this same sales volume, the commission would have been at 14%, or $15.50.
The determination of this scale was worked out by the president of Southern Sales and the controller. Utilizing cost accounting techniques, allocations of both fixed and variable operating costs were made to each machine. A main element of fixed costs is the depreciation of the machine itself, and a main element of the variable cost is the cost of the product being vended by the machine. In addition to fixed and variable costs, the company has figured into the scale a two percent profit for itself on gross sales. When the point is reached that the assigned fixed and variable costs are covered plus a two percent margin for error, the customer begins to share in the commissions. His rate increases as higher sales volumes are reached.

The use of this system allows for precision in bidding which generally provides profit from any installations obtained. Since the company is engaged mainly in providing full service vending, including hot food operations for in-plant feeding, the ability to match costs against revenues in paying commissions gives the company a distinct advantage in contract negotiations. In practice, hot food vending itself is frequently unprofitable. However, if the vendor can acquire the right to install a full line of other more profitable types of machines on the location, the operating deficit of the hot food machines can be offset. In practice, when
the technique of commission allocation has been explained, plant officers have shown a willingness to expect no commissions on the non-profitable hot food operations and rely instead on profits from other machines of the full line granted to the vendor. Southern Sales feels strongly that plant managers respect the greater precision of this method and that it has contributed to securing valuable contracts. In a company manual, the president of Southern Sales has stated:

To the knowledge of this writer, this is a system unique to Southern Sales in this industry. It would seem to be the perfect combination of economic theory, accounting practice, competitive pricing and a realistic sales tool.\(^5\)

It is anticipated that this system will be extended to the other units in the Venda-Craft system as a very early phase of the unification of operating policies. They should be in a position to present identical bids on any job so that determination may be made at the holding company level as to the operating unit best able to undertake the additional service. This decision would be based on its proximity to other operating facilities of the company, present load volume, available equipment, and experience in the particular field. Conversion of the one rate

sliding scale now used by Mid-Georgia and Canteen to the more complex but more accurate method used by Southern Sales will be an important step in coordination of operations.

In the vending industry, especially those firms providing full service lines in industrial plants, a common operating problem is the placing of installations which fail to generate the expected volume business resulting in operating losses. If it can be expected that the volume of business will grow and eventually result in a profit, the present losses can be accepted as a part of the cost of business development. The real dilemma occurs when there is little likelihood of subsequent volume increases eliminating the operating deficits. If there is no other immediately available profitable installation site, the management must select from two unpleasant choices. He can continue operating at a loss in the location, or he can withdraw the equipment from the site by giving 90 days notice of cancellation of the contract. However, if the latter alternative is taken, the withdrawal leaves substantial unproductive equipment on hand whose high fixed cost of depreciation (and possible interest on the borrowed purchase price) still represent operating losses for the company.

Similarly, excessive used equipment on hand which has little immediate prospect for installation in a profitable location may suggest bidding for a contract in a location known to be unprofitable or bidding for a contract at such high commission rates that
it is known that some operating losses will be incurred.

Although it is hoped that combining operations and pooling equipment will alleviate the problem somewhat, provisions are being made to appraise opportunities for utilization of surplus equipment. The approach used is the contribution margin approach to distribution cost analysis.

The essence of the approach is that all direct costs that can be assigned to a specific function are assigned. Then all the indirect costs that can be assigned to a particular function are then assigned. However, those general overall company expenses, which can in no way be assigned to a specific function, are withheld and not allocated. In other words, the department, or function, does not include in its individual break-down of accounting the fact that it bears part of the burden of the other costs of the firm. These other costs may be general administrative, executive talent or institutional advertising. The result is that sometimes a department, or function, will show a profit where, if it were allocated its pro rata share of the expenses, it would not show a profit. The theory of the contribution margin is that each segment is viewed as a profit center. The segment's existence is justified by the fact that the other costs of running the business would continue and this segment would show a profit based solely on its own direct costs, therefore,
it contributes something toward the balance of the remainder of the expenses of a business as a whole. While its contribution might not be as much as is desired, the company is better off with this segment of the business than without it. It is particularly helpful in a situation where management is considering alternatives that will change relative volumes of the various segments. The net profit approach is indirect because it is necessary to take into account the effect which a redistribution of indirect cost will have upon costs of other segments. When a product, territory, or other unit shows a net loss after being charged with a full share of all costs, dropping the unit does not increase overall profit by the amount of the loss. The reason is that fixed costs formerly allocated to the unit are not saved but instead are charged to other units or against profits as unabsorbed overhead.

There are some advantages to this contribution plan. Basically simple, the plan enables company executives to make quick decisions concerning the acceptance or rejection of special order business. The approach is readily understandable by executives who might otherwise have difficulty in following, or who might even refuse to accept, the intricacies of allocation techniques.
Furthermore, even in the most advanced and technical cost accounting systems, some arbitrary allocations must be made of those elements of cost which are not directly the product of activities of individual cost centers. An example of one such overhead cost is the salary of the president and other executive officers who are not directly involved with the operation of cost centers. The center's measure of profitability can be materially affected by the manner in which these indirect costs are assigned. By considering only those costs which are clearly and definitely the outgrowth of operations of each cost center, the problem of allocation is removed and the question of profitability of the centers is reduced to simplest terms. There is less likelihood of an unwise decision resulting from imprecise or erroneous allocation of cost data.

There are some dangers in using direct allocation only. One is the assumption that none of the unallocated fixed costs directly affect any cost center. If this assumption is in any way incorrect, then contribution theory will obviously lose some of its accuracy and value. To be useful, the technique requires a comparison to all costs which will be incurred by the company if the cost center continues in existence with all costs which
will remain if it is discontinued. Operations of the cost center are justified if they cover all direct costs and make some contribution to general overhead. For a center which covers its direct cost but is not considered to be operating at a profit when overhead costs are assigned to it, its removal should come only when alternative use of its resources can make a greater contribution to the overhead of the firm.

The use of contribution theory is most applicable for short run decision making. It is useful under a given set of circumstances when the alternatives are to continue operations of a certain type or to discontinue them. For the long run, it is generally expected that every cost center maintained will be completely self-supporting and contribute to the profit of the firm. This expectation ignores, however, occasional use of an unprofitable department or product maintained for its prestige value or other objectives not directly profit related.

Venda-Craft has no such objectives at this time and does expect to develop presently unprofitable locations into profitable operations or replace them as rapidly as other alternatives for the use of equipment can be found.
Chapter VIII

SUMMARY AND CONCLUSIONS

This study has traced the creation and development of a particular holding company, investigated the objectives of the promoters who conceived the idea for its existence, studied the contributions of the component units, and analyzed the factors which influenced the final form of the company. The organizational structure of the new company, its financial program, and its operational problems received special emphasis.

Necessity of Combination to Meet Objectives

Combination of some type was necessary to reach the objectives set by the promoters. Although the publicly stated objective is obtaining additional profits generated through economies of combined operations, a more significant reason for the creation of Venda-Craft is obtaining liquidity of past profits. Each promoter is already the successful promoter and operator of a profitable company which has shown substantial growth. Although book value per share of common stock has increased as profits were earned and retained, the lack of an established trading market has prevented these earnings from being realized by the owners through the sale of a non-controlling portion of the business.
Individually, the companies creating Venda-Craft are too small to market economically public issues of common stock. But by combination, they can jointly place a public issue of sufficient size to provide an aftermarket for regular trading. Through this means, "locked-in" profits of the individual companies can be indirectly realized through the marketability of the stock acquired through the creation of the holding company.

Suitability of the Holding Company

Although direct fusion through merger or consolidation would have satisfied the size requirement for a public issue, it would have violated the autonomy objectives of the promoters. A paradoxical relationship exists between the objective for combination and the objectives for independence. Through an initial grouping of companies into a loose federation, a Venda-Craft executive structure is super-imposed over the existing structures of the operating companies in order to leave them undisturbed for the present time. The function of the holding company is limited to being a vehicle for communication and co-ordination between the operating companies, thus leaving them relatively free.

Flexibility for future development is also provided by the holding company. Structural reforms in the operating companies are necessary if they take on expanded operations made possible
by the combination. As the holding company system expands, the strong force of personality by which the promoters have operated their independent companies will have to be reduced because of the physical limitations of these men in taking on increased responsibilities. Operational effectiveness will require the development of organizational procedures and systems. Changes, however, must come slowly and must be introduced at a time and in a manner which will not antagonize other promoters who feel that their operating rights are suffering an infringement. The holding company, as a central co-ordinating unit must exert influence for reforms and improvements to be initiated by the promoters within their own companies. The holding company, through the pooling of knowledge and experience of all the operating units, and through the recommendations made by consulting specialists, can provide the leadership for evolutionary change in the leadership for evolutionary change in the structure of its operating companies.

The holding company has been a frequently used device in other vending combinations because of its particular suitability for continuous acquisition of small, local companies. It is effective because it allows continued operation of acquired
companies in their own location, using their own name and whatever local goodwill has been developed. The disruption of organizational structure and operations is held to a minimum. Dissenting minority stockholders are left undisturbed. The anticipated expansion of Venda-Craft by further acquisitions makes it desirable to utilize this form. Furthermore, experience gained in its use at the present time can be applied to later expansion.

Factors Influencing Form and Operating Policies

The decisions which led to the development of Venda-Craft were not based entirely upon consideration of the objectives of the promoters and the contributions of the operating company groups. A number of additional factors which exerted influence were noted during the course of this case study.

Experience and Background of the Promoters

The promoters who established Venda-Craft are active practitioners of business affairs rather than theorists or academicians. With the exception of the president of one of the combining companies, the promoters have had very little formal training in the theory of management. Each has, however, substantial knowledge of business affairs drawn from his own past experience and observation. Each has a past record of successful development and operation of small businesses.
Personality of the Promoters

The individuals creating Venda-Craft are strong leaders, independent in their thought and activity, and forceful in maintaining their right for autonomous action. These characteristics pervade the entire structure of Venda-Craft.

The Promoters are aggressive. They are willing to set an objective and allocate whatever resources in the form of time, money, or manpower which are necessary to achieve it. As a result of this characteristic in the promoters, Venda-Craft will have added strength. The promoter's willingness to work to develop new contracts for locations and to acquire other operating units will aid in the growth of the company.

Recommendations of Consulting Specialists

Consultants with specialized training have contributed to the final form of Venda-Craft and to the plans which are being developed. In addition to the use of accountants and lawyers who made recommendations affecting the legal organization and the accounting unification, several consultants made recommendations which were followed in determining the scope of operations to be undertaken by the holding company. The investment banker has had a significant effect on the financial plans of the company. His recommendations were used in shaping the capital
structure and in developing a pattern of financial operation which will be used to persuade an investor that the stock of Venda-Craft is a desirable investment. The investment banker's advice is particularly important in preparing for the final step of transition to public ownership which is essential to accomplish the ultimate goals of the promoters.

Use of specialists should be increased as operational problems develop as the operating companies attempt to coordinate their activities. The experience and knowledge of experts who can appraise the operations of the companies in an unbiased fashion will be especially helpful at that time.

Trade Custom and Usage

The development of Venda-Craft parallels the development of the leading vending companies. A pattern of small initial size of operating units, locally owned which expanded through retained earnings, under the leadership of a strong manager or management group is typical of the vending industry. These local companies then combined through direct fusion or through loose holding company federations. Public offerings of stock, including shares owned by the promoters, followed as soon as conditions permitted. Some companies, such as Prophet, were already established in the food line, but even here, large
size and national prominence in the automatic vending industry was attained with some acquisitions in the decade of the 1950's. The successful example of the combination of such firms as Automatic Retailers of America and Interstate Vending was studied by the Venda-Craft promoters and followed as closely as changed time, place, and conditions permitted.

The promoters, as a result of their practical background and long experience as independent operators in the vending field, are relying on trade custom in many of the more routine techniques of operation. Relations with suppliers, machine location owners, and prospective customers are dictated in accordance with usual arrangements of other vending companies. This is done in part in order to provide particular services at costs which are competitive with others, and in part because evolution within the vending industry has tended to develop patterns of successful operation in surviving companies.

Innovation and Adaptive Response

In analyzing economic innovation, Joseph Schumpeter makes the distinction between creative innovation and adaptive response. The former goes beyond existing practices and procedures. The latter involves major changes for the individual firm making the response, but stays within the range of current custom. Most
of the changes to the individual operating companies fall within
the category of adaptive response.¹

The development of a unique pricing arrangement of rent on
machine locations is an innovation which goes beyond present
practice of the industry. Although a sliding scale based on
total volume is not unusual, the additional step of allocating
costs for each class of merchandise sold and paying rent only
when the costs have been completely covered is unknown elsewhe
in the industry. Even though somewhat similar devices may be
used by other firms, the secrecy with which location contracts
are handled makes such information or even knowledge of its use,
completely unavailable to the Venda-Craft promoters. Since such
a program was developed directly by one of the combining companies,
without knowledge of its use in any other situation, this is a
creative innovation.

A significant example of adaptive response is the utilization
of one corporation to handle items ranging in price up through
10¢ and a separate corporation to handle items of 11¢ and over.
The savings in sales tax remittance offsets the added cost of

¹ Joseph A. Schumpeter, "The Creative Response in Economic
History", Journal of Economic History, VII (November, 1947)
149-159.
establishing and maintaining two corporations. This is considered an adaptive response because it is a technique known and used by other vending companies. However, its application is not so widely used that it is considered a matter of general trade custom and practice.

**Conscious Application of Management, Financial, and Accounting Theory**

Although the most dominant influence is the practical experience and backgrounds of the promoters, a conscious application of management theory was present as plans were being formulated. In the planning of functions of the holding company, conscious effort was applied to establish principles of organization as a communication and co-ordination device. Also, consideration was given to the forms and effects of decentralization of operation for the component units of the system.

Conscious application of management theory was also applied in standards developed by Southern Sales Company which are being modified to fit additional situations for application to the entire system.

Financial and accounting theory was applied both in setting the capitalization of the new company and in developing the exchange ratio of operating company stock for holding company stock. Separate consideration of the adjusted value of assets and
earning power of each company is in keeping with traditional theoretical concepts.

Establishing operating units as separate cost centers reflects contemporary theory of the use of accounting as a control technique. Also commendable is the use of contribution margin theory as a technique for determining whether or not to withdraw from locations which are not operating at a return which covers all assigned costs.

Tax Regulations

Tax considerations were considered in the initial phases of fusion before the legal form had been decided upon. It was desirable that the form selected should result in a tax-free exchange in order to defer any tax liability and to avoid weakening the present working capital position of the company by a large cash drain for tax payments.

In its pattern of operation, Venda-Craft is acting to minimize taxes at both the state and federal levels. The grouping of machines by price of merchandise sold in separate corporations, and the technique for transfer of operating funds to the holding company were both dictated by tax policy.

Influence of the Stock Market

The rising stock market and the favorable position which vending issues were enjoying as "glamour issues" were
significant factors in the initial decision for the Venda-Craft combination. Then, the falling market of 1962 altered the entire financial pattern. The lack of interest in new speculative issues, and the predominantly low prices at which over-the-counter stocks are selling make an issue at this time impractical. The price at which stocks could be sold on the public market is less than the amount which the promoters consider the fair book value of the stock as represented by assets.

The change in market conditions was the most important factor resulting in the change in policy from an immediate stock issue to plans for a deferred issue with interim debt financing being privately placed to meet immediate capital needs for expansion.

Development of Norms For the Vending Industry

The emergence of vending companies which are regional or national in scope and which are publicly held is a development coming mainly in the decade of the 1950's. The rapid movement for consolidation of individual operating companies into regional or national systems brought equally rapid changes in methods of operation. In 1962 and 1963, the wave of combinations began to abate to allow time to fuse the operating units into sound, workable systems. The problem of setting standards of performance is
intensified by the rapid changes incurred as a result of the rapid growth. Changes have been so rapid and so drastic that comparative examples and supporting figures have been difficult to find. Much of the information currently available concerning operations of the new and dominant vending corporations is inaccurate and unreliable. Recapitalizations and acquisitions of new firms have caused different bases to be used in computing operating statistics from one company to another. As a result, the raw figures have questionable application for comparison with another company or even within the same company for different years. The writer's major criticism stems from the failure of most reporting sources to indicate if adjustments have been made, or if so, on what basis.

The writer has collected data on financial operations on six important vending companies which are considered leaders in the field. These data were arranged in tables and analyzed to determine if an emerging pattern of basic characteristics could be found. Certain characteristics were discovered as being representative of well-managed firms in the industry. These characteristics were then used as a standard for comparing the form and expected operations of Venda-Craft.

Significant characteristics of the national vending industry drawn from the analysis of the previously mentioned tables include:
1. Profit after taxes to net sales for the national companies typically range from 2.5% to 3.0%.

2. As companies increased volume from the lower ranges ($10 million) to the medium ranges (up to 65 million), margin showed more increase than in higher ranges.

3. The market price of vending shares reached a peak in 1961 then showed declines in 1962.

4. Price earnings ratios of 30 to 1 were common in 1961 with some stocks going as high as 50 to 1, 60 to 1 or even 85 to 1. For 1962, ratios are lower but still run from 20 to 1 to 40 to 1. (The 353 to 1 ratio of Automatic Canteen is excluded from consideration here because of their 1962 operational difficulties resulting in substantially reduced profit.)

5. Most vending stocks in 1961 and 1962 were selling for about four times the book value of their assets.

6. The current ratio during 1961 and 1962 was typically between 1.3 to 1 and 1.6 to 1.

7. Typically, current assets comprise approximately 40% of a company's assets. Fixed assets, including vending equipment, make up the remaining 60%.

8. Current liabilities most frequently fall between 20% to 30% of the capital structure. Fixed liabilities most typically comprise 30% to 40% of the capital structure. Common equity ranges from a low of 30% to a high of 61%. The 40% to 50% range would be considered typical.

9. Return on common equity is typically between 13% and 19%.

These conclusions are taken from a very limited sample. However, the companies studied are the leaders in the industry. They include both recent combinations (Automatic Retailers of America) and old established food companies which have expanded into
vending operations (Prophet Company). They include stocks which are traded on the New York Stock Exchange (ABC Vending), the American Stock Exchange (Prophet Company) and stocks traded over-the-counter (Interstate Vending). They include a company with a sales volume of $33 million (Macke) and the largest firm in the vending industry (Automatic Canteen) which has a sales volume of $223 million. With such diversity of scope, the similarities in operating figures indicate that some major patterns of operation are discernable.

Further investigation into the operating statistics of the emerging vending companies would be a valuable study yielding significant results both for academic understanding of an economic change and as operating guides for vending operators.

Application of Industry Norms to Venda-Craft

As a result of the comparative study of the six vending companies selected as representative of the industry, their structure and their operating results are being taken as guides for development of Venda-Craft. Comparable structure and operating results are reasonable objectives for the end of fiscal 1965.

The present capital structure of Venda-Craft shows a much greater reliance on short term debt than is found in the other
vending companies with which comparison was made. The direct plans during the next four years include a program of intermediate borrowing to supply additional needs and replace short term debt with intermediate term debt.

The present Venda-Craft margin of profit after taxes to net sales is lower (1.4%) than that which is considered representative of the other companies (2.5% to 3.0%). A comparable margin is obtainable by 1965 through continued efforts to increase sales volume and to replace unprofitable installations with higher yield operations.

The ability to meet accepted industry standards of structure and return is essential to complete transition to public ownership. An attempt at public offering before this is accomplished will result in rejection of the securities by the investing public or a limited acceptance by speculators under conditions and a price highly unfavorable to the promoters. In order to successfully accomplish their market objectives, the promoters must be willing to wait until the operational results of Venda-Craft are closer to industry standards. Conservative financial projections indicate that the desired level of performance will not be reached until fiscal 1965. The promoters can prepare for eventual completion of the transition to public ownership by concentrating on present operations of the holding company system. They must develop a stable organization which can promise potential profits
for the investor by demonstrating a present ability to operate effectively and realize profits.
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SELECTED BIBLIOGRAPHY

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APPENDICES
APPENDIX I

BY-LAWS

of

VENDA-CRAFT

ARTICLE I

NAME

The name of this corporation shall be: "Venda-Craft, Inc."

ARTICLE II

STOCKHOLDERS' MEETINGS

All meetings of the stockholders shall be held at the principal place of business of the corporation unless some other place in Georgia is stated in the call.

ARTICLE III

ANNUAL MEETING OF STOCKHOLDERS

The annual meeting of the stockholders shall be held on the first Monday in April.

In the event that such annual meeting is omitted by oversight, or otherwise, on the date herein provided for, a subsequent meeting may be held in place thereof, and any business transacted, or elections held, at such meeting shall be as valid as if transacted or held at the annual meeting. Such subsequent meeting shall be called in the same manner as provided for special stockholders' meetings.
ARTICLE IV

SPECIAL MEETINGS OF STOCKHOLDERS

Special meetings of stockholders may be called at any time by the President. It shall be the duty of the President to call a special meeting of the stockholders whenever requested in writing so to do by three Directors.

ARTICLE V

NOTICE OF MEETINGS OF STOCKHOLDERS

Notice of all stockholders' meetings, stating the time, place and objects for which such meetings are called, shall be given by the Secretary by mail, postage prepaid, to each stockholder of record entitled to vote at stockholders' meetings when the notice is given, at his or her address, as shown on the corporation's records, at least three (3) days prior to the date of the meeting.

No notice of the time, place or purpose of any regular or special meeting of the stockholders shall be required, provided each stockholder, or his attorney thereunto duly authorized by a writing which is filed with the records of the meetings, waives such notice, either before or after the meeting.

ARTICLE VI

QUORUM OF STOCKHOLDERS' MEETINGS

At any meeting of the stockholders a majority in amount of the capital stock then issued and outstanding, represented in person or by proxy, shall constitute a quorum to do business, but a less number may adjourn a meeting from time to time, and the meeting may be held as adjourned without further notice. When a quorum is present at any meeting, a majority of the stock represented thereat and entitled to vote shall decide any question properly brought before such meeting. Only a stockholder shall act as proxy for an absent stockholder.
ARTICLE VII

BOARD OF DIRECTORS

The number of Directors of this corporation shall be not less than seven (7) nor more than twelve (12). They shall be elected at the annual meeting of stockholders, and shall hold office for one (1) year and until their successors are elected and qualify. A Director may be removed from office at any time during his term of office by a majority vote of a quorum of the stockholders.

The minimum of seven (7) Directors must be elected, as indicated, from the following groups:

(a) Two (2) Directors from those who were former stockholders or are present officers or Directors of Southern Sales Company;

(b) Two (2) Directors from those who were former stockholders or are present officers or Directors of Piedmont Dairies, Inc.;

(c) Two (2) Directors from those who were former stockholders or are present officers or Directors of Canteen Company, Inc.;

(d) One (1) Director from those who were former stockholders or are present officers or Directors of Mid-Georgia Candy Company.

Directors need not be stockholders of this corporation.

ARTICLE VIII

POWERS OF DIRECTORS

The Board of Directors shall have the entire and general charge of the affairs of the corporation. The Board may, however, from time to time delegate authority to one or more officers, and may constitute and clothe said officers with specific authority.

The Board of Directors may authorize loans of corporate funds to Directors, officers or stockholders of this corporation as well as to other parties.
If a Director should have a personal interest in a transaction or contract which is considered by the Board of Directors, that Director shall not vote on the transaction or contract, although he will be counted for purposes of a quorum.

A majority of the Board shall constitute a quorum and a majority of the quorum present at a meeting shall determine all questions.

ARTICLE IX

MEETINGS OF BOARD OF DIRECTORS

Regular meetings of the Board of Directors shall be held in such places, either within or without the State of Georgia, and at such time as the Board may from time to time determine, and if so determined, no notice thereof need be given. Special meetings of the Board of Directors may be held at any time and place whenever called by the President, or, by any three (3) members of the Board of Directors, three (3) days notice thereof to be given by the Secretary. Meetings of the Board of Directors may be held at any time without formal notice, provided all the Directors are present, or those not present have waived notice thereof. Such special meetings shall be held at such time and places as the notice thereof or waiver may specify, either without or within the State.

ARTICLE X

EXECUTIVE COMMITTEE

The Board of Directors shall elect an Executive Committee from its members. The committee shall consist of no less than three (3) members, one of whom will be the President, who will be Chairman of the Executive Committee.

The Executive Committee shall have and may exercise the powers of the Board of Directors in the management of the affairs and property of the corporation and the exercise of its corporate powers.
The Executive Committee must approve all capital expenditures over $10,000.00 per year. It must approve all leases for a period of more than a year, and it must approve any lease, irrespective of duration, whose rental, on an annualized basis, aggregates $2,000.00 or more. A majority of the Executive Committee shall constitute a quorum, and a quorum may act on any issue; provided that any decision of the Executive Committee must be approved by at least two (2) members of the Committee.

ARTICLE XI

OFFICERS

The officers of this corporation shall be a President, one or more Vice-Presidents, a Secretary and a Treasurer. One person may hold more than one office in the corporation, except that no person shall at the same time serve as President and Secretary of the corporation. All officers shall be elected by the Directors. All officers shall hold office for one (1) year and until their successors are elected and qualify. Any officer may be removed from office by a majority vote of a quorum of the Directors. The salaries and commissions of the officers shall be fixed by a majority vote of the Directors.

ARTICLE XII

ELIGIBILITY OF OFFICERS

Neither Directors nor officers are required to be stockholders of this corporation.

ARTICLE XIII

PRESIDENT

It shall be the duty of the President to preside at all meetings of the stockholders and Directors. He shall be the chief executive officer of the corporation, and subject to the Board of Directors, shall be in general charge of the affairs of the corporation. He, together with any other one (1)
member of the Executive Committee, may sign and execute all notes, contracts or other such obligations in the name of the corporation, and may with the Secretary sign all certificates of shares of the capital stock of the corporation. He shall do and perform such other duties as from time to time may be assigned to him by the Board of Directors.

ARTICLE XIV

VICE-PRESIDENT

The Vice-President, in the absence of the President, shall preside at all meetings of the stockholders. He shall do and perform such other duties as from time to time may be assigned to him by the Board of Directors.

ARTICLE XV

SECRETARY

The Secretary shall be present at all meetings of the stockholders or the Board of Directors and shall keep an accurate record of the proceedings at such meetings in books provided for that purpose, and the Secretary shall perform such other duties and have such other powers as the President shall from time to time designate. In the absence of the Secretary from any such meeting, a Secretary pro tempore shall be chosen, who shall record the proceedings of such meeting in the aforesaid books.

ARTICLE XVI

TREASURER

The Treasurer shall have the care and custody of the funds of this corporation and shall have all the powers and duties commonly incident to his office. He shall have the custody of all valuable papers and documents of this corporation. The Treasurer shall deposit all the funds of this corporation in such bank, or banks, trust company, or trust companies as the Board may determine. The Treasurer shall keep accurate records of the corporation's financial affairs.
ARTICLE XVII

VACANCIES

If the office of any Director or officer becomes vacant by reason of death, resignation, removal, disqualification or otherwise, the Directors shall choose a successor, or successors, who shall hold office for the unexpired term.

ARTICLE XVIII

FISCAL YEAR

The fiscal year of this corporation shall end on April 30 in each year.

ARTICLE XIX

SEAL

The seal of this corporation shall consist of a flat faced, circular die, and around the outer circle shall be written the words: "Venda-Craft, Inc. Georgia", and within the words and figures: "Corporate Seal 1961".

ARTICLE XX

AMENDMENTS

The by-laws may be amended or added to, altered, or repealed, at any annual or special meeting of the stockholders by vote of two-thirds (2/3) of the capital stock issued and outstanding.

ARTICLE XXI

SECURITIES CERTIFICATES

The transfer and registry of all registered securities of the corporation will be handled by the Secretary of the corporation.

The Board of Directors shall determine the content and form of all securities issued by the corporation.
APPENDIX II

(Sample Vending Contract)

VENDING SERVICES AGREEMENT

Date.

This Agreement between Southern Sales, Inc. and our organization grants to Southern Sales the exclusive right to provide food, tobacco and beverage products on the premises of our plant, except as mutually agreed otherwise.

This Agreement, effective this date, shall be for a period of three years - subject to our written 90 day notice of cancellation, and shall automatically be renewed each year thereafter.

The attached list describing the obligations and responsibilities assumed by Southern Sales shall be a part of the Agreement.

By: _______________________

CONCUR:

Southern Sales Company

By: _______________________

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LIST OF OBLIGATIONS AND RESPONSIBILITIES

1. Southern Sales shall, without cost, install a sufficient number of automatic food, beverage and cigarette vending machines on the described premises and will keep the machines supplied so as to provide, under normal conditions, location's employees with sufficient amounts of food, beverages, and tobacco products of good quality, prepared and dispensed in conformity with all applicable federal, State and local laws and health and sanitation standards. Such food and beverages shall be available for purchase at reasonable prices and size per portion. If the average number of employees using the vending machine services increases appreciably, the Operator at no extra cost to the location, shall furnish such additional machines as may be necessary and proper for the prompt servicing of location's employees and to permit convenient consumption of the food and beverages.

2. ACCOUNTING: Southern Sales will submit to the location, by the 10th day of each quarter, following a calendar quarter a statement covering the sales through the machines for the preceding months together with a check for the sums due the location under this agreement.

3. RENEGOTIATION-TAX AND MERCHANDISE COST CHANGE: It is understood and agreed that the schedule of payments under this contract is based upon the Federal, State and City sales and excise taxes and license fees and upon the costs of merchandise sold through the machines existing at the date of this contract. In the event of a change in the rates of taxes or license fees; or in the event of a change in the cost of merchandise sold through the machines exceeding 5%, then the schedule of payments provided shall be adjusted to reflect such change upon a mutually agreeable basis without in any way affecting any of the other provisions of this Agreement.

4. LICENSES: State, county and city license fees, of course, shall be charged against the sums due the location under the contract. However, all State, county and city license fees shall be paid by Southern Sales who agrees to reimburse the location for any penalties or necessary expense due to the Carolina Vending failure to obtain any of the necessary licenses.
5. **REPLACEMENT-TITLE:** The vending machines included in this Agreement remain the property of Southern Sales, who shall have the right at any reasonable time to remove the machines and replace any of the machines as he deems necessary. The location agrees to permit only authorized personnel of Southern Sales to remove or tamper with any of the machines.

6. **TAXES-SALES AND EXCISE:** Southern Sales agrees to pay all sales and excise taxes incident to sales through the machines and agrees to reimburse the location for any penalties or costs necessarily resulting from Southern Sales' failure to promptly pay such taxes.

7. **MAINTENANCE:** Southern Sales will maintain, service, and keep vending machines in good working order on all working shifts. Southern Sales will keep all machines sanitary throughout. Southern Sales assumes all responsibility for the mechanical operation of the vending machines. The location agrees to provide janitor service to keep vending areas clean.

8. **PERSONNEL:** Southern Sales' service personnel will at all times be dressed in clean uniforms and will observe all regulations in effect upon the described premises. The location agrees to furnish Southern Sales' personnel with any necessary identification passes required for entrance to or exit from the described premises at any time for day, night or weekend service call.

9. **INSURANCE:** Southern Sales carries and agrees to continue in force, Workmen's Compensation Insurance in compliance with the laws of the State of South Carolina, Southern Sales also carries and agrees to continue in force product liability and property damage insurance.

   Southern Sales will furnish the location evidence of this coverage satisfactory to the location, if requested.

10. **TERM:** This Agreement shall remain in force for a period of one year from the date hereof and unless canceled, is deemed to be automatically renewed from year to year thereafter without notice.
11. **Cancellation:** Southern Sales agrees to have the machines removed from the described premises 90 days after giving or receiving written notice by registered or certified mail of cancellation of this Agreement. The location agrees, however, that it will only exercise its cancellation option if Southern Sales permits its services to fall below normal good vending standards.

12. **Business Interruption:** If, because of strikes, riots, wars, or for any other reason, business operations at the described premises shall be interrupted or stopped for periods of time other than is customary for such business, then the expiration date of this agreement shall be extended for an equal period of time.

13. **Alterations:** Each of the parties to the Agreement agrees to obtain approval of the other before any alterations are made that would materially affect the operations in the described premises or of any of the vending machine installations.

14. **Entire Agreement:** This Agreement constitutes the entire Agreement between the parties and no modifications or waivers shall be valid unless made in writing.

15. **Utilities:** The location agrees to provide adequate water and electrical outlets (when required) at the sites mutually selected by Southern Sales and the location for the installation of Southern Sales' machines.
16. **COMPENSATION:** Southern Sales further agrees to pay the location the following sums, subject to the other provisions of this Agreement. These percentages will be based on net volume of sales, after sales taxes (if any) have been deducted.*

Based on per Machine Average for One Month.

**Example:** Two Candy Machines sell $132.00
Comm. Rate 5%

<table>
<thead>
<tr>
<th>COMM.</th>
<th>CANDY</th>
<th>PASTRY</th>
<th>HOT</th>
<th>FOOD</th>
<th>MILK</th>
<th>5¢</th>
<th>10¢</th>
<th>CIGARETTES</th>
<th>RATE</th>
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<tr>
<td>0%</td>
<td>$48</td>
<td>$92</td>
<td>$187</td>
<td>$218</td>
<td>$103</td>
<td>$71</td>
<td>$114</td>
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<td></td>
</tr>
<tr>
<td>1%</td>
<td>51</td>
<td>97</td>
<td>206</td>
<td>235</td>
<td>109</td>
<td>79</td>
<td>126</td>
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<tr>
<td>2%</td>
<td>55</td>
<td>109</td>
<td>231</td>
<td>258</td>
<td>115</td>
<td>81</td>
<td>150</td>
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<td></td>
</tr>
<tr>
<td>3%</td>
<td>58</td>
<td>120</td>
<td>251</td>
<td>281</td>
<td>120</td>
<td>83</td>
<td>186</td>
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</tr>
<tr>
<td>4%</td>
<td>62</td>
<td>132</td>
<td>293</td>
<td>310</td>
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<td>85</td>
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<tr>
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<td>66</td>
<td>149</td>
<td>331</td>
<td>345</td>
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<td>336</td>
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<tr>
<td>6%</td>
<td>72</td>
<td>166</td>
<td>343</td>
<td>391</td>
<td>138</td>
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<td>448</td>
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<td>8%</td>
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<td>224</td>
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<td>517</td>
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<tr>
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<td>270</td>
<td>562</td>
<td>598</td>
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<td>10%</td>
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<td>690</td>
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<tr>
<td>11%</td>
<td>102</td>
<td>437</td>
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<td>166</td>
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<td>1100</td>
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<tr>
<td>12%</td>
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<td></td>
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<td>172</td>
<td>118</td>
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<td>14%</td>
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<td>189</td>
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<tr>
<td>15%</td>
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<td></td>
<td>200</td>
<td>132</td>
<td>1500</td>
<td>15%</td>
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</tbody>
</table>

The commissions described above shall be paid quarterly for a period of one year, after which a median or an average commission may be established for future compensations. Any losses to Southern Sales from the sale of merchandise and/or the installation of machines at the request of and/or the convenience of the location are to be charged against any commissions owed to the location.

From time to time, as operating costs fluctuate up or down, Southern Sales may make appropriate adjustment in the commission scales shown above.

*The figures given are not indicative of actual commissions paid. All amounts have been adjusted to conceal the actual payments.
VITA

James LeRoy Caldwell, son of James Luther Caldwell and Georgie Hill Caldwell, was born in Winnaboo, Louisiana, on February 13, 1931. Raised in Delhi, Louisiana, he attended Delhi High School and was graduated in 1948 as class valedictorian.

Entering Louisiana Polytechnic Institute, Ruston, Louisiana, he majored in accounting and was graduated in August, 1951, with a Bachelor of Science degree. In August, 1953, he was graduated from Louisiana State University, Baton Rouge, Louisiana, with the degree of Master of Business Administration. The major field of study was business organization and management. He held a graduate fellowship in the Division of Business Research during the spring of 1952 and a teaching fellowship in the spring of 1953.

From 1953 to 1955, he served in the Finance Corp of the United States Army, spending one year at Eniwetok Atoll, Marshall Islands, as a member of Operation Castle being conducted by the Atomic Energy Commission.

In 1955, he returned to Louisiana State University as an instructor, teaching and taking courses in the College of Business Administration. During the summer of 1957, he
studied with the Austro-American Society in Salzburg, Austria. In 1958, he accepted his present position as Assistant Professor of Industrial Management at Georgia Institute of Technology, Atlanta, Georgia. In August, 1963, he is a candidate for the Doctor of Philosophy degree from Louisiana State University. The major area of study for this degree is business administration and management.

Candidate:  James LeRoy Caldwell

Major Field:  Business Administration

Title of Thesis:  A CASE STUDY OF COMBINATION OF CLOSELY HELD VENDING CORPORATIONS IN TRANSITION TO PUBLIC OWNERSHIP

Approved:

[Signatures]

Major Professor and Chairman

Dean of the Graduate School

EXAMINING COMMITTEE:

[Signatures]

May 31, 1963