Investor's Reader

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The Case of the Missing Millions

Investors Are Deprived Of Millions Every Year by Inside and Outside Crooks

ONE of the senior executives of a well-known manufacturer was recently caught in an extra-curricular venture which had netted him a hot $1,000,000 in about a year. He had been in charge of the sale of company salvage and surplus equipment to the highest bidder. He surreptitiously organized his own private company to buy the equipment for one tenth its value. The trusted executive submitted his own company's offer as the highest. The rest was routine—the private company sold the same equipment at the market price which was sometimes as much as $45,000 on a single transaction.

This incident dramatizes one version of employe theft which right now costs American business an estimated billion dollars a year. This is an increase of 15-to-20% since 1960. Comments Lincoln Zonn, president of his own security consultant firm with head offices in Manhattan: "If your employes didn't steal money, merchandise or time from you last year, you're an exception to the rule."

Perhaps the biggest "inside" fraud of all times is in the still-unfolding vegetable oil mess which has already thrown a dozen firms into the bankruptcy courts and has produced claims of over $170,000,000.

Notoriously vulnerable to quick-fingered employes are department stores and supermarkets which also suffer from chronic shoplifting. Compared to inside crooks, most store executives consider shoplifters as neophytes. One estimate indicates that "for every $1 taken by shoplifters, $15 is taken on the inside." President Arnold H Bachner of Holly Stores Corp (a 31-state women's & children's apparel chain headquartered in Manhattan) recently reported, "a major factor in final earnings will be shrinkage, the amount of merchandise lost through theft and pilferage." The company estimates such merchandise losses came

to more than 3% of total sales in the January 1963 year, up from 2½% the year before.

"One fact retailers often forget," observes Lincoln Zonn, "is that people always steal from net, never from gross." He continues: "It's easy for a supermarket manager to shrug off the occasional theft of a 28¢ pack of cigarets. But when a cashier pockets cigarets selling for 28¢ he has taken your investment of 27¢." Zonn's reasoning is that if the store shows a 2% net profit margin, it has taken 27¢ in total costs to get the cigarets in & out of the store—whether they leave via cash register or hip pocket. Therefore, for every pack of cigarets stolen the store must sell another 27 just to break even.

Two years ago Brooklyn-based retailer J W Mays Inc distressed colleagues by publicly reporting discovery of an "abnormal inventory shortage" which cost it $811,000 before taxes in the nine months ended April 1962. Mays treasurer Alex Slobodin says the problem has been eased since then "by a process of tightening our security safeguards." He feels "our biggest problems occur among the lower echelons."

Another view comes from Norman Jaspan, author of The Thief in the White Collar which has sold more than 35,000 copies since Lippincott published it in 1960. He is president of Manhattan-based management engineering firm Norman Jaspan Associates and its "fact-finding" division, Investigations Inc. He states: "Of the $60,000,000 in losses uncovered last year by our fact-finding division, more than 60% is attributable to employes at either executive or supervisory levels.

Lax Management

There is disagreement on where theft is most prevalent but the consensus is "they're all honest before they start to work." Security agencies place the responsibility for employe-thieves squarely on the shoulders of lackadaisical management. Insurance executive David Porter of Surety Association of America notes "an unmistakable relationship between the increase in the size of business and the rise in thefts." One generally proffered solution is an overall strengthening of security regulations. A bigger company obviously needs more protection than a smaller one.

The major problem [illegible] decline in employe mo[illegible] a lack of liaison between [illegible] and employers. "In [illegible]" Jaspan says, "employes [illegible] that management cares [illegible] what's going on in [illegible]

If an employe comes into a situation which is already out of hand, it won't be long before he realizes how easy it is to steal. Unlike burglars, employes do not have to jimmy their way into the office or blow the safe; they already have the key and the right combination."

This is one reason for the success of the sophisticated embezzler—especially in banks. The American Bankers Association estimates inside crooks stole "in the neighborhood of $9,000,000" last year and the actual total is much higher because many of them are still enjoying life. A publicized case was a dimpled, elderly lady named Minnie Clark Mangum who used her executive position to "borrow" $3,000,000 from the Commonwealth Building & Loan Association of Norfolk some years ago. As an outside example, a California builder is now on trial because he used "theft by false pretenses" to steal $373,000 from an S&L company.

Lie Detector Probes

Methods of seeking out crooked employes vary according to the size and nature of the company. One highly controversial device is the polygraph or lie detector. Polygraph expert Lincoln Zonn considers the test a vital tool of his trade, "more than 98% effective; it sometimes does its work in a roundabout way but it always works."

He cites an incident when a Midwestern discount store submitted all employes to polygraphs after noticing a loss of $500. They were all cleared and the $500 was later discovered in the back of a cash register. The chart of one employe, however, showed a deviation from the norm. It was later discovered that he did not swipe the $500 but had pocketed another $1,800 in cash.

Since 1954 drug wholesaler McKesson & Robbins has required a polygraph test of all applicants for drug warehouse positions. Explains senior vice president Charles Davidson Doerr: "In our business we handle narcotics and drugs of all kinds. We only employ those who can be trusted with such merchandise. During the past few years we've had to institute an extremely tight security program."

Among these steps: 1) prospective employes must fill out application blanks which make pointed inquiries into their honesty in previous employment; 2) during their probationary employment period, new employes are given a polygraph exam; 3) new employes receive a company handbook which emphasizes the importance of on-the-job honesty and outlines explicitly the company's security policy; 4) periodic personnel sessions are held to remind employes of McKesson's regular policy of turning security violators over to civil authorities for prosecution.

Vice president Doerr refuses to release any figures but notes "we're satisfied with the results of our general tightening up and feel that for us this method works best." As a point of history, McKesson may be especially sensitive because of the famed Musica embezzlement of 26 years ago which put the company in bankruptcy.

On the other side, the November 1962 issue of *Harvard Business Review* stated "only 10% of those who conduct lie detector tests are qualified

Lie detector detecting

to interpret the squiggles that are supposed to represent the subject's changes in pulse rate, breathing, blood pressure, muscle tension and perspiration." Adds one expert: "You can't run an organization on fear."

It has been said that "if a good crook had put his mind to better things he would be rich and respectable." Some schemes are simple; others are complicated. In the supermarket field alone, Safeway Stores had to quit selling small bottles of liquor because so many vanished in coat pockets.

Another grocery chain discovered its inside burglars worked under the very brightest lights—when the midnight police patrol investigated, the crooks were "taking inventory—and shipping out the old goods."

In restaurants a shifty waiter presents a happy table of seven the bill from the next happy table of nine. Most times the seven pay for nine, the waiter collects nine from nine and keeps the change.

In the construction business, theft is common. The bigger the job, the more activity—and frequently the most losses. Despite watchmen, checkers and supers, 650 boxes of tile dwindle to 580 boxes, steel or copper pipe seems to shrink, 325 squares of big shingles become 290. Says youthful Larry Harris, president of Northeast Plywood of St Albans, LI: "If a builder is not extra careful, they'll walk off with everything but the land."

When the thieves are finally exposed, the police may or may not step in. Saul Astor, president of Management Safeguards Inc, which works with management to set up security controls once theft has been reported, estimates that for reasons of bad publicity "less than 5% of the employe-thieves are prosecuted." To this Norman Jaspan adds "out of one billion lost each year less than 3% is recovered."

McKesson & Robbins, which gets particularly close cooperation from the police because it sells narcotics and prescription drugs as medicine, notes that "in California local authorities don't prosecute for grand theft unless the amount exceeds $200." Because of the difficulty in establishing proof of ownership of stolen merchandise, a grand larcenist is often tried for petty larceny.

Slight Restitution

In other cases restitution is virtually impossible. Lincoln Zonn cites an instance of a wholesale grocery for which he obtained signed confessions of pilferage of perishable goods "in excess of $3,000 for one year; only $50 was ever paid back." If stolen goods are sold, buried or tossed in the sea, chances of recovery are slim.

Insurance executive David Porter estimates that "only 15-to-20% of the nation's business establishments carry fidelity bonds." Surety companies have the right to pursue bonded employes until restitution is made. The amount in losses paid by insurance companies in 1962 totaled nearly $40,000,000. "It is obvious," notes David Porter, "from the known losses suffered that the unknown and unreported losses to employers present a staggeringly large figure."

Probably the worst penalty for employe-thieves is the blot on the employment record which makes it difficult if not impossible to find another job. The McKesson system does not result in the automatic dismissal of revealed thieves. Explains vice president Doerr: "If in our opinion an employe deserves another chance, he is allowed to stay on with us providing he agrees to future polygraph examinations from time to time; arrangements are made for him to pay back the amount stolen. We have faith in this rehabilitation plan."

Honor System

Perhaps the most unique approach for dealing with inside crimes comes from British retailers Marks & Spencer which first responded to the increase in employe pilferage three years ago by instituting a system of trust which involves eliminating stockroom guards and allowing salespeople free access to stockrooms (IR, March 1, 1961). A recent progress report indicates the honor system still works "extremely well;" the store, which has more than 237 outlets throughout Britain, has observed no increase in pilferage during the last few years. "In fact," one store official claims, "we don't have any problem at all along these lines."

COAL
Hard Facts on Soft Coal

BIGGEST MONTH of the year for retail deliveries of bituminous coal is ordinarily January. This January's figures, released by the US Bureau of Mines two weeks ago, were the lowest in many years—only 2,968,000 tons compared with 4,710,000 in January 1963 and 8,336,000 in January 1954. The constant descent reflects the decreasing use of coal in factories, offices and homes. In hot contrast is the remarkable climb in consumption by electric utilities. January's total of 20,390,000 tons compares with 19,680,000 a year ago and 10,620,000 in 1954.

The longer-term picture presses the point even more sharply. Consolidating their decade-old position as coal's best customer, electric utilities bought 209,000,000 tons of bituminous in 1963 compared with only 76,700,000 in 1944. The utilities are the main reason why total production of coal has swung up again in each of the past two years to reach 452,000,000 tons in 1963 its best figure since 1957.

This is despite declines in many traditional uses of coal. The 1963 total for retail deliveries was 23,500,000 tons, compared with 122,100,000 in 1944. Anthracite (hard coal) production was off from 63,700,000 tons in 1944 to 19,300,000 last year.

Perhaps the most extreme of all changes in the use of coal has come with the diesel rail engine: deliveries to Class I railroads in 1944 were a vital component of the market at 132,000,000 tons. By 1960 the total was down to 2,100,000. The figures are no longer even published separately.