

DEPARTMENT OF BUSINESS MANAGEMENT

Conducted by Paul C. Olsen.*

COMMENTS, QUESTIONS AND SUGGESTIONS ARE INVITED AND WELCOME.

Readers are invited to submit comments, criticisms and suggestions regarding the material which appears in this department. The Editor will also undertake to answer questions regarding general problems of business management. Letters of general interest will be published, but the writer's name will not be revealed without his permission.

A PROBLEM FOR MANUFACTURERS OF PRICE CUT MERCHANDISE.

BY PAUL C. OLSEN.

In the drug business the class of merchandise on which price competition is the keenest is, of course, standard identified items which are in wide demand. The apparent saving in the purchase price is thus immediately evident and, especially upon merchandise which large numbers of people are likely to buy frequently.

The attitude of manufacturers of this class of merchandise ranges, all the way, as everyone knows, from active encouragement of price cutting through complete indifference to aggressive opposition.

The purpose of this discussion is not to review the situation to-day with respect to price cutting in the drug trade but rather to indicate one important aspect of the situation as it exists to-day which, in my judgment, is not fully realized by all concerned.

Before detailing just what this aspect of the situation is, it is necessary to set down briefly some of the facts which create the conditions that exist to-day.

The great majority of retail druggists do not initiate price reductions on popular standard identified merchandise. They follow these price reductions only when aggressive price-cutting competitors compel them to do so and then only to a limited degree. Naturally, these steps are taken by them with the greatest reluctance and resentment.

It is obvious that the great majority of retailers in the drug trade therefore would welcome the coming of a condition which would make price cutting on popular standard identified merchandise impossible.

It is also obvious that if the full prices on popular standard identified merchandise could be obtained, the total profits of retail druggists would be greatly increased. This is a statement of the generally known fact that cut prices on popular identified merchandise in the drug trade do not increase the sales of that product to a volume sufficient to offset the reduced price. This fact is of particular importance in the drug trade because most of the items sold are of small purchase price, and the price cuts, while large, proportionate to the purchase price, are not large individually in amount.

On the other hand the very fact that merchandise on which price cutting is the keenest is in wide and constant demand is an indication that it is easy to sell and, therefore, that the costs of carrying it and selling it are much below the costs

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of carrying and selling other merchandise in the drug trade which, though it must be stocked, sells slowly and in small volume.

It is true, also, that some popular identified merchandise in the drug trade is sold at retail by aggressive price cutters at prices which are below the prices they pay for this merchandise. The losses resulting from this practice are customarily considered to be the costs of attracting business to the store—an advertising cost. Incidentally, the ethics of the loss leader is open to serious question and for obvious reasons.

With these preliminary statements it is possible now to consider the position of manufacturers of popular identified merchandise on which price cutting is aggressive.

A salesman for a well-known brand of tooth paste in calling on retail druggists frequently meets this objection. "Yes, I'll have to buy some of your merchandise but I certainly do hate to sell it. They're cutting the life out of it and every time I sell it there's an argument about the price."

It requires no particular amount of imagination to realize that the salesman will carry away from that store an order for the smallest possible quantity of that tooth paste with which that druggist believes he can meet the demands of those of his customers who will take that tooth paste and no other.

Remember I am speaking of the great majority of retailers, the group who do not initiate and are opposed to price cutting on popular identified merchandise.

Another way in which the attitude of this great majority of retail druggists expresses itself is in their relations with their wholesalers. Orders are given for such merchandise in thousands of instances in such absurdly small quantities that it is all sold and has to be re-ordered again within a day or two.

It is perfectly plain that a wholesaler who fills 12 orders in the course of a month, each for a quarter of a dozen of the same brand of tooth paste, is not going to make the profit from the transaction that he would if a single order were given monthly for a quarter of a gross instead of an order for a quarter of a dozen every two or three days.

Contrast this situation with the reception which is accorded a salesman with the following proposition. Smilingly he greets the harassed proprietor on a bright spring morning.

"Good morning Mr. Pharmacist. I have a proposition here which is an absolutely 'sure-fire' way to take business away from the price cutters and bring it back to your store where it belongs. I have here a tooth paste—as fine a tooth paste as anyone ever used. This tooth paste costs you not \$4.00 or \$3.60 or \$3.56 a dozen but only \$3.00 a dozen.

"We're only offering this tooth paste to one selected druggist in this locality. No cutter can get it. Do you think you'd have any trouble in getting your full price for this tooth paste? Remember you're the only store in this locality that has it. Customers will have to come to you to get it. No cutter has it or ever will have it.

"Here's a chance to make some real money, double your money in fact, because you get your full price and this tooth paste costs you 25 cents a tube."

It is little wonder that the druggist selling day after day dozens of tubes of popular tooth paste which costs him 30 to 33 cents for, say, 40 cents is tempted

by the enthusiastic salesman's proposition. Here's a chance to get a gross profit of 25 cents a tube instead of only 7 to 10 cents. It is little wonder that in a surprisingly large number of cases retail druggists invest \$36.00 in just such propositions.

The one question that the druggist forgot to ask himself in considering the proposition was, "How much of this unknown tooth paste can I sell and how long will it take me to sell it?"

Even assuming he can sell it at all and actually does succeed in selling this gross of unknown tooth paste in a year's time, which any druggist who has tried to do it will say, vehemently, is an almost impossible task, there is still this to consider.

The total gross profit from the \$36.00 he has invested in this new tooth paste which he obtains when, as and if he sells it, is \$36.00 (he "doubles his money"). From this \$36.00 must come the cost of carrying it and selling it and whatever profit is to be made.

If, on the other hand, \$36.00 were invested in 2 dozen each of 5 leading brands of popular tooth pastes selling at wholesale for \$3.60 a dozen, there is hardly a drug store in the entire United States which would not be able to sell the entire lot within one month's time and then repeat the process the next month, and then month after month for the whole 12 months of the year. Even if the druggist who bought 2 dozen of these 5 popular brands of tooth paste at a cost of 30 cents a tube is compelled, by competitive conditions, to sell them for 37 cents a tube, note the following facts:

The gross margin of 7 cents a tube amounts, on the entire purchase, to a total of \$8.40. But this gross profit is earned within a month's time and the \$36.00 investment in the merchandise is returned to the proprietor 12 times during the year so that he can repeat the process 12 times in a similar way.

This makes the annual gross profit from the \$36.00 reinvested monthly in 2 dozen each of 5 popular brands of tooth paste 12 times \$8.40 or \$100.80. From this \$100.80 has to be paid, of course, the cost of carrying and selling this merchandise, and whatever profits are to be earned from the investment.

Compare this \$100.80 gross margin available from the \$36.00 investment in 5 popular tooth pastes with the \$36.00 gross margin from the \$36.00 investment in the unknown tooth paste. Remember also that this \$36.00 gross profit was achieved only if the tooth paste was all sold, and any druggist who has occasion to look over the surplus stock in his store does not need to be reminded of what a difficult thing this is to do.

Only one question needs to be asked now—"Would a druggist with \$36.00 to invest in merchandise, prefer to put this \$36.00 into merchandise on which the gross margin available for paying the expenses of operating his store and for his own profits could not be more than \$36.00, even if the merchandise was all sold within a year's time? Or, would he rather put the \$36.00 in 5 popular items of merchandise from which it was practically certain there would be returned to him a gross profit of \$100.80 in a year's time with which to pay the expenses of operating his store and for his profits?"

Notice above that I have deliberately chosen a price for the tooth paste which is considerably below that prevailing to-day in most drug stores. It is easy to

see, for instance, the advantages of the situation when the customary price of popular tooth paste is not 37 cents but is, as it is in thousands of drug stores to-day, 45 cents.

The purpose of this article is to try to make clear that manufacturers of popular identified merchandise in the drug trade are losing selling opportunities and good will because they have not made clear to retail druggists who sell their merchandise the profit opportunities which are inherent in this merchandise, even at prices which are very materially below the customary gross margins of $33\frac{1}{3}$ to 40 per cent.

When a retail druggist says that he is interested in *price* maintenance, it signifies that he is interested in *profit* maintenance. It is thus clearly the responsibility as well as the interest of all manufacturers and wholesalers in the drug trade to make clear to retail druggists the profit opportunities which exist in the merchandise they make and distribute. Profits, it should be borne in mind, are determined not alone by gross margins, but also by volume and turnover.

VIRGIN ISLANDS AS SOURCE OF INSECTICIDES.

The possibility of establishing an insecticidal plant industry in the Virgin Islands to supply this country with important insecticidal materials, which are now imported at high cost from foreign countries, will be investigated by Dr. W. W. Skinner, Assistant Chief of the Chemical and Technological Research Unit of the Bureau of Chemistry and Soils, U. S. Department of Agriculture, who will leave Washington for the Islands on February 26th.

Dr. Skinner goes to the Virgin Islands at the request of the Department of the Interior, which recently was placed in charge of the Islands and which is seeking to rehabilitate the agriculture by the introduction of new industries to take the place of the production of oil for bay rum and sugar. These were formerly the leading native industries but have recently been suffering from the world depression and the over-production of sugar.

Doctor Skinner will investigate the possibility of aiding the islanders to rehabilitate the bay rum industry by assistance of a chemical character; he will study the situation with regard to the production of sugar; and particularly he will investigate the possibilities of growing such insecticidal plants as pyrethrum,

derris and "cube," and the extraction from these plants of valuable insecticidal materials. He will also consider the advisability of establishing a chemical laboratory to aid such developments in the islands.

Scientists of the U. S. Department of Agriculture have found rotenone to be superior to materials now generally used in the United States for insect control. This new insecticide is found in quantities up to 7 per cent in the roots of the South American "cube" plant, and up to $5\frac{1}{2}$ per cent in derris roots. The derris and cube now grow in the Malay States and in parts of South America, and it is hoped that the climatic and soil conditions of the Virgin Islands will prove sufficiently favorable to allow the profitable production of this and other tropical insecticidal plants.

It is possible that Doctor Skinner may visit Trinidad where the British colonial experiment station is carrying on experiments in an attempt to grow derris for insecticide. On his return passage Doctor Skinner will visit Porto Rico to review the activities of the sugar laboratory of the Bureau of Chemistry and Soils at Fajarado where experimental work has been under way for several years, and will study the possibilities of developing a citrus by-product industry in Porto Rico.

The 1931 A. Ph. A. meeting will be held in Miami, Fla., during the week of July 27th.