

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 also will 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.

ARE YOU WONDERING WHERE YOUR PROFITS GO?

BY PAUL C. OLSEN.

Martin Daniels had one of those twentieth century curiosities. He had a business which showed month after month a small increase in sales and which, from all accounts, looked as if it certainly should be profitable.

Yet, when Martin Daniels looked in his check book there was another story to be told. His bank balance was never more than \$100 or so and most of the time, especially after some extraordinary demand, it was considerably less than that.

It wasn't that Martin Daniels spent his money as fast or faster than he made it. No indeed. He still lived in a little house on Willow Street to which he had moved with his bride many years before. He drew from his business a regular and quite modest salary. That was all. Theoretically, at least he should have had quite a tidy amount of profits accumulating in his bank account.

"That's what puzzles me," said Daniels. "Year after year I go on making a profit according to my books but year after year I am no better off than when I started in business ten years ago. What I would like to know is what happens to the profits. Why don't I get them?"

"Now, look here," went on Daniels, pointing to one of his assistants, "he's just sold that woman a \$1.50 fever thermometer. Mighty good value, too. Retail for \$1.50; costs me \$10.80 a dozen in dozen lots or 90 cents each. My total operating expenses average twenty-five per cent of sales which, on a \$1.50 sale, is 37½ cents.

"That certainly should leave me a clear profit of 22½ cents for the transaction. Yet, I'd be willing to bet my bottom dollar—and I haven't very many of them in the bank—that I'll no more see that 22½ cents profit than I'll see somebody walk in here this afternoon and buy a dozen pounds of bay leaves."

Unfortunately, Martin Daniels is right and in the purchase of those fever thermometers it is easy to prove just why he is right. According to the way Daniels is figuring, he made a 22½ cent profit every time he sold one of those fever thermometers. That's theory for you.

The facts in the matter are quite different. When Daniels placed the order for those fever thermometers he bought a dozen. The merchandise had come in that very morning and the transaction which Daniels happened to see was the first of the dozen to be sold.

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Now trace actually, not theoretically, what happens to the \$1.50 which was received in cash for this thermometer. It goes, of course, into the cash register, later in the day to the office and, eventually, into Martin Daniels' none too healthy bank account. Does this \$1.50 stay there to increase Martin Daniels' bank account permanently?

Far from it. Back on Daniels' desk, awaiting his official O. K. is an invoice which reads:

"1 doz. E-D-E fever thermometers in pocket case, No. 3590 $\frac{1}{4}$ \$10.80"

It is perfectly obvious that the only place from which the money can come to pay this bill is from the receipts from sales. This first \$1.50 and another and another, until eight such sales have been made, go right out again to pay for this merchandise.

Where's the mythical 22 $\frac{1}{2}$ -cent profit that he received? Daniels has to make eight sales before he has taken in enough money to pay for the merchandise. Of course, if the unexpected happens—and it has an unpleasant habit of so doing—Daniels may not sell even eight of the dozen.

He then has to dip down into his none too capacious bank account to pay the bill. He may be able to put off paying the bill for awhile but, eventually, it can't be avoided and then he has to hand out the cash. Whether or not he is ever able to restore this money to his bank account depends, of course, upon his selling more of these fever thermometers.

But the cost of the merchandise is only one of the costs incident to its sale. There is the cost of selling it and the cost of keeping it in the store ready to sell. As Daniels has explained already, these two additional costs average a total of 25 per cent of the sales.

The situation with respect to this dozen purchase then looks as follows:

When the entire dozen are sold, the receipts will be	\$18.00
This merchandise cost	\$10.80
The operating costs of the store average 25 per cent of sales,	
or	4.50
Leaving a profit, apparently of	\$2.70

Eight of these fever thermometers must be sold before enough money is taken in to pay the cost of the merchandise. Three more must be sold to cover the necessary operating expenses of the store.

What if three more aren't sold? Once again Martin Daniels' long-suffering bank account must bear the burden. Expenses must be paid at once. They can't wait on sales. What will the assistant who made this first sale say if he can't draw his wages before he leaves Saturday? What will the landlord say if the rent isn't forthcoming? What will the light company say if the bill isn't paid on the due date?

It thus becomes apparent that only if and when the last of these dozen thermometers are sold does Martin Daniels receive the 22 $\frac{1}{2}$ -cent profits he expects to make on each of the twelve sales. Everything else takes precedence over Daniels' profits. Cash profits are the last thing to be realized and then they come only if he has been able to sell all of his purchase and then only if all are sold at the full price.

I purposely have made this illustration as conservative as possible. Lots and

lots of purchases are made in greater quantities than single dozens. It is easy to imagine how long a druggist must wait for profits on these quantity purchases if, indeed, he ever receives any profit at all.

I purposely have assumed that all of the purchase could be sold quickly enough for each one to yield the full retail price. However, under these ideal conditions it is apparent that on as small a purchase as a single dozen the druggist has a long, long wait for cash profits. Many times they never come at all because the part of the order on which the profits are locked is still on hand, tucked away in some dark corner.

It isn't unnatural for a druggist to buy a quantity of an item on which the gross margins are liberal as they are in this case. Net profits in a drug store are determined by gross margin, by the volume of business possible to do on the item and the rate of turnover obtainable on it.

It is only natural, therefore, that a druggist will want to stock and feature items on which he can obtain a liberal gross margin, hoping that through his efforts turnover and volume will be obtained.

There is the crux of the whole situation. Unless volume and turnover can be obtained there is no profit. A druggist can't make a profit unless he makes sales. That's the only possible source from which he can make profits. Profits come not from buying merchandise but from selling it. Therefore, the acid test to be applied is not how much does an item cost and what's the gross margin but should include, also, how long a time will be required to sell it.

One other moral is to be drawn from this little story, which is all too true. Ask Martin Daniels if he ever takes an inventory of his merchandise stock and his answer is, "Oh no, I never bother. My stock stays about the same year after year. I do about the same volume of business, increasing a little each year but I don't seem to be getting anywhere."

And the reason Martin Daniels "doesn't seem to be getting anywhere" is the continued accumulation of these unsold odds and ends of purchases which slowly but steadily have increased his stock of merchandise. A regular inventory of his merchandise stock at least once a year by a competent person would have brought these facts to light. It would tell Martin Daniels that his merchandise stock was increasing slowly, steadily; it would tell him that the profits which his business should be earning instead of being returned to him in case were locked up in a growing pile of unsold and, perhaps, unsalable merchandise.

With these facts before him, Martin Daniels wouldn't have wondered long what to do.

But without the facts he is in the unfortunate position outlined in the beginning of this story, "I go on year after year, apparently making a profit, but I don't seem to be getting anywhere."

President John M. Thomas, of Rutgers University, has resigned to become a vice-president of the National Life Insurance Company, of Montpelier, Vt.

Investigations are being made of the effect on the individual of wood alcohol when used

as an anti-freeze mixture for automobile radiators. The question is whether the fumes can get into the body by absorption through the skin, or by inhalation, and produce the poisonous effects of methanol.