THE FINANCIAL EDUCATION OF A MARKETING ENTREPRENEUR

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When the classical formation of an enterprise occurs within a capitalistic system, the members of the organization are generally specialists. For example, the inventor seeks a financial backer, a patent attorney, and a businessman to help launch the company that is to manufacture and sell his invention. Critical stages are reached when the continued growth or even survival of business requires an integrated effort requiring the owners or managers to think beyond their narrow areas of expertise. Such was the case in the history of the American Hospital Supply Corporation. The company's development reflects the challenges faced by a marketing specialist in mastering the complexities of finance and developing an understanding of the interrelatedness of these functional areas of management.

During the years between 1922 and the late 1960s the American Hospital Supply Corporation emerged as the leading supplier of health-science products in the United States. The company is part of an industry composed of wholesale and manufacturing firms selling instruments, supplies, equipment, furniture, and sundries to hospitals, physicians, and various health facilities. Although a hospital supply industry of sorts has existed since the early days of the nation's history, it was still largely undeveloped when the American Hospital Supply Corporation was founded in 1922.

The slow development of hospital supply industry paralleled the expansion of hospital facilities in the United States. As late as 1873, in the entire country there were only 178 hospitals with a total capacity of less than 36,000 beds.[1] While not all of these were showplaces for medical advances, the hospital was, nonetheless, establishing itself as an essential institution on the national scene. In fact, by 1923, 6,830 hospitals were listed by the American Medical Association's Council on Medical Education and Hospitals. These hospitals contained over 750,000 beds which were occupied on any one day be an average of nearly 550,000 patients.[2] Their remarkable growth during the period between 1873 and 1923 created a multitude of problems for hospitals and encouraged the development of an industry to supply hospitals with their medical and housekeeping needs.[3]

Among the hundreds of small firms created for the purpose of serving the rapidly expanding hospital market was the American Hospital Supply Corporation.[4] American's transition from a small jobber of hospital supplies to a large and diverse manufacturing-distributive complex was primarily attributable to the imaginative marketing strategies of its principal founder, Foster G. McGaw. However, McGaw's early training, his emphasis on marketing as the means of attaining success, and his relationship with the company's initial major stockholder caused him to be rather slow in developing an understanding of the importance of the role of financial management. Nevertheless, his understanding of this aspect of the company's management did increase though his education was slow in coming and often painful.

McGaw's financial education can be seen as having developed in three stages. During the first period, 1922-1946, he played a very subordinate role in the area of finance to the major stockholder in the corporation who insisted on making all important financial decisions in this area. The second stage of McGaw's education lasted for some thirteen years and began with a financial crisis precipitated by the death of the dominant financial figure in 1946. Once this crisis was met, the remainder of this period was characterized by a change in attitude on McGaw's part. He no longer believed that financial matters were of secondary importance and merited careful attention only when the company's marketing activities were in some way restricted by a lack of capital. Instead, he came to recognize the close interrelationship between finance and marketing. The final stage of McGaw's education began in 1959 when a decision was made to systematize the financial management of the company by bringing "professional" managers into the company's executive ranks for the first time. The remainder of this paper will review the events of these three periods

First Period: The Dominance of Drake

The man who so completely dominated the finances of the American Hospital Supply Corporation during the first twenty-four years of its history was Harry I. Drake. Drake was the son of the owner of one of the largest privately held small loan companies in the United States. His own activities were concentrated on real estate development and management in the Chicago area. Although he was only twenty-seven at the time American was founded in 1922, he had already established a local reputation as a prudent and highly successful investor.

Drake's role in American was that of financial backer. He became involved in the project because McGaw, with whom he used to play tennis occasionally, was so greatly enthused about the opportunities in the hospital supply industry. McGaw's enthusiasm, however, was not supported by any personal wealth. When American was founded Drake supplied every cent of the initial capitalization. The company's total authorized capital was $40,000 with stock having a par value of $100 per share. Initially, one-hundred shares were subscribed by the incorporators. Drake purchased sixty of the shares and loaned McGaw and another associate the funds with which to acquire the other forty shares. Thus, from the very beginning Drake was in control of the corporation. Not only did he own a majority of the outstanding stock, but he also held the notes of the other stockholders.

Drake's insistence on control was a reflection of his conservative policy toward investment. His already cautious attitude was reinforced by the fact that his father had opposed the idea of his backing McGaw. It was foreign to the kind of investments in which the family had been involved previously. The senior Drake was sufficiently concerned with his son's investment that he asked his attorney, Charles F. Hough, to act as a "watchdog" to see that none of the money was improperly used.[5] Accordingly, Hough was elected secretary of the board of directors.

The fact that the unique venture was unrelated to the family's other activities seemed to make Harry Drake that much more determined to see it succeed. In Drake's mind, to insure the company's success meant to control it carefully. His policy toward growth was conservative. He expressed the conviction to Hough many times that he wanted "a good small company." It should be large enough to operate at a profitable level, but not so large that it became difficult to control. Another cardinal rule was that the company not engage in any activity which would involve it with organized labor. The existence of a union would threaten the totality of his control.

Drake was to control the corporation and doninate its financial affairs for twenty-four years although he never assumed an active role in the day-to day operations. In fact, Drake did not maintain an office at the company's headquarters although he was the president of the corporation until 1935 and chairman of the board from then until his death in 1946.

The man who actually created and directed Drake's "good, small company" was McGaw. McGaw's orientation and background were quite different than Drake's. Whereas Drake stressed caution and prompt return on his investment, McGaw sought innovativeness and long-range growth. Drake had attended the Wharton School while McGaw was able to complete high school in Keokuk, Iowa only after having to quit for a year because of family financial problems. Unlike the rather introverted Drake, McGaw was a master of salesmanship. He began his sales career at age nineteen, only a few weeks after being graduated from high school. With a loosely defined sales territory of "all the doctors in Iowa, Minnesota, and North and South Dakota" be began selling the wares of Huston Brothers, a Chicago surgical supply house. Within a year McGaw became the top salesman representing the company. McGaw's forte was his mastery of the art of the soft sell. He had a seemingly unique ability to gain the trust and confidence of his customers and was able to establish long-term relationships based on mutual respect.

Because of his excellent record in the sales field, McGaw had complete confidence in his ability to lead his own company to the top of its industry through effective selling. The company's performance between 1922 and 1946 only reinforced his belief. By the end of 1946 the company's product line, which had numbered only a few hundred items in 1922, included some 10,000 products. Net sales had grown from less than $78,000 to nearly $9 million. During the same period, net earnings before income taxes mounted from $1,795 to $682,093. Whereas in 1922 American was represented in only a few Midwestern states by three salesmen, by 1946 sixty-seven salesmen were working out of offices in Chicago, New York, San Francisco, Atlanta, and Washington, D.C., calling on nearly 90 per cent of the nation's hospitals. However, McGaw's preoccupation with his highly successful sales, advertising, and public relations efforts, coupled with Drake's complete control of the finances of the firm, caused McGaw to remain quite undereducated in matters of finance during the first period.

Because McGaw was so central to the success of the company, he might have challenged Drake's dominance of the financial area. There is no evidence that he attempted to do so, however. When American needed money Drake either extended a personal loan to the company or arranged for financing through a bank. He made all decisions regarding stock distributions and dividends. When economic crisis hit the company in the early months of the depression, Drake notified suppliers and other creditors that he stood behind past and future debts by American and for several weeks he met the company's payroll directly from his own resources. In many respects, therefore, he was the company's protector and benefactor.

His role was often perceived differently by McGaw, however. Drake kept the company financially exigent during most of this period by declaring generous dividends and paying himself a rather handsome salary. Between 1936 and 1940, for example, Drake received nearly $350,000 in salary and dividends while the company's net earnings for that five year period totalled only slightly over $550,000. No record exists of the interest he received on loans extended to the company to provide operating capital during this period. Drake's policies certainly helped him attain his two objectives. He earned an excellent return on his investment and also kept McGaw's more aggressive plans for expansion in check by forcing him to rely on Drake for capital.

In sum, this period was marked by an underlying conflict between Drake and McGaw. The latter was marketing and growth oriented. The former sought more immediate rewards and took a dim view of McGaw's plans for rapid expansion. One important consequence of these divergent objectives and interests was that McGaw ended the period a financial neophyte.

Second Period: McGaw and the World of Finance

McGaw's belated introduction to the world of finance was to be abrupt and, at least at the outset, rather harrowing. Harry Drake's death on April 11, 1946 precipitated a financial crisis.[6] While Foster McGaw was undeniably shocked and saddened at the loss of his long time friend and close associate, Drake's passing was the cause of some concern to McGaw. It had been known for some time that Drake's illness was incurable. Moreover, as Drake's health grew steadily worse, his attention to business matters declined and as it did so his relationship with McGaw became strained. Oftentimes he would leave the city without informing McGaw or giving him authority to conclude important negotiations which were underway.[7] And as the situation deteriorated McGaw's anxiety about control of the firm deepened.

As early as 1934, McGaw had attempted to secure greater protection for himself by suggesting to Drake that he add a codicil to his will which would give the company the right to purchase Drake's stock in the event of his death. The provision was discussed at great length, and when terms had been agreed upon by both men, McGaw asked Charles Hough to draw up the agreement. When the will provision was completed, McGaw mailed it to Drake, expressing the hope that the company would "never have a chance to take up this option."[8] When McGaw telephoned Drake a few days later, he was assured by the thirty-eight-year-old millionaire that he would complete the necessary arrengements. However, from that day on, Drake would never discuss the question again. No matter how frequently McGaw brought the matter up thereafter, Drake always cut short any inquiry by responding, "Don't worry, Mac, it's all been taken care of." Although Drake had never broken a promise to him, the matter was of such importance to McGaw that the assurances did little to lessen his trepidation. On at least two different occasions McGaw attempted to get Drake's assent to a survivorship agreement concerning their stock holdings in the company. These agreements, submitted in December, 1943, and February, 1946, were patterned on the will provision McGaw had tried to get Drake to accept in the early 1930s. Both of the proposed agreements were ignored by Drake. Thus it was not only a saddened but an alarmed McGaw who returned to Chicago from a business trip when he learned of Drake's death. The fruits of years of hard work, imagination, and drive hung in the balance as represented in the settlement of Drake's estate.

McGaw spent a trying seven days until Drake's will was filed with the clerk of the Probate Court of Cook County on April 18. Paragraph nine of the last will and testament of Harry I. Drake, dated November 26, 1935, (less than one year after McGaw first suggested the will provision) set fourth the arrangement by which his executors were to sell all of his American stock to the company in the event he should predecease McGaw. Under the terms of the will the company was granted a period of four months after the will was admitted to probate within which to purchase all of the stock. The payment was either to be in cash or $25,000 in cash and the balance in 6 percent cummulative preferred stock in the corporation. The following was the most crucial subsection of paragraph nine:

> The purchase price of said stock shall be the book value thereof at the time of my death. The good will of the corporation shall not be considered in determining the book value of the stock. In the event that Foster G. McGaw and my Executors shall be unable to agree upon the value of said stock within thirty (30) days after the admission of my Will to probate, my Executors shall select a nationally known public accountant, who shall fix the book value of said stock, and the price so fixed shall be binding upon my Executors and upon said Corporation.

Of major importance was the fact that the stock was to be sold to the corporation at a price exculsive of any consideration for good will. This meant that the selling price to American would be substantially below the actual value of the stock. A second point of major importance was the provision for the selection of a nationally known public accountant if the two parties should be unable to agree on the book value.

Although the intent of the will was quite clear, there was no guarantee that it would be carried out by the executors. McGaw, in fact, could not be assured that the company would even exercise the option. With the death of Drake, there remained four members on the board of directors--McGaw, Frank Connolly (one of McGaw's salesmen), Delbert Ruggles and Charles Hough. Ruggles, who was also one of the executors of the will, (the other executor was Drake's widow, Alice Bremner Drake) and Hough had both served over the years as Drake's "watch-dogs." If, in the interest of getting a better settlement for the estate, they chose to vote against exercising the option and McGaw and Connolly voted in favor of such action, a deadlock could have been broken by an election of the stockholders to fill the vacancy on the board. In such an election Drake's shares could have been voted by his executors thereby assuring victory for the estate.

On the afternoon of May 1, a meeting of the board of directors was held in the company's office in the Merchandise Mart. The four directors were present plus Delta I. Jarrett, attorney for the Drake estate. After the unanimous adoption of a memorial resolution concerning Drake's untimely death a second resolution to purchase the 20,487 shares of American stock left by Drake was moved and seconded. Jarrett objected to the motion and stated that it was premature in that the will had not been admitted to probate. A long discussion was followed by a vote in which the resolution was passed. Only Ruggles voted against the resolution (Jarrett was present as a guest of the directors and had no right to vote in the proceedings). Hough's decision to vote for the resolution came after hours of soul searching and a discussion with a committee of the Chicago Bar Association. As the will had directed the executors to consummate this sale to the company, it was clearly the responsibility and duty to carry out the express ideas of Drake. Further, any higher evaluation of the stock would clearly have been contingent upon McGaw remaining with the company, which he declared he would not do if the will were not carried out. Following the vote McGaw reported that an analysis of the company's records by the accounting department established "the book value per share of the stock of the company on April 11, as $31.06 per share, which would make the entire value of the 20,487 shares of the stock of Harry I. Drake on that date $636,326.22."[9]

In subsequent weeks American undertook legal action to enforce its rights under the terms of the will. Charles Hough, acting on behalf of American and McGaw, petitioned the Probate Court of Cook County to direct the executors to comply with the terms of paragarph nine of the will. A decree favoring the petition was issued by the court on August 28, 1946. A book value of $32.39 per share was established by Alexander Grant & Company, certified public accountants. On September 12, checks totaling $663,573.93 delivered to the executors in exchange for the 20,487 shares of stock. The stock was retired by the company as well as an additional 1,771 shares of treasury stock, thus making McGaw's 9,599 shares a majority of the 16,165 shares of outstanding stock of the corporation.[10]

The financing of the stock purchase placed a tremendous strain on McGaw and made 1946 a turning point in the company's history. For the first time financial problems had to be handled without the advice and backing of Drake. A major financial problem, indeed, existed. Not only was it necessary to raise the amount needed to pay the Drake estate, a substantial debt also existed with the Continental Illinois National Bank in Chicago.

The rapid expansion of the company s business during the war, coupled with the slowness which characterized the military's payments for goods received, had forced American to turn to outside sources for financing. The company needed money for expanded inventories and new offices in New York and San Francisco McGaw had quickly discovered, however, that American's net worth was insufficient to negotiate the amount he felt was needed. Once again, therefore, he had turned to Drake. Drake merely signed his name to an agreement personally guaranteeing repayment for a loan of $1 million by the Continental Bank. Drake's death meant that McGaw was faced with having to refinance the balance of the Continental debt which still exceeded the company's net worth.

In his search for new sources of funds McGaw soon learned that not all of the marble-walled institutions in Chicago's financial district could be trusted. One of Chicago s leading banks and a major investment house proposed an arrengement whereby they would purchase a sizeable block of convertible preferred stock which would provide American with sufficient funds to pay its debts and settle its arrangement with the Drake estate. It took McGaw only a few minutes to review the proposal and discover that the convertible provision would have given the bank and security firm control of the corporation within three years.[11]

After many days of hunting, and detailing his plans for the company's future, McGaw finally found a bank that was willing to offer him the backing he needed. The Harris Trust and Saving Bank agreed to handle all of American's financial needs. Initially, a ninety-day note in the amount of $1,063,573.93 was obtained from the Harris Bank. These funds, combined with receipts from four large insurance policies which American held on Drake s life, provided enough to pay the Drake estate and the balance of the Continental loan.

In order to finance the transaction permanently and to pro- the company with operating capital, American sold, through Harris, Hall & Company, serial notes amounting to $750,000 which matured annually in the amount of $50,000 for fifteen years. Interest rates on the notes ranged from 2-1/2 to 3-3/8 percent. Subordinated debentures in the amount of $300,000 and bearing an interest rate of 5 percent per annum were also sold. The notes and subordinated debentures were purchased by the Harris Bank, The Lincoln National Life Insurance Company, the Aid Association for Lutherans, and Armour and Company Employees' Pension Fund.[12]

Additional funds were raised through equity financing which was a vehicle McGaw would turn to more and more frequently in the future. This first step involved increasing the authorized common stock from 70,000 to 350,000 shares. A meeting of the shareholders also approved a seven-for-one stock split for outstanding shares and the sale of 41,545 shares of the new stock at $7 per share. The sale of the stock, which was restricted to employees, grossed an additional $290,815.

McGaw felt a great deal of satisfaction following his first encounter with the men of finance. He was much more confident about facing the challenges of financing the company's needs without having Drake's convenient though restricting crutch. In a sense, he was now liberated and he moved aggressively to take advantage of his new freedom. While he continued to emphasize marketing activities he developed a fuller appreciation for the interrelatedness of finance and marketing. Systematic management, of the company's financial activities, however, was still some years away.

During the period between 1947 and 1959, American accelerated its rate of growth. The number of items in the company's product line more than doubled, it opened six new regional distribution centers, and initiated an ambitious program of creating and acquiring manufacturing subsidiaries to develop its own sources of supply for certain of its product lines. All of these activities, especially the company's acquisitions, required large amounts of capital.

American's initial acquisitions, made during the immediate postwar period, were financed largely by long-term indebtedness. The funds were raised through the sales of sinking fund notes in the aggregate amount of $1,250,000 in December, 1948.[13] The 4-1/4 percent notes were sold through Harris, Hall & Company and were due in fifteen years with annual repayments ranging between $25,000 and $150,000. A substantial part of the funds acquired by the sale of the new notes was used to retire the subordinate debentures in the amount of $285,000 issued shortly after Drake's death and current bank loans of approximately $300,000. The balance, which was added to American's treasury, was taxed by the company's acquisition and expansion and the demands for greater working capital as the company continued its rapid growth.

At the same board of directors meeting in 1948 at which the sinking fund notes were approved, McGaw announced that "the ultimate goal of the company was a stock issue to pick up the notes then outstanding,"[14] as well as to provide additional financial strength. But he went on to point out that the company would probably be unable to secure public equity financing because of its poor dividend record. Although earnings had been good, they had been plowed back into the business for growth. Now, with the need for funds greater than could be met internally, all this would have to be changed. Accordingly, the board adopted a policy of paying regular dividends beginning with the payment of a $1.50 dividend in December, 1948. It was only the second dividend paid in eight years, but it initiated an unbroken series of quarterly dividends.

An improved dividend payment record was only one of two prerequisites for public financing which were advanced by McGaw's financial advisor, C. Longford Felske of Harris, Hall & Company. Felske advised McGaw against any attempt to sell American common stock to the public without first acquiring more substantial manfacturing operations. While the company's initial efforts had been a step in the right direction, Felske expressed concern that potential investors would regard American as too dependent on the whims of large suppliers for its well-being. This was especially true of the company's sale of intravenous solutions which represented 34 percent of American's net sales in 1949 and were supplied exclusively by one company.

The acquisition by American during this period of eleven companies (two of which were engaged in the production of intravenous solutions) was a reflection then not only of McGaw's strategies for greater market penetration, but also his plan for improving the salability of American's stock to the public. At a meeting of the board of directors held February 13, 1951, McGaw announced his intention of making the initial test of his efforts to prepare American for a public offering. He proposed that the company change its authorized capital stock from 350,000 shares without par value to 1,000,000 shares with a par value of $4 per share. He further proposed a two-for-one stock split for the then outstanding 232,197 shares and the sale of 150,000 shares to the public and 25,000 shares to employees.

American stock was sold on the over-the counter market for the first time on April 3, 1951. The originating underwriters were Harris, Hall & Company of Chicago and Union Securities Corporation of New York. The underwriting syndicate consisted of fourteen other investment banking houses. The stock was sold to the public for $22 per share with an underwriting commission of $1.75 per share. The shares sold to employees were priced at $20.25. Both blocks of stock were over subscribed. The total proceeds to American from the sale of the 175,000 shares were in excess of $3,500,000.

The success of American's first public stock offering had an important impact on the company's future acquisition program and other strategies. The sale proved that there was a ready market for the company's stock and that American could rely heavily on equity financing. The sales also marked the beginning of the dilution of the holdings of American's principal stockholder. McGaw's 156,800 shares represented 33.77 percent of the corporation's stock prior to the public offering. His percentage of the outstanding stock steadily declined as American returned to the stock market for financing in the years ahead. (The company was listed on the New York Stock Exchange in 1960). The days of majority stock ownership by one man, as enjoyed by both Drake and McGaw, had ended. However, the relative decline of McGaw's holdings had no appreciable effect on either company policy or his power to direct the company. And there was little doubt that McGaw's plans were moving the company ahead at a breathtaking rate. Net sales, which were less than $12 million in 1947, soared to nearly $78 million by the end of this period in 1959. At the same time net earnings before income taxes mounted from some $900,000 to over $6,660,000.

Perhaps the most important characteristics of this period in McGaw's financial education were his growing confidence and his attitude toward financial activities. On the one hand, he demonstrated that he was fully capable of dealing with the bankers and surviving. In addition, he proved that American was an attractive stock and that substantial sums could be raised by turning to the stockmarket. Most importantly, however, while McGaw continued to focus on marketing, he developed a better appreciation for the importance of coordinating marketing and financial activities. The market expansion that he sought could only be accomplished with substantial financial support. What became increasingly apparent during this period was that this growth had been accomplished in spite of an inefficient organizational structure and an incredibly thin line of sound mangers. In no area of the management's hierarchy was this more true than in finance.

Third Period: Toward Systematic Financial Management

The company's organizational problems reached such a stage of confusion by the fall of 1957 that the firm of Booz, Allen & Hamilton was retained to study the company and to recommend corrective action. In considering McGaw's educational growth it should be noted that his awareness and acceptance of the need for building a new organizational structure were quite significant. As Professor Chandler has noted, only rarely do creative enterprise-builders personally initiate the changes in administrative organization necessary to assure proper control of the enterprise and its continued growth.[15] That the Booz, Allen study was not only requested, but the recommendations largely implemented is a commentary on McGaw's personal growth as an executive. It stood in vivid contrast to an event fifteen years earlier.

In 1943 the same management consulting firm had been retained to conduct a study of the company's outdated structure and increasingly inefficient operation. The rapid growth and pressures of the war years had nearly overwhelmed the company. A 234-page report was submitted on August 11, 1943. An introductory letter addressed to McGaw stated the findings very succinctly:

> As may well be expected we find an unbalanced condition resulting from your rapid expansion which warrants your immediate attention to the program of specific corrective measures outlined below. This program is one of consolidation rather than of radical alteration of basic objective or nature of your operation. . . . Today your company has set as its objective the attainment of a predominant position in the hospital supply field. From the external aspects the company is in an excellent position to move closer to this goal. This is the result of having concentrated the bulk of management attention and effort in the direction of marketing activities.

> However, in building a strong customer relationship the internal phases of your operation have been neglected and outdistanced. There is today a wide gulf between the dynamic sales power in the field and the unprogressive supporting organization. . In short, the company finds itself today with the vision and the opportunity to step into the position of leadership, but its short-sighted focus on immediate profits and misplaced over-emphasis on economy in the past have left it underdeveloped organizationally, in quality of personnel and methods to implement the broad policy.[16]

McGaw's reaction to the report was quite direct: he ignored it. Coming as it did while Drake was still alive there were a number of problems which McGaw was powerless to correct. The "short-sighted focus on immediate profits and misplaced over-emphasis on economy", for example, were perhaps more the fault of Drake than McGaw. However, it is clear that McGaw was personally stung by the censorious report for it continued to collect dust in the company's files even after Drake's death and few of its recommendations were implemented. The company muddled through the period and seemed to make evolutionary adjustments in spite of the Booz, Alen report

McGaw's reaction to the second Booz, Allen & Hamilton study some fifteen years later was quite different. The report, which was submitted to American's management in March, 1958, recommended sweeping changes in organization and personnel. While not every step recommended in the report was taken, McGaw vigorously implemented most of the changes.

Without question the most far-reaching change in American s central staff recommended by the lengthy consulting report was in the area of finance. At long last it was made clear that the ultimate success or failure of the company's attempt to develop a smoothly functioning system of manufacturing and distribution depended on financial controls. Proper systems of gathering and evaluating financial data from American's various operating units would provide top management with the materials it needed to plan strategies and exercise the proper control over its decentralized and many-faceted operations. McGaw learned, as had men such as Alfred Sloan at General Motors, that if top management had the means to review and evaluate the performance of the various operations, the details of the operations could be left to the men in charge of them.[17]

Over the years American s financial controls had become rather loose and outdated. While a great deal of financial data were gathered, little effort was made to evaluate the data or to compress the material into a form which was useful to management. And finally, standards of performance were not established for subsidiaries and divisions.

Leo Stevens, the man responsible for the management of American s financial activities, had joined the company in the early Thirties when it was quite small and at a time when Drake was making all major decisions in this area. With Drake's death and the rapid expansion of the company, the job and the challenges simply outgrew Stevens. In Stevens defense it should be noted that there is no evidence that McGaw brought pressure to bear upon Stevens to update his systems even though the 1943 consulting report had pinpointed this area as one of American s major weaknesses. In fact, his employment was extended for one year beyond the company's mandatory retirement age and he was asked to remain on the board of directors even after his retirement from the company

When Steven retired, American recruited Amos Schuster as corporate financial vice-president. Schuster, who was hired in November of 1959, had an extensive background in business management including work as an account manager for Booz, Allen & Hamilton for seven years, financial manager and director of Gulf States Paper Corporation for a similar period of time, and administrative vice-president for Virginia Carolina Chemical Company for the two years prior to joining American. Simultaneously, American added the services of a new controller, Robert K DiVall, who also had an extensive background in business.

The hiring of Schuster and DiVall brought into the company two tough minded trouble shooters. The fact that they had been brought in from the outside did not make their initial efforts any easier. To the normal misgivings that strangers always encounter was added the fact that the staff of the financial office had become a close-knit group fully devoted to Stevens. Hence it is not surprising that the two men met with a rather cool and skeptical reception. But this awkward circumstance did not deter Schuster and DiVall from instituting immediate financial reforms of some significance. And members of American's financial department soon found that they were given more responsibilities and that they were expected to perform at a high level of efficiency or move on.

The program devised by Schuster consisted of two parts. The first involved controls and evaluation and the second centralization of certain financial functions The first step in establishing controls and evaluation procedures, which were aggressively implemented by American's new controller, was the standarization of the contents of all financial statements submitted by the company s subsidiaries, divisions, and regions. Previously, the data had varied widely in content and form With the new standarized chart of accounts a more systematic comparison of reports could be made. The new procedures also included the requirement that each operating unit submit, in addition to its budget, an annual profit plan against which their actual performance could be evaluated, and a special profit planning manager was added to the company's staff. Therefore, instead of managers being able to boast about the percentage increase over their previous year's business, they were evaluated in terms of how well they performed as compared to what they predicted they would to. DiVall also began measuring the performance of the operating units in terms of the rate of return on investment, a concept which was new to most of the managers. He also instituted a system of internal audits in which a representative of the parent company's accounting staff would visit the offices of the various units and inspect their records. DiVall also placed controllers in each of the company's divisions, as new controllers were needed by subsidiaries he saw to it that they came from his own staff, thereby assuring a greater degree of standardization in procedures and a greater loyalty to the parent company

The financial data were evaluated by Schuster and DiVall and submitted to management and the members of the board of directors in concise monthly reports. The monthly reports included key operating results and an interpretation of the data by Schuster and DiVall. They tended to emphasize the problems and weaknesses of the individual units rather than dwelling on the strong points as had been the case too often in the past. If either management or the board desired a more elaborate discussion of one of the units, detailed reports were prepared and submitted.

The centralizing procedures incorporated in Schuster's program included the establishment of an intra-company bank. The bank provided a means of marshalling the cash reserves of the company s units in an effective manner to the advantage of all parts of the corporation. Subsidiaries and divisions with excess cash deposited such funds in the bank and received 3 percent interest theron. Units in need of cash could borrow from the bank at 5 percent interest, thereby keeping the interest payments within the corporate family. Capital expenditures were also centralized by requiring initial approval by Schuster and final approval by the parent company's board of directors. Previously, such decisions had rested in the hands of subsidiary boards.

The addition of men like Schuster and DiVall to American's corporate staff provided top management not only with improved tools for decision making, but the objectivity of a fresh viewpoint. Their extensive business backgrounds were also assets in evaluating prospective acquisitions and company policies. However, their major contribution lay in the fact that they tightened management's controls over operations and improved the integration of the corporate family. Within this better ordered framework, American rapidly moved beyond the $200 million sales level and produced higher rates of profit than ever before.

Conclusion

Foster McGaw's financial education may be viewed as having progressed from an elementary level to a rather advanced stage in some forty years. In the process he was transformed from a supersalesman to the chief executive officer of a very large manufacturing-distributive complex. Perhaps the single most important quality that enabled him to succeed was his ability to grow as an individual. From the outset his objectives were clear--he wanted the largest and most widely respected company in the industry and effective and imaginative salesmanship was to be his vehicle However, he came to realize that the very structure which he created through his aggressive marketing strategies was subject to decay and decline if accurate and effective controls were not established in the financial area. That he was able to recognize the ture diversity of the management task is certainly to his credit.

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[1]Journal of the American Medical Association, LXXXXVII (June 11, 1932), p. 2142. Hospital size is traditionally stated in terms of the number of beds.

[2]American Medical Association, Hospital Services in the United States (Chicago: American Medical Association, 1923), p. 118. The American Medical Association is the best source for early data on hospitals. Annual surveys were reported in the Journal and reprinted each year in the form cited. However, beginning in 1946, the American Hospital Association began publishing hospital statistics. These data are the most complete available from any source. In fact, they are utilized by the federal government for the official U.S. Census.

[3]The history of the hospital in the United States is rather well documented. The field in general and numerous hospitals in particular have been the subject of careful study. A very complete collection of these materials is available in the American Hospital Association library in Chicago. By contrast, the hospital supply industry is generally a virgin field for scholarly investigation.

[4]For a detailed account of the company s development see, Frederick D. Sturdivant, Growth Through Service: A History of American Hospital Supply Corporation (Evanston: Northwestern University Press, forthcoming)

[5]Interview with Charles F. Hough, December 1, 1962.

[6]An article concerning Drake's death in the Chicago Daily News, April 12, 1946, p. 38, referred to Drake as the owner of the Mayfair Management Company (a real estate and insurance firm), Chairman of the Board of American, and "one of Chicago s largest property owners." The article noted that Drake had recently been responsible for the largest real estate transaction in Chicago for a number of years. The newspaper had reference to the purchase by Drake of two buildings in the Loop from the Northwestern Mutual Life Insurance Company for $1,775,000.

[7]Interviews with Delbert M. Ruggles, January 6, 1963, and March 14, 1963; Charles F Hough, January 5, 1963, and April 9, 1963; and Foster G. McGaw, January 18, 1963.

[8]Letter from Foster G. McGaw to Harry I. Drake, December 19, 1934

[9]American Hospital Supply Corporation, Board of Directors Minute Book, May 1, 1946.

[10]AHSC Minutes, November 29, 1946

[11]The company has requested that the two financial institutions involved not be identified in view of the fact that none of the parties responsible for the proposal are still associated with the firms. A review of a copy of the proposal reveals that the intent to gain control of American was so obvious that the men involved must have either believed McGaw to be terribly naive or extremely desperate for funds.

[12]AHSC Minutes, September 4, 1946; November 29, 1946; and December 17, 1946.

[13]AHSC Minutes, December 1, 1948.

[14]*Ibid.*

[15]Alfred D. Chandler, Jr., *Strategy and Structure: Chapters in the History of Industrial Enterprise* (Cambridge, Massachusetts: The M.I.T. Press, 1962), p. 37.

[16]Letter from Booz, Allan & Hamilton, August 11, 1943.

[17]Alfred P. Sloan, Jr., *My Years With General Motors* (New York: Doubleday and Company, 1964), p. 140.