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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

RELEASED

HUMAN RESOURCES DIVISION

May 14, 1981

B-203155

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The Honorable John M. Ashbrook
Ranking Minority Member
Committee on Education and Labor
House of Representatives

Dear Mr. Ashbrook:

Subject: [Alaska Commercial Company's Activities Regarding Competition ~~and Other Factors~~ After Acquisition by Community Services Administration Grantee] (HRD-81-97)

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Pursuant to your December 16, 1980, request, we developed information regarding allegations that an Alaskan business venture, "CEDC Sales, Inc.," doing business under the name Alaska Commercial Company (ACC), had obtained a significant competitive edge and unfairly challenged privately financed grocery businesses by receiving Federal funding provided through a Community Services Administration (CSA) grantee. The grantee--Community Enterprise Development Corporation of Alaska (CEDC)--is a rural development corporation formed in 1968 and funded by CSA under title VII of the Economic Opportunity Act of 1964, as amended.

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The information we developed was provided in an April 28, 1981, briefing to Committee staff. We understand that this information will be used in ongoing deliberations on H.R. 3045, a bill to amend the Economic Opportunity Act of 1964 (42 U.S.C. 2701 et seq.) to reauthorize, among other things, title VII of the act relating to community economic development.

We obtained information on the specific topics mentioned in your December 16 letter primarily through discussions with officials from CSA's Office of Economic Development in Washington, D.C.; the CSA grantee, CEDC, in Anchorage, Alaska; and the ACC headquarters office in Kent, Washington. Available documentation was obtained at these locations.

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Also, we met with and obtained needed information from ACC's store and department managers, owners and store managers of ACC's business competitors, members of ACC's and CEDC's boards of directors, and leaders of community organizations during our visits to the Alaskan communities of Bethel, Kotzebue, and Nome. Certain financial matters affecting ACC were discussed with officials of the Seattle-First National Bank in Seattle.

This report is in no way intended to be representative of any business ventures funded by other CSA community development corporation grantees. Such an effort was beyond the scope of our inquiry.

In October 1977, CEDC Sales, Inc., a wholly owned subsidiary of CEDC, acquired ACC's 11 retail branch stores and its electric utility. At the time, the purchase was the largest acquisition made by any CSA-funded community development corporation. The total sales price for the company, which had been conducting business in Alaska for over 200 years, was about $9.0 million. The purchase was financed from $2.5 million in CSA grants made to CEDC and a $6.1 million, 25-year loan provided by the Alaska Bank of Commerce and the Seattle-First National Bank. The acquiring corporation assumed the selling corporation's outstanding accounts payable.

After the stores were acquired, ACC entered a period of cash shortage. In November 1978, CEDC requested that $1.5 million of subordinated convertible debentures be placed by ACC with CEDC to improve ACC's financial position and allow continued expansion.

Between October 1977 and December 1978, ACC's inventory increased by about 36 percent, and accounts receivable rose by about 84 percent. The company continued to operate; however, liabilities increased significantly. Trade payables increased by 142 percent, and the bank line of credit rose by 87 percent. Other activities also affected ACC's financial position, including the operation of a travel agency and the purchase of additional property for $800,000 in Nome to expand its store.

In January 1979, CSA approved a $1.5 million loan from CEDC to ACC. Funds were released only as required. The entire $1.5 million was released by February 1981.

As of early May 1981, the audited ACC financial statements for the fiscal year ended March 31, 1981, were not available. However, ACC's unaudited financial statements for the 11-month period ended February 28, 1981, indicate net earnings of $56,742, after taxes and extraordinary items, on net sales of $20,891,241.

This compared to net earnings of $325,217 on net sales of $15,469,591 and net earnings of $750,209 on net sales of $18,087,235 in fiscal years 1979 and 1980, respectively. The net earnings from 1980 included $552,000 of fire insurance proceeds. The net earnings for 1981 will reflect ACC's trend to a lower gross profit margin and the increases in overall interest expenses. Significantly higher interest expenses in future years are a distinct possibility since the terms of certain outstanding loans can be adjusted at predetermined intervals to reflect, for example, interest at several points above the prime interest rate of the Seattle-First National Bank or the discount rate charged by the Federal Reserve Bank in San Francisco.

CSA's August 1977 review of the CEDC acquisition of ACC consisted primarily of a financial analysis of ACC for 1975 and 1976, which was summarized in a later memorandum. CSA also reviewed the acquisition of the proposed venture in terms of its compliance with provisions of title VII of the Economic Opportunity Act, but no memorandum or other written documentation was prepared. CSA officials said they did not spend undue time assessing the competitive nature of the situation because the ACC stores had been in existence for years. In their view, the ACC venture was not a case of a new business being established, but of an existing business changing ownership. CSA made a similar review, with the emphasis being placed on ACC's financial condition, in late 1978 for the CEDC request of $1.5 million supplemental funding to ACC.

Due to the lack of documentation concerning these funding actions' impact on competition, we had no means by which to review the rationale for CSA's belief that the CEDC purchase of and subsequent loan to ACC were in compliance with legislative requirements. As agreed with Committee staff, we did not conduct this type of analysis. Consequently, we are unable to conclude whether the actions described in this report are in compliance with title VII requirements.

Since the change in ACC ownership in October 1977, ACC has lowered its overall gross profit margin, increased the number of its stores from 11 to 14, and implemented new techniques to better merchandise its goods and services. Our March 1981 price comparisons of common grocery items sold by ACC and its competitors in Bethel, Kotzebue, and Nome disclosed no overall trend by ACC to lower its prices to beat its competitors' prices. Our study complemented the results of a study conducted in Bethel in 1977, 1978, and 1979 by the "Tundra Drums" newspaper. Nevertheless, most of ACC's competitors in Bethel, Kotzebue, and Nome complained to us about ACC's pricing practices.

The former owner of the U.S. Mercantile, an independent food store in Nome, which went out of business in May 1980, said that three factors contributed to his store's closure--(1) the inability to meet the lower prices offered by the Nome ACC store, (2) the longer shopping hours offered by U.S. Mercantile's competitors, and (3) the encouragement of portions of the town's population by some members of the ACC board of directors to shop only at the ACC store. U.S. Mercantile's net sales decreased from $1.2 million in 1977 to $853,000 in 1980. During that period, the store's gross profit margin declined from 43.1 to 25.9 percent. We were told that other factors, including the age of the owner and the issue of absentee ownership, affected the decision to close the store.

ACC stores have provided increased employment opportunities for community members and offered a larger variety of goods and other services. ACC has received $4 million in CSA funding since October 1977. No other Federal or State funds have been received by ACC, nor are any requests pending. However, Federal assistance has been provided to ACC competitors in five communities--Bethel, Cordova, McGrath, Nome, and Unalakleet.

Since the acquisition, the president of ACC, with the board of directors' knowledge, has sold some assets and is considering selling others. Currently ACC is studying the closure or sale of marginal stores in some villages. It has previously discussed the sale and leaseback of individual stores with various village and regional Native corporations.

The enclosure to this letter discusses the historical background of community development corporations, matters relating to CEDC's acquisition of and subsequent loan to ACC, ACC's current financial condition, CSA's review of the impact of its grantee's funding actions on ACC competitors, and other detailed information developed concerning the matters discussed above.

As requested by your office, we have not obtained written comments on this report. However, its contents were discussed with CSA headquarters officials and ACC officials in Kent, Washington, and appropriate changes were made based on their oral comments.

Also, as arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 5 days from its issue date. At that time, copies will be sent to the CSA Acting Director and other interested parties, and copies will be made available to others on request.

Sincerely yours,

Edward A Densmore

for Gregory J. Ahart
Director

Enclosure

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ABBREVIATIONS

ACC	Alaska Commercial Company
CEDC	Community Enterprise Development Corporation of Alaska
CSA	Community Services Administration

ALASKA COMMERCIAL COMPANY'S ACTIVITIES REGARDING COMPETITION AND OTHER FACTORS AFTER ACQUISITION BY COMMUNITY SERVICES ADMINISTRATION GRANTEE

INTRODUCTION

In a December 16, 1980, letter, Congressman John M. Ashbrook requested that we investigate a specific business venture in Alaska funded through a Community Services Administration (CSA) community economic development grantee--the Community Enterprise Development Corporation of Alaska (CEDC).

The letter alleged that an Alaskan business venture, "CEDC Sales, Inc.," doing business under the name Alaska Commercial Company (ACC), had obtained a significant competitive edge and unfairly challenged existing privately financed grocery businesses in Alaska by receiving Federal funding through CEDC. It was also claimed that ACC was lowering prices in so many areas that other Alaskan grocery businesses viewed this as unfair competition. To substantiate this claim, the requestor indicated that one major independent food store, U.S. Mercantile, could no longer compete with ACC and had gone out of business.

Congressman Ashbrook, as Ranking Minority Member of the House Committee on Education and Labor, asked us to determine

--whether the allegations described above were accurate,

--to what extent minority residents in Alaska have actually benefited from Federal funding being provided to ACC,

--whether any Federal or State officials have benefited from their involvement in or relationship with ACC,

--whether ACC will be sold to private sector for-profit companies, and

--what other Federal assistance ACC has received and/or applied for.

The information we developed on these matters was provided in an April 28, 1981, briefing to Committee staff. It will be used by the Committee in its deliberations on H.R. 3045, a bill to amend the Economic Opportunity Act of 1964 (42 U.S.C. 2701 *et seq.*), to reauthorize, among other things, title VII of the act relating to community economic development.

This report discusses the historical background of community development corporations, matters relating to CEDC's acquisition of and subsequent loan to ACC, ACC's current financial condition; CSA's review of the impact of its grantee's funding actions on ACC competitors, and other detailed information developed concerning the requestor's specific areas of interest.

We obtained information on the topics mentioned above primarily through discussions with officials from CSA's Office of Economic Development in Washington, D.C.; the CSA grantee, CEDC, in Anchorage, Alaska; and the ACC headquarters office in Kent, Washington. Available documentation was obtained at these locations.

Also, we met with and obtained needed information from ACC's store and department managers, owners and store managers of ACC's business competitors, members of ACC's and CEDC's boards of directors, and leaders of community organizations during our visits to Bethel, Kotzebue, and Nome. Certain financial matters affecting ACC were discussed with officials of the Seattle-First National Bank in Seattle.

The information in this report applies primarily to ACC and its interactions with CSA headquarters and CEDC only. This report is in no way intended to be representative of any business ventures funded by other CSA community development corporation grantees. Such an effort was beyond the scope of our inquiry.

BACKGROUND

Title VII of the Economic Opportunity Act of 1964, as amended (42 U.S.C. 2981), is the legislative authority for the CSA economic development program to arrest chronic unemployment, dependence, and deterioration in blighted neighborhoods through community-controlled economic development and profit-oriented business development. Community development corporations act as catalysts for revitalization in special impact areas targeted for CSA's community economic development program.

CSA views its relationship with community development corporations as a partnership. CSA serves as the financial resource liaison between the Congress and the corporations. This relationship is intended to give the corporations much of the strength and support needed to help a community help itself.

Community development corporation programs are intended to be carried out with the participation of residents, local businessmen, and representatives of financial institutions. CSA grants from its Office of Economic Development, bank loans, equity from private investors, and investment funds from foundations provide venture capital. Programs are planned and implemented at the local level. CSA is to provide technical assistance and program guidance.

Under section 713(a) of the Economic Opportunity Act, as amended (42 U.S.C. 2982b), the CSA Director is not permitted to provide financial assistance for any community economic development program unless, among other things, he determines that

--the applicant is fulfilling or will fulfill a need for services, supplies, or facilities that is otherwise not being met;

--projects will, where feasible, promote the development of entrepreneurial and management skills; and

--the program will, to the maximum extent feasible, contribute to the occupational development or upward mobility of individual participants.

CSA's Office of Economic Development administers the program; no CSA regional offices are involved. There are currently 38 community development corporations--24 urban and 14 rural. In fiscal year 1981, $48.5 million was appropriated for the program. Grants to the corporations range from $150,000 to $7 million and average $1.5 million.

Each corporation must develop an overall economic development plan for the community. Using CSA and other funds leveraged from local and Federal sources, the corporations invest directly in subsidiary profitmaking ventures. These investments are subject to CSA headquarters approval.

A funding decision for new CSA grant applications is based on a corporation's proposal, on-site evaluations by CSA personnel, and criteria established by the Office of Economic Development. Re-funding decisions for ongoing grants are based on evaluations of progress made during the last grant period, monitoring reports, and visits made by a team from the Office.

CEDC, a rural community development corporation, was formed in 1968 and serves a 570,000-square-mile area encompassing all of the rural areas of Alaska. Its service area is inhabited by 38,000 people, nearly all of whom are Eskimo, Aleut, or American Indian. Since it began, the corporation has assisted over 60 community-owned businesses in such industries as fish processing, real estate, retail stores, tourism, fuel distribution, and construction. Through April 1981 CEDC had received about $24.5 million in CSA grants and about $3.2 million from other sources, including interest income from loans and investments.

CEDC'S ACQUISITION OF AND LOAN TO ACC

In October 1977, CEDC Sales, Inc., a wholly owned subsidiary of CEDC, acquired ACC's 11 retail branch stores and land in rural

Alaska, as well as an ACC electric utility in McGrath, Alaska. The stores were located in Aniak, Bethel, Emmonak, Fort Yukon, Kotlik, McGrath, Nome, St. Michael, Sheldon Point, Tanana, and Unalakleet. Other items in the purchase included the ACC headquarters office and warehouse in Kent, Washington, and all other ACC assets, including buildings, equipment, inventory, and accounts receivable. At the time, the purchase was the largest acquisition made by any CSA-funded community development corporation.

Before October 1977, ACC had been controlled by the Richmond family for 55 years. In 1922, Volney Richmond, Sr., and associates bought ACC, which had evolved from a fur trading business established in Russian America in 1776 by two Siberian merchants. At that time ACC's main offices were moved to the Seattle area, where they have remained as the purchasing and supply headquarters for the branches.

Over the years, ACC's business interests in Alaska included department stores, tire distribution centers, heavy equipment centers, oil distribution centers, and light and power businesses. In the 1970s, Volney Richmond, Jr., ACC's chief stockholder, decided to liquidate his holdings and sell off various parts of ACC. In 1976 ACC's residual holdings, except for the grocery business and electric utility, were sold to the Skinner Corporation.

By acquiring ACC, CEDC believed it would be able to act as a unifying, leading force in Alaskan rural economic development. Specific benefits cited by CEDC in acquiring ACC included

--transferring ACC ownership to Alaskan owners,

--bringing CEDC closer to eventual self-sufficiency by owning a profitable business, and

--providing a vehicle for rural Alaskans to enhance their personal and economic growth.

Also, some CEDC board of director members wanted CEDC to acquire the ACC stores to assure reasonable prices to rural Alaskans. One board member indicated that the purchase would allow CEDC to own and control about 600 acres of prime Alaskan real estate.

The total sales price to acquire ACC was about $9.0 million. The purchase was financed from $2.5 million in CSA grants to CEDC and from a $6.1 million loan. The acquiring corporation also assumed the selling corporation's outstanding accounts payable. The $6.1 million, 25-year loan was provided by the Alaska Bank of Commerce and the Seattle-First National Bank. It consisted of a $4 million real estate loan, a $1.1 million personal property loan, and a $1 million operating demand note.

Interest on the real estate loan was initially set at 10.625 percent per year until December 1, 1982, after which interest will be calculated at the highest of (1) the initial rate, (2) a rate 4 percent above the prime interest rate charged by Seattle-First National Bank, or (3) a rate 5 percent above the annual rate charged member banks for commercial advances (known as the discount rate) by the Federal Reserve Bank of San Francisco. The interest rate may be adjusted at the lender's option every 5 years. The interest rate on the personal property loan and the operating demand note also can be changed to reflect periodic changes in the prime rate. In addition, the lenders required CEDC to guarantee $2 million of the $6.1 million loan.

In the "Financing Proposal for Supplemental Funding for the Alaska Commercial Company" submitted to CSA in November 1978, CEDC requested that $1.5 million of subordinated convertible debentures be placed by CEDC Sales, Inc. (ACC), with CEDC to improve ACC's financial position and allow continued expansion.

ACC needed assistance from CSA because it had had a cash shortage since it was purchased in October 1977. Between that date and December 1978, ACC's inventory increased by about 36 percent and its accounts receivable rose by about 84 percent. The company continued to operate; however, liabilities increased significantly. In this regard, trade payables increased by about 142 percent and the bank line of credit rose 87 percent.

Other activities also affected ACC's financial position. In 1978 ACC purchased additional property for $800,000 to expand its Nome store. Also, a travel agency which was later closed was acquired in 1979 at a cost of about $80,000. The travel agency had not been discussed in the 1977 ACC business plan or the updated business plan and feasibility study submitted in November 1978.

In a January 26, 1979, letter to CEDC, the ACC president indicated that the company's tight cash bind had become an untenable position:

> "We can't keep enough cash in the stores to cash checks, the banks are actively complaining of our overdrawn position, our creditors are refusing to ship until paid, and the bank requested [payment of] the $300,000 over borrowing on our credit line."

According to the president, additional supplemental funding was needed to

--increase inventory at three stores,

--reduce accounts payable balances,

--remodel and refixture four stores,

--reduce the bank line of credit to the maximum limit, and

--increase cash on hand at branch stores.

Also, the supplemental funding would allow ACC to increase its operating line of credit by $1.5 million to $2.5 million.

In January 1979, CSA approved the $1.5 million loan from CEDC to ACC. Funds for the loan were provided by CSA and were subject to the same conditions applicable to the initial $2.5 million grant. Terms of the note required ACC to pay interest only at a 10-percent annual rate on a monthly basis from May 1979 to December 1983. At that time the loan's principal and interest must be included in ACC's monthly payments. The note is due and payable in full on December 1, 1993. Funds under the promissory note were to be released only as required. The entire $1.5 million was released between January 1979 and February 1981.

ACC'S FINANCIAL CONDITION

For the fiscal year ended March 31, 1981, the ACC president expects only a minimal profit. At the ACC board of directors meeting in April 1981, he estimated that ACC would have net profits of no more than $40,000. In fiscal years 1979 and 1980, ACC's net earnings were $325,217 and $750,209, respectively. Below is a comparative income statement of ACC operations since the October 1977 acquisition.

	Fiscal year ended March 31			
	1978 (note a)	1979	1980	1981 (note b)
Net sales	$5,788,873	$15,469,591	$18,087,235	$20,891,241
Cost of sales	3,570,528	9,890,749	11,707,482	13,857,776
Gross profit	2,218,345	5,578,842	6,379,753	7,033,465
Expenses	2,000,558	4,771,207	6,639,228	6,251,135
Other income or expense (-)	-216,199	-482,418	c/1,009,684	-725,588
Net earnings after taxes and extraordinary items	$ 1,588	$ 325,217	$ 750,209	$ 56,742

a/6 months ended March 31, 1978.

b/11 months ended February 28, 1981. Audited financial statements for the fiscal year ended March 31, 1981, will be available in mid-May.

c/Includes $552,000 extraordinary gain from fire insurance proceeds.

During ACC's fiscal year ended March 31, 1981, the president periodically reported to the store managers on the company's financial problems. Special attention was noted concerning increases in inventory imbalances, bad debt expenses, energy costs, freight costs, payroll costs, and interest expense. As of February 28, 1981, the inventory records indicated a difference of about $647,000 at cost or about $1,153,000 at retail prices. In terms of retail prices, the inventory imbalance was about 5.5 percent of ACC sales for the 11-month period ended February 28, 1981.

A comparison of other significant expense items follows:

	11 months ended		
	2/28/80	2/28/81	Increase
Payroll	$2,178,884	$2,509,882	$330,998
Heat and utilities	437,374	549,202	111,828
Bad debts	41,507	205,719	164,212
Interest expense	939,449	1,145,720	206,271
Total increase			$813,309

During the April 1981 board of directors meeting, the president indicated that he was not diligent in reviewing store operations first hand. He explained that he read the balance sheets but did not visit the stores or look at the operations behind the numbers on the balance sheet. So that management could oversee the Alaska operations more closely, the board directed the president to fill a vacant vice president position. The board further directed the divestiture of the ACC Consulting Division, which often performed consultative services in nongrocery businesses outside Alaska. The president admitted that he spent too much time working on Consulting Division matters and that this had limited his ability to oversee the ACC stores.

As shown above, ACC paid considerably more interest costs in 1981 than in 1980. Starting in June 1981, however, ACC will begin paying even higher interest costs on its outstanding real estate loans.

One note, currently at 12 percent per year, will increase in June 1981 to 3 percent above the prime rate of Seattle-First National Bank. A second and larger note (about $3.5 million) will increase in December 1982 from 10.625 percent to about 4 percent above Seattle-First National Bank's prime rate. The rate will be adjusted every 5 years thereafter. If prime interest rates remain at current levels, ACC could be required to pay an annual rate well above 20 percent starting in December 1982. This would double ACC's interest costs for this loan alone. The interest rate on most of ACC's other long-term debt is adjusted periodically with fluctuations in the prime rate.

In addition to the real estate interest costs, ACC pays 3 percent above the prime rate for its operating line of credit from the Alaska Bank of Commerce. As of April 1981 ACC's outstanding line of credit was about $2 million.

Except for a 9-month period in 1980 when ACC did not make interest payments on its $1.5 million loan from CEDC, ACC has been current on its monthly loan repayment schedules. As of April 1981, however, the delinquent and unpaid interest on the $1.5 million loan totaled about $107,000 for the period January through September 1980. CEDC has elected not to call the note in default and declare the unpaid principal and interest due and payable. The ACC president informed CEDC officials that requiring payment of the entire unpaid principal and interest payable would force ACC to obtain a loan from other sources at an interest rate of over 20 percent. Such action, he said, would further degrade ACC's financial condition. In April 1981 the CEDC board of directors and the ACC president agreed to formulate a short-term interest-bearing note to repay the delinquent 1980 interest.

CSA REVIEW OF IMPACT OF FUNDING ACTIONS ON ACC COMPETITORS

In reviewing CEDC's acquisition of and subsequent loan to ACC, CSA's emphasis was on the business venture's financial condition, and internal documentation was prepared on that subject. However, CSA's review of the impact of these funding actions on existing competition and other legislatively related requirements were undocumented.

CSA review of ACC acquisition

In August 1977, the associate director of CSA's Office of Economic Development approved the investment of $2.5 million in CSA funds as equity captial for CEDC's use in purchasing ACC. Before the August approval, CSA analyzed and conditionally approved the acquisition subject to written certification of the loan commitment and receipt of forecasted cash flow and profit and loss statements for ACC.

CSA's review of the proposed acquisition was documented in a seven-page memorandum providing a comparative analysis of profit and loss statements and retained earnings statements for 1975 and 1976. The review concluded that ACC's management staff appeared capable; however, the review cited problems "* * * in maintaining a positive-oriented growth rate in profitability." Increased costs were noted for such items as payroll and employee benefits, equipment usage, insurance, and ACC headquarters' administrative expense.

The chief, Program Monitoring and Review Division, within the Office of Economic Development, said that CSA reviewed the proposed ACC acquisition as it would any other proposed venture, primarily from a business standpoint to assess its financial viability. The proposed venture was reviewed to ensure compliance with title VII of the Economic Opportunity Act of 1964, as amended. In reviewing the proposal for such compliance, only the public law was used as an assessment guide. After finding no problem with legislative compliance, CSA personnel forwarded the proposal for final approval. Other than the previously mentioned memorandum, no other written documentation for the legislative compliance review was prepared.

CSA officials stated that no specific criteria are used to assess whether a venture will produce unfair competition. According to CSA officials, it is the grantee's (i.e., CEDC's) responsibility to assess the impact of Federal funding on existing competition in its business plan submitted to CSA. CSA officials said that, in assessing potential unfair competition of a venture like ACC, they ask: "Will this venture put someone out of business?" However, in reviewing the proposed ACC acquisition, CSA officials said they did not spend undue time assessing the competitive nature of the situation since the company stores had been there for many years. They added that the ACC venture was not a case of a new business being established, but of ownership of an existing business changing.

An April 12, 1978, CSA internal analysis of CEDC's performance for October 1976 through April 1978 was prepared which covered the period in which CSA provided grants to CEDC for acquiring ACC. Also, a subsequent onsite visit to Alaska to review the performance of CEDC was made by a CSA headquarters team from July 10 to 14, 1978.

The April 1978 CSA analysis generally consisted of a discussion of information obtained by reviewing CEDC's quarterly monitoring reports and other data available at CSA headquarters. The CSA analysis stated that, since CEDC had not submitted an overall economic development plan, determining whether CEDC's investments (i.e., ACC) complemented the plan was impossible. At the time, the analysis indicated that, based on CEDC's investment strategy, its investments were not geared toward self-sufficiency. Also, CSA was unable to identify what process, if any, CEDC used to monitor loans or grants and equity interests in ventures.

However, the overall findings of the CSA review team's August 9, 1978, memorandum to the CSA Senior Council were positive. Consequently CEDC's overall performance in meeting its stated objectives was rated as excellent in an August 18, 1978, CSA Highlight Memorandum. Also, the project staff's general administrative and fiscal management was considered excellent.

According to the memorandum, except for being a few days late in submitting a few of their monitoring reports, CEDC adhered to grant conditions, CSA regulations, and reporting requirements scrupulously.

CSA review of ACC $1.5 million loan

As discussed previously, CSA conditionally approved the CEDC $1.5 million loan to ACC in January 1979. The four conditions imposed, however, generally referred to future monitoring requirements of CEDC in regard to ACC's use of the loan. The entire loan amount was eventually disbursed to ACC. The initial $500,000 of the loan was actually disbursed to ACC on January 2, 1979, 3 days before CSA conditionally approved the loan.

Despite approving the loan, CSA officials had questioned the amount of venture capital ACC actually needed. They expressed difficulty in obtaining a reliable assessment of needed funds. An internal CSA memorandum stated that

> "It is difficult to pin the * * * [CEDC] down to a hard figure * * *. The figures that are used to arrive at $1.5 million are soft in that the timing is not known and the projected cost is pulled from the top of someone's head at today's prices."

CSA officials said their review of the $1.5 million request for supplemental funding primarily addressed the proposed uses and financial aspects of the loan request. A memorandum concerning the proposed uses and financial aspects of the loan was prepared. They said, however, the proposed loan was also reviewed for compliance with title VII. Since they noted no problems, no memo or other written documentation on such compliance was prepared. This was the same procedure CSA followed in reviewing CEDC's acquisition of ACC.

Due to this lack of documentation for the loan and the previous acquisition, we were unable to review the rationale for CSA's belief that the CEDC purchase of and subsequent loan to ACC was in compliance with legislative requirements. As agreed with Committee staff, we did not conduct this type of analysis. Consequently, we are unable to conclude whether the actions described above are in compliance with title VII requirements.

CHANGES IN ACC'S OPERATIONS SINCE CEDC PURCHASE

Since the change in its ownership in October 1977, ACC has made various changes in its operating policies and practices. These changes have resulted in a lower overall gross profit margin, an increase in the number of stores, and new techniques being implemented to better merchandise goods and services.

In a February 12, 1981, letter to CSA headquarters, the ACC president summarized the changes in ACC's operating policies and practices:

> "We have lowered our gross profit because we believed that the profits made in the past were immoral and unjustified. Our competitors are unhappy, the days of gouging the poor of Rural Alaska are over. We have brought advertising, merchandising, and lower prices to the [Alaskan] bush not by Federal subsidy, but by aggressively running a well organized company."

The following sections discuss the change in ACC's gross profit margin, price comparisons for selected years between ACC and its competitors in certain communities, and other changes in ACC's operations. Also, allegations that ACC forced U.S. Mercantile of Nome to go out of business are discussed.

Lower gross profit margin

ACC attempts to maintain its gross profit margin rate on retail goods at the lowest level compatible with long-term financial viability. The gross profit margin for 1980 was less than the company achieved in the 2 years before its acquisition by CEDC. In fiscal years 1975 and 1976, ACC's gross profit margins were 37.8 percent and 35.5 percent, respectively. ACC's gross profit margin was 35.3 percent in fiscal year 1980 and 33.7 percent for the 11 months ended February 28, 1981. The following is a summary of the trends in ACC's net sales, gross profits, and net profits since January 1, 1975. The corresponding trend in the percentage of gross profit and net profit to net sales is also provided.

	Reporting period					
	12 months ended 12/31/75	12 months ended 12/31/76	6 months ended 3/31/78 (note a)	12 months ended 3/31/79	12 months ended 3/31/80	11 months ended 2/28/81
Net sales	$9,884,753	$10,507,784	$5,788,873	$15,469,591	$18,087,235	$20,891,241
Gross profit	$3,732,320	$3,725,798	$2,218,345	$5,578,842	$6,379,753	$7,033,465
Percent of net sales	37.8	35.5	38.3	36.0	35.3	33.7
Net profit	$688,145	$456,268	$1,588	$325,217	$750,209	$56,742
Percent of net sales	7.0	4.3	less than 0.1	2.1	4.1	0.3

a/The first 6 months of CEDC's ownership of ACC.

The May 30, 1980, re-funding proposal for the period October 1980 through September 1982 submitted by CEDC to CSA stated that a 35.3-percent gross profit margin was the lowest rate at which ACC stores could successfully operate. This compared to ACC's gross profit margin of 33.7 percent for the 11-month period ended February 28, 1981.

Competitive pricing practices

Most of ACC's competitors in Bethel, Kotzebue, and Nome complained about ACC's pricing practices. Also, these competitors were generally opposed to a federally supported ACC store in their communities.

In a February 1981 letter to CSA, the ACC president stated that ACC prices had been lowered since October 1977. This pricing reduction is reflected in the decline in the gross profit margin from about 38 percent for the 6-month period ended March 31, 1978, to about 34 percent for the 11-month period ended February 28, 1981. In comparison, one of ACC's major competitors in Bethel--and the only ACC competitor from whom we obtained financial information--increased its gross profit margin by about 217 percent from 1975 through 1980.

Newspaper price comparison study

In 1977, 1978, and 1979, the "Tundra Drums" newspaper in Bethel compared prices of grocery goods in three Bethel grocery stores. As shown below, ACC's total price for the goods common to all the stores in each yearly comparison fell between the two competitors in the first and third year and was the lowest in the second year.

Year	Number of items	ACC	Competitor A	Competitor B
1977	17	$33.19	$32.07	$34.34
1978	23	46.19	47.47	51.62
1979	26	57.77	57.12	60.62

Our price comparison study

In March 1981, we visited and compared prices among ACC and its competitors in Bethel, Kotzebue, and Nome. The list of grocery goods used by the "Tundra Drums" in its 3-year price comparison was the basis for selecting goods for our comparison. The total prices for each store in each location noted below reflect the total number of items common to each store.

In Bethel, we visited three stores, including the ACC store, and compared prices for 28 common grocery items. We found, as shown below, that ACC's total price for the 28 items was $0.99 below the price of the next lowest competitor.

Store	Total price
ACC	$63.89
Competitor A	70.39
Competitor B	64.88

Our review of ACC's prices showed that ACC had the lowest price on 11 of the 28 items and the highest price on only 1 item. The following table summarizes the relative prices on the 28 items common to the three stores.

Relative price of common items	Number of items in each category by store		
	ACC	Competitor A	Competitor B
Lowest price	11	6	5
Highest price	1	10	15
Between	11	7	4
Same	5	5	4

In Kotzebue we compared the prices of 19 items common to ACC and its two competitors. The following tables summarize the total price and the relative prices for the common items at each store.

Store	Total prices
ACC	$65.45
Competitor A	64.05
Competitor B	56.86

Relative price of common items	Number of items in each category by store		
	ACC	Competitor A	Competitor B
Lowest price	5	3	10
Highest price	6	4	9
Between	7	11	0
Same	1	1	0

The differences in the total prices are primarily attributed to two items--a 50-quart container of milk, which competitor B sold for $16.95 versus $24.85 at ACC and $22.81 at competitor A, and a 24-ounce can of beef stew, which competitor B sold for $2.03 versus $2.55 at ACC and $2.52 at competitor A.

In Nome we visited four stores. However, one store was excluded from our price comparison because it had an inadequate inventory of items common to the other three. At the other stores we compared 21 common items. The results of our analysis follow.

Store	Total prices
ACC	$44.62
Competitor A	45.76
Competitor B	45.90

Collectively, ACC was $1.14 lower than competitor A and $1.28 lower than competitor B on the 21 common items. Further analysis of the relative prices is shown below:

Relative price of common items	Number of items in each category by store		
	ACC	Competitor A	Competitor B
Lowest price	8	5	4
Highest price	4	5	9
Between	2	6	6
Same	7	5	2

To better understand the effect of ACC operations on Bethel, Kotzebue, and Nome, we met with community leaders and managers/owners of stores in competition with ACC. Opinions varied. Some saw ACC as having a very positive effect on the community and providing a variety of products not previously available. Others indicated that ACC has hurt their businesses, contributed to their financial difficulties, or competed unfairly by using Federal dollars.

For example, the president of an ACC competitor in Bethel said that, since October 1977, ACC cost his store between $100,000 and $200,000 in profits. He said ACC's unfair competitive advantage is slowly "strangling" his business. He believes that his business may fail because the Federal Government is indirectly financing ACC. In his opinion, ACC has lowered gross profits and, in the process, has taken no risks which ACC competitors not having Federal funding would have taken. He is convinced ACC can obtain more money from CEDC if it has future financial problems.

He added that he did not believe ACC undercut his store's prices. In fact, he thought ACC's prices were slightly higher. He said, however, that Federal monies should not be used in direct competition with private industry.

In Kotzebue, the city manager told us that ACC provided people with an opportunity to shop competitively. He said ACC provided fresh meats and produce that had not been available before and increased the selection of goods available.

In Nome, we obtained further comments on ACC's effect on community businesses and consumers. The president of the Nome chamber of commerce told us that ACC--the second largest employer in the community--has provided greater services to the community since 1977 at reasonable prices. The manager of one of ACC's primary competitors in Nome told us that he does not believe ACC has taken unfair competitive measures. He said ACC acts like a normal "for profit" organization in its competitive practices.

In contrast, the manager of a Nome music store selling records, tapes, and stereo equipment observed that ACC began to expand its lines of goods to include such products after it was purchased in 1977. Using Federal dollars, the manager believed ACC expanded into existing markets and hurt other local businesses. In fact, the dual effects of increased ACC competition and the downturn in business upon the completion of the Alaskan pipeline in 1977 caused severe financial difficulties for his business. The resulting decline in profits forced a relocation of this business to a less desirable location.

Increase in the number of branch stores

ACC management increased the number of ACC stores in operation after October 1977. At that time there were 11 ACC stores. Since then, one store (Sheldon Point) has closed and four stores have opened. The four stores include two new stores established at Kotzebue and Dutch Harbor and the assumption of management at two existing facilities in Naknek and Cordova.

All four communities had existing grocery competition before ACC entered the local markets. As of March 1981, only 1 (McGrath) of the 14 current ACC stores had no grocery competition in its community. Nine stores had only one grocery competitor in their villages. There are at most three grocery competitors in any community having an ACC store.

As discussed, CSA funds allowed ACC to improve the condition of certain stores and increase goods provided to its customers. The Sheldon Point ACC store was closed because of huge inventory losses and significant deterioration of the building due to vandalism. However, an ACC official said that another company has opened a store in Sheldon Point since the ACC store closed.

In April 1981, the ACC president told the board of directors that he was going to study the marginal operations of certain stores with a view toward possible closure or sale.

Other changes in ACC's operations

In addition to lowering the overall gross profit margin and increasing the number of branch stores, ACC made other changes in the techniques used to merchandise its goods and services. These included efforts to:

--Increase newspaper advertising.

--Institute longer store hours during the evenings and on Sundays in certain locations.

--Expand inventory levels, brand availability, and product lines in some locations.

--Improve, refurbish, and remodel certain stores.

--Offer fresh meat, produce, and dairy products in some communities.

Factors related to U.S. Mercantile going out of business

The U.S. Mercantile grocery store in Nome went out of business in May 1980. The former owner of the store told us that three factors contributed to closing the business--(1) the inability to meet the lower prices offered by the Nome ACC store, (2) the longer shopping hours offered by U.S. Mercantile's competitors, and (3) the encouragement of portions of the town's population by some members of the ACC board of directors to shop only at the ACC store.

U.S. Mercantile's net sales dropped annually from $1.2 million in fiscal year 1977 to $853,000 in fiscal year 1980. The store's gross profit margin declined from 43.1 percent to 25.9 percent during the same period.

Several other factors may also have entered into the decision to close the grocery store. For example, U.S. Mercantile's owner had attempted to sell the store about 5 years earlier. Also, the owner was 74 years old in 1980 and was thinking of retiring. Further, the owner resided in the Seattle, Washington, area. Absentee ownership apparently hindered the acceptance of U.S. Mercantile by local citizens. Also, it may have limited the opportunity for day-to-day oversight of the store's operation needed in a more competitive environment.

Community leaders in Nome, including officials of the chamber of commerce, a regional Native corporation, and a Native Eskimo organization, said that, because U.S. Mercantile had the highest prices in Nome, its business was suffering. However, during the firm's decline in sales, another grocery business in Nome significantly expanded its operations and another new grocery store was opened.

When the store was closed in May 1980, its inventory was sold to ACC. The U.S. Mercantile owner said he was satisfied with the price received for his inventory.

EFFECT OF CEDC PURCHASE ON NATIVE ALASKANS

Since CEDC's purchase of the ACC stores, the stores have provided increased employment opportunities for community members and offered a larger variety of goods and other services.

Between September 1977 and January 1981, total ACC employment increased from 166 to 215 full-time equivalent employees. The proportion of Native Alaskans decreased from 51 percent to 49 percent. However, during the same period, the number of Native Alaskans serving either as a store or department manager rose from 8 to 19. Native Alaskans comprised about 35 percent of the branch stores' managerial positions in 1977, compared to about 45 percent in January 1981. Only one Native Alaskan served in an ACC headquarters position in January 1981.

ACC's operations vice president at the time of our visit told us that few store and department managers are hired from the local community. He stated that many management positions are filled by persons living outside Alaska. There is relatively little transfer of management personnel between stores; however, a few individuals have worked as department or store managers at one location and then moved to another location.

Under title VII of the Economic Development Act, community economic development programs must, where feasible, promote the development of entrepreneurial and management skills. These programs must also contribute, to the maximum extent feasible, to the occupational development or upward mobility of program participants.

ACC does not have a formal employee training program. The only training is on-the-job training. However, in May 1981, ACC intends to schedule a 2-day training seminar for all its store managers and perhaps department managers. An ACC official told us that the last group meeting of ACC store managers took place in 1978.

CEDC has recognized the effect that the lack of adequate and consistent training for ACC's store and department managers has had on ACC's declining profitability. In a November 1978 supplemental funding proposal to CSA, CEDC indicated that ACC operations cannot expand and grow without trained, experienced staff. A major CEDC objective is to improve the skills of rural Alaskans in organizational and business management for the long-term success of rural economic development efforts. In its May 1980 re-funding proposal, CEDC concluded that "management has been a major contributing factor in every unsuccessful rural business venture supported by * * * [CEDC]."

Beyond providing additional employment opportunities, ACC has increased the number of goods and types of services in certain areas of Alaska since 1977. For example, fresh food is available in additional communities, longer shopping hours have been established, and additional product lines and brand availability have been introduced. Also, the opening of additional ACC facilities since 1977 brought ACC goods and services to the inhabitants of other areas.

Finally, CEDC's intention to continue ownership of ACC within Alaska rather than turn to absentee ownership has been known since its purchase of the ACC stores. At the time of ACC's acquisition, the CEDC board of directors was determined to allow village and regional Native corporations to have the first opportunity to buy any ACC stores offered for sale.

EXTENT OF GOVERNMENT ASSISTANCE PROVIDED TO ACC AND ITS COMPETITORS

Our review of ACC financial records and discussions with CEDC and ACC management officials as well as Federal and State officials disclosed that no other government funding assistance has been requested or received by ACC beyond the initial $2.5 million equity capital grant through CEDC and the subsequent $1.5 million loan from CEDC with CSA headquarters approval. This was verified with Federal officials from CSA headquarters, the Small Business Administration, the Department of Commerce's Economic Development Administration, the Department of Agriculture's Farmers Home Administration, and the Department of the Interior's Bureau of Indian Affairs. State officials in the Department of Community and Regional Affairs and the Department of Commerce and Economic Development were also consulted.

In pursuing the extent of government assistance provided to ACC, we identified five communities (Bethel, Cordova, McGrath, Nome, and Unalakleet) in which ACC competitors have received Federal or federally guaranteed loans.

For example, one competitor in Nome obtained a $600,000, 25-year federally guaranteed loan in 1979. The Farmers Home Administration guaranteed the loan for building a completely new store about five times the size of this competitor's old store. Three other Nome competitors received Small Business Administration disaster relief loans.

Also, an ACC competitor in Bethel received two loans guaranteed by the Small Business Administration. A $200,000 loan made in 1974 was for building improvements, and a $150,000 loan made in 1976 was for the purchase of equipment. Both loans had an interest rate of 10.5 percent; one was for 5 years and the other for 15 years.

NO EVIDENCE OF FEDERAL OR STATE EMPLOYEES BENEFITING FROM RELATIONSHIP WITH ACC

We found no evidence that any Federal or State employees had benefited financially from their involvement in or relationship with ACC. To verify this, we reviewed ACC's payments for the 6-month period from April 1 to September 30, 1980, and traced certain payments to supporting statements or invoices. We later discussed this matter with officials from ACC, its competitors, and community organizations. In addition, no other Federal or State officials we met knew of any government employee benefiting from any association with ACC.

FUTURE PLANS FOR ACC

The acquisition of ACC by CEDC as a wholly owned, for-profit subsidiary is permitted by public law and CSA regulations.

Section 712 of the Economic Opportunity Act of 1964, as amended (42 U.S.C. 2982a), authorizes financial assistance to non-profit and for-profit community development corporations and other affiliated organizations associated with qualifying community development corporations.

Since CEDC's acquisition of the ACC stores, the president of ACC, with the board of directors' knowledge, has sold some assets and is considering selling others. For example, in 1978, ACC sold the McGrath utility to a local village corporation and recently made arrangements to sell fuel storage facilities at Aniak. ACC is also studying the closure or sale of marginal stores in some villages and has discussed the sale and leaseback of individual stores with various village and regional Native corporations. At present, the Kotzebue store is leased by ACC from a Native corporation.

On a related matter we found, after reviewing ACC records and meeting with ACC officials, that there was no evidence that ACC had targeted competing businesses with the intention of forcing them out of business.