

DEPARTMENT OF BUSINESS MANAGEMENT

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WHY FAST TURNOVER PRODUCES LARGER MARGINS.

A thousand dollars invested in a stock of merchandise which is turning over once a week is producing on each turnover a net profit of, say, \$10. It is simple arithmetic then to note that this investment of \$1000 will earn in a year's time 52 times \$10 or \$520, which of course, is a net return of 52 per cent on the investment in merchandise.

On the other hand, a thousand dollars invested in some other line of merchandise may produce a net profit of \$250 every time it is sold. The rub is that the characteristics of this stock of merchandise are such that it won't turn over more than once a year and thus the \$250 profit on the \$1000 investment is earned but once in a year's time. This is, to be sure, a 25 per cent return on the investment, but this rate of return is less than half that earned in the first case, although the profit on the individual sale is 25 times as great.

Above I have given the theoretical explanation of the turnover principle. From this theoretical explanation, it is perfectly apparent why shrewd merchants are willing to make sacrifices in their net margins of profits if the effect will be to increase turnover. On this account it would be expected, therefore, that the businesses with the highest average turnover would be the ones showing rather low net margins of profit on sales. For instance, a drug store doing \$50,000 with a profit of \$2500 and an average turnover of its merchandise stock 5 times a year obviously is earning more on its merchandise investment than a firm which made \$2500 profit on a \$25,000 business but which had an average turnover of its merchandise stock only once a year.

So much for the theory. The facts which are needed to support or to controvert the hypothesis I have just outlined are available so far in sufficient detail only for department stores. However, I am sure that the conditions found in this field can be taken as illustrative, at least, of what undoubtedly exists in other retail lines, including, of course, the drug store.

One striking conclusion is apparent at once from these facts, as the table below shows. The stores with the fastest turnover not only make the most money on their merchandise investment but their profits per dollar of sales average more than they do in the stores with slow turnovers. The figures recently released by the Harvard University Bureau of Business Research show this.

These stores, all of them with annual sales over \$1,000,000, were grouped according to the profits earned on sales with the following result:

Profits earned on sales.		Annual turnover of merchandise stock.	
4% and over	Under 2%	4.1	3.5
2% to 4%	Loss	3.9	3.3

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The three things that determine the profitableness of a business are the volume of business done, the net margin of profit on each dollar's worth of business and the turnover. The Harvard figures certainly indicate that turnover, in its own right, vitally affects the profitableness of a business but, in addition, is a determining influence upon the net margin of profit on each individual sale.

The reason for this inter-relationship lies in the following situation. The costs of conducting a retail business fall into two general groups. One group is composed of those items which result from expenditures for keeping the merchandise in the store ready for sale. It includes rent, taxes, insurance, depreciation and so on—the expenses which go on regardless of the amount of business done, or, in fact, regardless of whether or not any business at all is done. In a manufacturing business these expenses would be called the fixed charges.

The other group of expenses is composed of items which result entirely from selling or efforts to sell. They include, of course, salaries of sales people, delivery costs, credit and collection expenses and so on. This class of expenses occurs, naturally, only if and as sales are made.

The only source, of course, from which the money can come to pay either of these classes of expenses is the money received from the sale of merchandise. Now take a hypothetical example and see how it works out.

Suppose a sale is made amounting to.....	\$1.00
This merchandise costs, say.....	0.65
Assume that the purely selling expenses amounted to.....	0.18
And that the cost of keeping the merchandise in the store ready for sale (rent, insurance, taxes, depreciation and so on) averaged.....	0.11
Leaving a profit of.....	0.06

Assume that the average turnover of this merchandise stock was four times a year. Again, in theory, it looks as if the business is on perfectly safe ground if every dollar's worth of business it does can be done on this basis. It is, *if every dollar's worth of business is done on this basis*. Notice, however, that one of the requirements for compliance with this condition is that the turnover of the merchandise stock shall average four times a year, or once every three months.

That is to say, the average time which, in the hypothetical example above, elapses between the purchase and the sale of a dollar's worth of merchandise is three months. The cost of keeping it on hand for this three months' period is, as enumerated, 11 cents.

Suppose, however, things don't go as planned. The merchandise isn't sold in three months. The merchandise isn't sold until six months have passed. Instead of a turnover of four times a year, it now averages only twice a year. If eleven cents is the cost of keeping merchandise on hand ready to sell for three months, it follows that the cost of keeping it on hand ready to sell for twice as long, or six months, will be twice eleven cents or twenty-two cents. Now look at the hypothetical example:

The merchandise is sold at the end of six months for.....	\$1.00
This merchandise cost.....	0.65
The costs of making the sale totaled.....	0.18
And the cost of keeping the merchandise on hand ready to sell for six months instead of three amounted to.....	0.22
Thus causing a net loss on the sale of.....	0.05

A reduced rate of turnover of merchandise stock thus decreased the earning power of this merchant's business in two vital ways. In the first place, he had to wait six months instead of three months before receiving any return at all on his 65-cent investment in merchandise. Second, and more important, the mere fact that he had to wait this additional time before making a sale caused the costs of keeping the merchandise in the store ready for sale to amount to a total which destroyed all possibility of any profit at all when the sale finally was made.

Shrewd merchants always bend every effort to make sales as quickly as possible. If, for example, the average sale could be made within one month instead of three, the following would be the costs and profits:

Selling price of the merchandise.....	\$1.00
Cost of this merchandise.....	0.65
Cost of making the sale.....	0.18
Cost of keeping the merchandise on hand for one month ready to sell (one-third of 11 cents).....	0.04
Resulting in a profit of.....	0.13

Thus, if it were possible to increase the turnover of merchandise stock from once every three months to once a month the margin of profit on each individual sale would be more than doubled. In every one of the cases above I have considered the merchandise to be staple, non-depreciating items. The effect upon profits of merchandise which is kept so long that it has to be marked down before it can be sold can be imagined readily. For instance, look at this:

Merchandise bought to sell at \$1.00 finally has to be disposed of at the end of six months for.....	0.85
This merchandise cost.....	0.65
Cost of making the sale.....	0.18
Cost of keeping the merchandise on hand for six months ready for sale.....	0.22
Resulting in a loss of.....	0.20

It is not necessary even to mention the losses which are bound to occur on merchandise which is of such a perishable nature that if it is allowed to remain on hand too long it spoils and becomes, of course, absolutely unsalable at any price.

Certainly these facts are justification enough for a druggist to bend every effort to sell merchandise *quickly*, for the more *quickly* merchandise is sold the more quickly profits are received. In addition, these profits, if earned quickly, are bound to be greater than if the merchandise is kept on hand for a longer time because the shorter the period merchandise has to be kept in a store the lower the cost inevitably of keeping it there.

N. W. D. A. URGES ENACTMENT OF PRICE MAINTENANCE.

The N. W. D. A. is giving support to the Capper-Kelly Price Maintenance Bill, and has requested the members to assist in the effort. The points made by Congressman Clyde Kelly are stressed in favor of the enactment and the words of Mr. Justice Holmes, of the U. S. Supreme Court, in the Miles' decision is quoted in the literature being sent out. The statement made by the Justice is

as follows: "I cannot believe that in the long run the public will profit by this court permitting knaves to cut reasonable prices for some ulterior purpose of their own and thus to impair if not to destroy the production and sale of articles which it is assumed to be desirable that the public should be glad to get."

Further arguments are that the measure will place business on a more honest plane and stimulate the national growth and enterprise.