REVIEW OF THE OPERATIONS

OF

F. C. McCORDICK LEATHERS LIMITED

October, 1962.

PAYNE ROSS LIMITED
management consultants
REVIEW OF THE OPERATIONS

OF

F. C. McCORDICK LEATHERS LIMITED

October, 1962.

PAYNE-ROSS
LIMITED

October 2, 1962.

Mr. E. J. McCordick,
President,
F. C. McCordick Leathers Limited,
P. O. Box 2100,
Cathcart, B.C.

Dear Mr. McCordick:

We are pleased to present a draft report titled "Review of the Operations of F. C. McCordick Leathers Limited" that may have been established to you by F. E. Payne, Assistant General Manager, The Toronto Dominion Bank.

It is a pleasure for us to work with you on this assignment, and we wish to record our appreciation for the cooperation received from you and your staff.

October, 1962.

[Signature]

PAYNE-ROSS
LIMITED

[Signature]
Mr. E. F. McCordick,
President,
F. C. McCordick Leathers Limited,
86 Grantham Avenue,
St. Catharines, Ontario.

Dear Mr. McCordick:

We are pleased to present a draft report entitled "Review of the Operations of F. C. McCordick Leathers Limited". One copy has been forwarded to Mr. L. C. E. Lawrence, Assistant General Manager for Ontario, The Toronto-Dominion Bank.

It was a pleasure for our staff to work with you on this assignment, and we wish to record our appreciation for the co-operation received from you and your staff.

Yours very truly,

PAYNE-ROSS LIMITED,

K. R. Oswell,
Vice-President.
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OBJECTIVES

To determine ways and means of improving inventory control.

To determine areas for cost reduction.

To examine the market potential for present products and possible other products.

To review possibilities of selling company at a fair price.
INTRODUCTION

Prior to 1957, the financial position and earnings record of the
Payne-Ross Limited was satisfactory, as by net
profit was equal to about 5% of the annual sales, and 30% on the aver-
age capital. Although the foregoing represents a satisfactory return, it
would be considered reasonable for a closely held company. The
working capital of about $20,000 at January 1, 1957 was also satis-
factory in relation to the volume of business being conducted.

In September 1957, the company moved to new premises, the
financing of which eliminated the company's working capital. The
additional financing costs for the new plant and equipment have
completely eliminated the former level of profit. After provision for
a reasonable amount of depreciation, the operating results show a loss
in each year since 1957.
INTRODUCTION

Prior to 1957, the financial position and earnings record of the F. C. McCordick Leathers Limited was satisfactory, as its net profit was equal to about 5% of the annual sales and 10% on the invested capital. Although the foregoing represents a minimum return, it could be considered reasonable for a closely held company. The working capital of about $50,000 at January 1, 1957 was also satisfactory in relation to the volume of business being conducted.

In September 1957, the company moved to its new premises, the financing of which eliminated the company's working capital. The additional financing costs for the new premises and overhead costs have completely eliminated the former level of profit. After provision for a reasonable amount of depreciation, the operating results show a loss in each year since 1957.
SUMMARY OF FINDINGS

Payment and Management Controls:

There are many weaknesses in the system and control, some of which can have an effect on the financial reports and result in inaccurate information. The main weaknesses are:

1. The inventory and production control records are almost non-existent.
2. Purchases and receiving of materials and supplies are not properly controlled.
3. Competitive prices are not obtained for purchases of materials.
4. A duplicate inventory control system is apparent.
5. The financial statements as at July 31, 1967, understated the inventory by $2,500 due to a cutoff error.

Manufacturing Operations:

Opportunities exist for cost reduction in the following areas:

1. Improved methods and equipment in the packaging and materials handling could produce savings of $5,000 per annum.
2. Better utilization of space is possible by rearranging the manufacturing operations. The existing operation is satisfactory.
SUMMARY OF FINDINGS

Systems and Management Controls:

There are many weaknesses in the system and control, some of which can have an effect on the financial reports and result in inaccurate information. The main weaknesses are:

1. The inventory and production control records are almost non-existent.
2. Purchases and receiving of material and supplies are not properly controlled.
3. Competitive prices are not obtained for purchases of materials.
4. A duplication of effort in the accounting system is apparent.
5. The financial statement as at July 31, 1962 understated the inventory by $2,800 due to a cut-off error.

Manufacturing Operations:

Opportunities exist for cost reduction in the following areas:

1. Improved methods and incentives in the packaging and materials handling could produce savings of $15,000 per annum.
2. Better utilization of space is possible by rearranging the manufacturing operations. The tanning operation is satisfactory.
3. Capacity is available for additional production using the present facilities.

**Selling Operations:**
Sales have not increased since moving to the new plant in 1957 which can be attributed to:

1. Inadequate representation in the United States.
2. The Province of Quebec has not received sufficient attention.
3. Only one salesman is employed by the company.
4. Very little promotional effort in the form of direct mail advertising is undertaken by the company.

**General Comments:**
The highlights of the financial condition are:

1. There is a lack of working capital.
2. The operations have been unprofitable since 1957.
3. The present sales volume is about $270,000 per annum.
4. A sales volume of $340,000 is required to produce a minimum net profit after provision for depreciation.

The total sales for the months of August, September and October are about $83,500. The backlog of orders amounts to $24,000 as at October 24, 1962.
SUMMARY OF RECOMMENDATIONS

Systems and Management Control:

To provide the maximum reliable reporting financial information and reduce administrative costs, the following recommendations should be considered:

1. Perpetual inventory records should be established.
2. Purchase orders should be issued for all purchases and competitive prices obtained by contractors and suppliers.
3. Reduction in clerical effort can be achieved by use of one summary of recommendations.

Manufacturing Operations:

Opportunities for cost reduction in manufacturing operations are apparent and improved methods and practices could produce an average of about $5,000 per annum. Improvements in layout costs are reflected in a saving of about 1,000 square feet.

Sales Operations:

A substantial increase in sales volume is essential to the continued operation of the company and to achieve this objective, the following recommendations should be considered:

1. The U.K. market appears to offer the greatest potential. Additional sales representatives should be appointed to ensure better coverage of this market.
SUMMARY OF RECOMMENDATIONS

Systems and Management Control

To provide the minimum reliable monthly financial information and reduce administrative costs, the following recommendations should be considered:

1. Perpetual inventory records should be established.
2. Purchase orders should be issued for all purchases, and competitive prices obtained for materials and supplies.
3. Reduction in clerical effort can be effected by use of one-write forms for accounting purposes.

Manufacturing Operations

Opportunities for cost reduction in manufacturing operations are apparent and improved methods and incentives could produce savings of about $15,000 per annum. Improvements in layout could reduce space occupied by about 3,000 square feet.

Selling Operations

A substantial increase in sales volume is essential to the continued operation of the company and to achieve this objective, the following recommendations should be considered:

1. The U. S. market appears to offer the greatest potential.

Additional sales' representatives should be appointed to obtain better coverage of this market.
2. Weak representation in the U. S. should be replaced.

3. New outlets for products, possibly through cotton lace manufacturers, should be explored.

4. Better representation in the Province of Quebec should be sought.

5. Promotional campaign by direct mail should be considered.

6. Development of new leather products should be continued.

7. Expansion of blister package production should be explored.

General Comments

Additional temporary financing of about $50,000 is required to provide a reasonable amount of working capital and eliminate the present deficiency of about $20,000.

Disposal of the business should be deferred until the volume of business and profits are at a satisfactory level for a reasonable period of time.

It is essential that the volume of business be increased and the service of an aggressive sales manager is required to accomplish this objective.
FINDINGS

Although monthly financial statements are prepared, the operating results shown by these statements cannot be considered entirely accurate due to the lack of basic inventory control records. The personal inventory records are maintained for raw materials, work-in-progress, and finished goods (except for goods in consignment). The production records maintained include only units of items to which transferred from the purchasing to the cutting and sewing departments. The records are in manual form and are not assembled with the physical inventory records. The following are required: work-in-progress and finished goods files are not to use.

The control over these used in the cutting operation shows not adequate to be adequately maintained.

No records are maintained for raw and composite materials. The company does not have any established procedure to control goods received and goods shipped. For example, in January of the year 1968 financial statements included 100 hides valued at £1,500 were included in the purchase for the month of July, but the hides actually received were August, and therefore not included in the July 31 inventory. Instead, the operating results at July 31 was increased by £1,500.
FINDINGS

Systems and Management Controls

Although monthly financial statements are prepared, the operating results shown by these statements cannot be considered entirely accurate due to the lack of basic inventory control records. No perpetual inventory records are maintained for raw materials, work-in-process or finished goods (except for goods on consignment).

The production records maintained indicate only units of hides or sides transferred from hide processing to the curing and cutting departments. The records are in memo form and are not reconciled with the physical inventories. Requisitions for supplies, work-in-process and finished goods are not in use.

The control over sides used in the cutting operation does not appear to be adequately controlled.

No records are maintained for scrap and salvageable materials.

The company does not have a well established procedure to control goods received and goods shipped. For example, a review of the July 31, 1962 financial statements indicated 300 hides, valued at $2,800 were included in the purchases for the month of July, but not actually received until August, and therefore not included in the July 31 inventory. Accordingly, the operating result as at July 31 was misstated by $2,800.
During our review, we attempted to reconcile the number of sides transferred between the curing and cutting department for a six-month period, and this test, based on the records available, indicated approximately 200 sides short.

Hide purchases are made verbally by the President, but no purchase order is prepared; consequently, it is difficult to check the quantity and price of incoming hides.

Materials and supplies are ordered by the bookkeeper on requisition from the plant foreman. There does not appear to be an established practice of obtaining competitive prices or consideration given to economic order quantities when placing such orders.

The present bookkeeping system requires the duplication of effort in many instances, and presents an opportunity for cost reduction by eliminating one clerk or, alternatively, would permit the use of the clerk's time for the preparation of more essential information such as inventory control records.

An example of the duplication of effort in the preparation of bookkeeping records is evidenced in the payroll system which requires the preparation of the payroll register, employee's earnings records, and payroll cheques individually, whereas it is possible to prepare all of these records simultaneously by the use of a one-write system.
A similar procedure could be followed in the preparation of the sales analysis and accounts receivable records. An accounts payable system is presently in use, whereas the adoption of a voucher system would also reduce clerical effort.

Manufacturing Operations

After a plant tour and close examination of the high labour content operations, we concluded that five packaging operators at $1.10 per hour can be eliminated for an estimated annual saving of $11,000. Additional annual savings, amounting to $3,000 to $5,000, can be generated by developing incentive pay for operators on the packaging operation and replacement of some male operators with female operators on the slitting operation.

The hide preparation operations, up to and including drying, offer no significant opportunity for cost reduction at present volumes.

There is a low level of material handling efficiency which can be improved to reduce the manufacturing cycle and improve deliveries.

Space utilization is poor, due in part to the necessity of separating the tanning operations from subsequent manufacturing operations. The manufacturing operation layout can be improved which could make about 25% (3,000 sq. ft.) of the second floor space available for rental. No estimate is made of the potential return from this.
The estimated cost of achieving these savings of approximately $20,000 per year would be:

1. Consulting services $7 - 10,000
2. Methods improvement equipment 1,200
3. Re-layout costs 2,500

It is expected that an elapsed time to effect these savings would be from 9 to 12 months.

Selling Operations

The sales volume for the past six years can be summarized as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Sales Volume</th>
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<tbody>
<tr>
<td>1956</td>
<td>$266,874</td>
</tr>
<tr>
<td>1957</td>
<td>$257,214</td>
</tr>
<tr>
<td>1958</td>
<td>$275,872</td>
</tr>
<tr>
<td>1959</td>
<td>$332,131</td>
</tr>
<tr>
<td>1960</td>
<td>$263,659</td>
</tr>
<tr>
<td>1961</td>
<td>$272,106</td>
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During the above period, some increases in selling prices were made, principally in the year 1959. Accordingly, it would appear as though the actual volume of business has declined since the company moved into its new plant, with the exception of the year 1959.

In addition to leather laces and tanned and raw hide cut belt laces, the company also sells tanned sides and backs and bellies and flanks.

With the introduction of blister packaging for its own product, the company has recently been producing blister packages for other companies.
The company's products are sold through jobbers, distributors, finders and sales representatives in various areas of Canada and United States. The company has no representation in eleven states of the United States and four provinces of Canada. In ten of the states in which the company is represented, no significant sales were made by the company in 1961 and 1962 to date. The representative for the New England States appears to be very weak in comparison with the effective coverage provided by other representatives in the United States.

The Atlantic provinces are not covered by a representative and as the potential sales in that area are insignificant in relation to the cost of servicing the area it is not considered to be an important omission.

The company has one salesman who is responsible for the Ontario and Quebec territory.

The company does not distribute its products through cotton lace manufacturers, although several inquiries have been received from this source.

The company does very little direct mail advertising to jobbers, distributors, finders, etc. The representation in the Province of Quebec would appear to be inadequate considering the number of potential users, particularly in the home craft industry.
Sales to United States customers have represented 33 1/3% to 40% of the total volume during the past five years, and currently amount to approximately 40%.

The last major price changes for the company's products were made in 1959. The company is currently receiving the benefit of the premium on the U.S. dollars for sales made in the United States. The company does not maintain product cost records, whereas such records would be helpful when selling prices are established.

General Comments

The company's lack of working capital and unsatisfactory financial condition dates from the acquisition of the new building in 1957, the financing of which completely depleted the working capital. The unsatisfactory operating result since that time has also resulted in a further strain on the company's financial position.

The company needs additional volume of business in order to generate profits necessary to improve its financial position. However, the company's present lack of working capital makes it difficult to finance an increased volume of business. There is a need for additional capital to finance the required volume of business.

An annual sales volume of approximately $240,000 is necessary for the company to break even before the provision for depreciation.
A sales volume, amounting to approximately $340,000, would be required to provide a margin of profit to permit a reasonable allowance for depreciation and a sales volume of $420,000 to $450,000 to provide a minimum return on the present invested capital.

Inventory quantities on hand appear to be at a reasonable level for the present volume of business. The company's present tight financial position does not permit the accumulation of excess inventory quantities.

Sales for the past three months have been as follows:

<table>
<thead>
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<th>Month</th>
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</tr>
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<tbody>
<tr>
<td>August</td>
<td>$23,589</td>
</tr>
<tr>
<td>September</td>
<td>$29,990</td>
</tr>
<tr>
<td>October (estimated)</td>
<td>$30,000</td>
</tr>
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The unfilled orders on hand October 24 totalled $24,331.
RECOMMENDATIONS

Payne and Ross Limited

1. Physical inventory records showing quantities and unit prices should be established for each raw material and supplies. Inventory records should also be established for items in process and for finished goods.

2. The perpetual inventory records should be agreed periodically with the general ledger control accounts.

3. A system of reporting work done through the plant, together with a schedule for monthly or six-monthly stocktaking and measurement, should be established.

4. A requisition system is required for ordering sub-contractors.

5. Purchase orders should be issued to the suppliers and a copy of each purchase order used as a receiving document. Competitors' prices should be obtainable for the purchase of other materials and supplies.

6. Following the introduction of the improved inventory system, a limited number of physical inventory counts should be made in order to check the accuracy of the inventory records.

7. Discontinuance should be given to improving security standards as well as increasing the company's interests of work in progress and finished goods. The supervision of a night watchman and tighter control over the security and access to the plant should also receive consideration.

8. A non-taxable payroll system should be adopted.

9. A better system should be used for discounts and purchases.
RECOMMENDATIONS

Systems and Management Control

Perpetual inventory records showing quantities and unit prices should be established for hides, raw materials and supplies. Inventory records should also be established for sides in process and for finished goods. The perpetual inventory records should be agreed periodically with the general ledger control accounts.

A system of reporting work flow through the plant, together with requisitions for materials used in production, should be established.

A reporting system is required for scrap and salvageable materials.

Purchase orders should be issued for hide purchases and a copy of the purchase order used as a receiving document. Competitive prices should be obtained for the purchase of other materials and supplies.

Following the introduction of the improved inventory control records, frequent physical inventory counts should be made in order to prove the accuracy of the inventory records.

Consideration should be given to improving security measures to safeguard the company's inventory of work-in-process and finished goods. The employment of a night watchman and tighter control over the access and egress at the plant should also receive consideration.

A one-write payroll system should be adopted.

A voucher system should be used for disbursements and purchases.
The one-write system or a unit system should be used for accounts receivable and sales journal. More use should be made of combined forms instead of separate forms, e.g., sales order and sales invoice forms could be combined; purchase order and receiving document could be combined.

Manufacturing Operations

A cost reduction programme in the packaging operation and material handling should be instituted by adopting more efficient work methods and incentive pay for the packaging operations employees.

Consideration should be given to the possibility of improving the layout on the second floor if management is of the opinion that the space made available by the re-arrangement could be rented.

Selling Operations

Emphasis should be placed on increasing sales in the United States as this market appears to offer greater potential than the Canadian market.

Additional sales representatives should be appointed in the United States and some of the present representatives should be replaced in favour of representatives capable of providing the type of coverage which would increase sales.

Consideration should be given to a direct mail advertising on a regular basis to Canadian and U. S. shoe manufacturers, jobbers, finders, etc.
Further contact should be made with cotton lace manufacturers to promote the distribution of leather laces through this well established distribution channel.

Improved representation in the Province of Quebec is required in order to increase sales to the normal users and particularly to moccasin manufacturers and "home craft" users.

Selling prices should be reviewed and increased wherever possible. The increases during the past few years have not been consistent, and prices for certain lines have remained unchanged for an unreasonable period.

Slow-moving and obsolete lines should be deleted after a review of the product lines has been made.

The potential market for tanned leather should be explored as a means of increasing sales of this product.

The company's efforts to develop new products such as leather dogbones, dog harnesses, etc., should be continued.

To implement the additional sales coverage suggested, the services of another salesman would be required as the one salesman the company now has could not adequately cover all of the Canadian and U. S. customers.

The potential market for blister packages should be explored as a means of diversifying the company's operations. The company is now making blister packages for other users, and the sales of this product could possibly be expanded.
General Comments

Temporary financing, amounting to approximately $50,000, would eliminate the present working capital deficiency and provide approximately $30,000 working capital to finance the additional volume of business. Increased sales could be handled with little or no increase in the inventory, but the accounts receivable would increase proportionately.

As profits are generated following the implementation of the cost reduction programme and increase in the volume of business, the temporary financing could be retired.

As the earnings record of the company for the past five years has been unsatisfactory, and the potential capacity of the plant has not been utilized, we would recommend that every effort be made to improve the company's profit record and financial position before attempting to dispose of the business. If the company showed progress during the next three years, Mr. McCordick should be able to arrange for a satisfactory price for his interest in the company.

Consideration should be given to the possibility of attracting a partner who might be prepared to make a cash investment in the business with the option to purchase within a three to five year period. The ideal person would be one who could assume the responsibility for aggressively promoting the company's products and exploring possibilities for new products. Mr. McCordick could continue to devote his efforts to the direction of the plant operations and the day-to-day management of the company.