# TELEPHONE FACTS

ISSUED BY

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY

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THE question has been frequently asked why we do not furnish telephone service on a basis of charges similar to the fluctuating price of eggs, butter, shoes, and many other things. The facts of the telephone business answer this question.

## We Sell a Service, Not a Commodity

First, let us see just what telephone service is. What stands out at once is, that it is not a commodity, but a **Service.** We do not sell telephones, poles, wires, cables, or other physical items. We furnish the plant, equipment, and personnel whereby our customers may obtain an efficient and comprehensive **Telephone Service.**

We maintain and operate the intricate plant that will enable us to produce service on demand—each call being made to order. Whether customers use the resulting plant much or little, here it is. Our responsibility to inspect, maintain, and operate it remains intact. We must always be ready to make "deliveries."

Telephone companies do not have an investment in inventories of marketable merchandise. Their investment is in the fixed plant and facilities necessary to provide service—and this plant must be built at all times and at all places where public demands for service require it—for telephone companies are under the obligation of providing telephone service when and where it is needed regardless of price levels. This plant does not "turn over." It cannot be sold and replaced by plant purchased at a lower price.

A merchant can "turn over" his investment several times a year, renewing and disposing of his stock at current prices, or withholding his purchases of certain lines altogether. A manufacturer can shut down if he wishes. He can close the whole of his plant, or branches or parts of it; or he can eliminate products from his line that are unprofitable. But we are in a business obligated to furnish our product—service—immediately and accurately when it is demanded. We cannot shut down in whole or in part. We cannot "shut down" central offices. If we have a cable serving 100 customers, and 50 close up their homes or order out their telephones, it becomes proportionately more costly for us to serve the remaining 50. But we cannot reel the cable up, take out the poles, and tell those who are left that we must discontinue their service because it is no longer profitable. Obviously, our revenues fall off when times are hard, but the expense of operating and maintaining the whole plant goes on. The handling cost per call does not vary much between good times and bad, for the handling of each call is an individual transaction to which the economies of mass production do not apply. The plant cost per call, however, goes up in times of poor business.

## Regulation Does Not Guarantee Earnings

Our rates, the prices for our service, are determined, under regulation, on the fundamental of the "cost of rendering service." This cost of service comprehends reasonable expense of operation, depreciation, taxes, and a just compensation for the use of our property by the public. The prices we may charge for our service to our patrons have been **limited** to these items of cost. The public authorities having jurisdiction over our prices **do not guarantee** our company the payment of any or all of the items included in the cost of rendering service, but they **limit our prices to these costs.**

The public authorities limit the rate of return but they **do not guarantee** that the company will earn it or any other of the "costs of rendering service." Our prices under regulation are limited in good times as in times of depression. Private industry is not so limited, since in prosperous times earnings may advance without limitation. Our company—a public utility—is denied the right to make extra profits when others are making them. In bad times we suffer a decline in revenues and earnings along with the rest. We have no guarantee of earnings in good times or in bad—we operate on **prices limited by costs.** Thereafter, the success of the industry lies with the management.

## Investment Fixed by the Public's Requirements

With the aggregate investment fixed by the public's requirements, the carrying charges on telephone plant are likewise fixed. Since the plant does not turn over like a merchant's stock, but remains a fixed investment, it cannot be sold and replaced by poles, cables, and switchboards purchased at a lower price.

In lines of business in which a large proportion of the necessary capital is invested in stocks of merchandise in process of distribution, or in supplies of raw or semi-finished materials in the process of manufacture, the total investment reflects rather promptly changes in the price levels of these goods and materials; and, consequently, capital charges upon the investment are also promptly readjusted and the readjustments quickly reflected in the expenses of the business. In the telephone industry, on the other hand, even an exceptional change in the market prices for labor and materials entering into plant, although immediately reflected in the cost of additional plant and equipment, does not affect that portion of the investment represented by the plant installed prior to the price or wage changes, except as items of plant are gradually retired from service and replaced by plant constructed at the new price level. This operation is necessarily a slow one because these replacements, affecting the property as a whole, require a period of many years.

## Cost of Materials Has Minor Effect on Operating Expenses

The amount of materials entering into operating expenses is relatively small. They constitute less than 5%. Any reductions in material prices have, therefore, no substantial effect on operating expenses. While we, of course, buy our materials and supplies at the lowest obtainable prices, the effect on operating expenses of any favorable prices we are able to obtain is necessarily small.

## Wages Have a Major Effect on Operating Expenses

It is characteristic of the telephone industry that about three-fifths, or 60 cents, of every dollar of operating expenses are wage payments. This contrasts with a figure of about 15 cents out of every dollar of operating expenses paid as wages in retail and merchandising operations in general, and approximately 20 cents for manufacturing establishments. There are few industries in which wages count for so large a percentage of operating expenses as the telephone industry.

All employees of the company from the president down are working on a part-time basis and are paid accordingly. This has resulted in substantial reductions in the earnings of all employees, but, notwithstanding these reductions, the fact that the nature of our business requires a major portion of our activities in rendering service to be performed by labor, wages continue to be the largest single item of expense.

## Taxes—15 Per Cent of Operating Expenses Payment in 1932 Amounted to $10,518,000

An unescapable demand on the telephone industry is the payment of various taxes which represent about 15% of operating expenses, or 12% of our exchange and toll revenues. This amounts to 57 cents per telephone per month! Ten years ago it was 30 cents per telephone per month!

## Other Expenses—Vital Factors in Operating Costs

The remaining expenses cover a multitude of items such as wear and tear, station removals and changes, rent, postage, printing, stationery, power, lighting, heating, freight, cartage, motor vehicle expense, transportation, etc., etc. Wear and tear is continuous through good times and bad. Poles rot and iron rusts without reference to the economic situation. Parts wear out or grow obsolescent and must be replaced or the service will suffer. Inspection and repair must not cease, and provision for replacement must not be ignored. Every effort is made constantly to keep these expenses at a minimum, but we are still unable to offset the shrinking income due to lessened demand for service.

## Despite Loss in Telephones Large Construction Expenditures Required

## Expense Adversely Affected Due to "Station Movement"

In order to render a prompt, efficient, and satisfactory service at all times, additions must be continually made to the telephone plant. This is true in both good times and bad. Our gross construction program in 1932 required expenditures of $24,304,850. Despite the loss of 151,285 telephones net last year, we were required to spend this large amount of money in gross construction, 50% of which, or $12,265,991, was dictated by the number of telephones connected to plant. Notwithstanding a loss of 151,285 telephones, we were required to connect 528,810 telephones to plant and disconnect 680,095, a total station movement "in and out" of 1,208,905. The resultant charge to operating expenses from the "in and out" movement of stations amounted to $4,193,251. This large expense was entirely beyond our control since "station movement" must be provided for both in good times and in bad.

## Revenues Greatly Reduced

Sometimes it is said that the telephone business is "depression proof." This is absolutely contrary to the obvious facts. We have been hit like everyone else. Our revenues have constantly declined during the depression and, while drastic curtailments of expenses have been made, the loss in gross revenues has been of such major proportions that our financial results have continued to be adversely affected. In 1933 the gross revenues will be $21,000,000 less than in 1931! **The quality of our service is the only feature not permitted to know depression.**

## Reduction in Our Rates Would Not Increase the Number of Telephones

The suggestion is sometimes made that if telephone rates for local service were reduced, enough customers would be added to offset the loss in revenues which would result from lower rates. It is true that in some other businesses of a different nature reduced prices bring increased patronage. Our experience, however, has taught us that while the volume of telephone business will undoubtedly grow as the over-all business activity of the country grows, a change in the price of telephone service does not produce an appreciable change in the demand for the service. This also has been confirmed by the course of events during this depression. The number of telephones in service has declined during the depression, but investigation has shown that the great bulk of this loss has been due to the removal of telephones in business establishments which either have failed or have considerably curtailed operations and telephones in residences not now occupied or where the income has ceased or been severely reduced. Our losses are due not to rates but to the general economic conditions which have caused a widespread curtailment of business operations and the fact that many families, as a result of unemployment, have been forced to give up their own places of residence and move in with others.

## Rates—Financial Results

As a result of the reduction in revenues which has accompanied the unavoidable curtailment of telephone usage during the past two years, and despite a rigorous and pronounced expense control, our rate of return upon the cost of plant and working assets has constantly fallen as shown by the following figures:

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| 1928 | 6.07% | 1931 | 5.45% |
| 1929 | 6.00% | 1932 | 4.79% |
| 1930 | 5.49% | 1933 (est.) | 4.00% |

**These figures are a self-evident answer to the inquiry "why do we not reduce telephone rates?"**

While the facts of our business, inclusive of the detrimental financial effect which is resulting from the severe decline in our revenues, show that any rate reduction is clearly unwarranted, we nevertheless continue to receive inquiries why we do not reduce telephone rates—say, in the order of 20%. To show the effect of such a reduction, the following facts are presented:

**A decrease of 20% for the year 1933 would be a net reduction in our income of substantially $14,500,000. Such a reduction would mean that no dividends could be paid on the common stock; no dividends could be paid on the cumulative preferred stock, and the company would fail to earn its payments on its interest obligations by $1,500,000. We have always operated on such narrow margins that we have been unable to accumulate a surplus that would permit us to meet such a financial disaster! It is obvious that such a reduction would mean ruin for our business!**

**If a 10% reduction in telephone rates were made, it would result in only a small amount to the individual subscriber but would have a profound effect on our financial situation. It would place us in a position where we would earn for our common stockholders only six-tenths of one per cent on the money which they have put into our business!**

## Our Policy, the Most Telephone Service and the Best at the Least Cost to the Public

Our policy is to furnish at all times the best possible telephone service at the least cost to the public consistent with financial safety. In order that we may carry out this policy, it is incumbent upon each and every employee to see that the public has a clear understanding of the facts about our business.

We have a fundamental obligation both in good times and bad so to conduct our operations that the greatest possible benefit will accrue to our patrons. We fully recognize the interdependence of all business, commercial, and social relationships and the part we play in the upbuilding of the communities we serve. The dissemination of the truth of our operations and our sincerity of purpose are vital in our fully meeting our obligation to our customers.