

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.

SOME COMPLEXITIES IN QUANTITY DISCOUNT AND FREE GOODS OFFERS.

BY PAUL C. OLSEN.

The desirability or salability of merchandise is determined by the druggist's answer to just one question. That question is, "If you were rid of this merchandise, would you order any more of it?"

If the answer is, "No," it is obvious that the present stock is considered unsalable or undesirable to that extent.

The serious aspect of a large part of a druggist's merchandise stock being in unsalable or undesirable merchandise is that the smaller part of his stock must produce all or practically all of the net profits. Is it any wonder, then, that in many drug stores these net profits are decidedly unattractive? This is inevitable when a small share of the stock must produce a large share of the profits.

One of the reasons that the bulk of the stock in so many stores is composed of unsalable or undesirable merchandise is the prevalence of quantity discounts and free goods offers. Profits are determined in a drug store by three factors: the gross margin obtainable on the merchandise, its rate of turnover and the volume of sales possible in that item.

Of these three the only one that can be determined at all definitely in advance is gross margin. It is natural, therefore, that it should receive the largest share of the attention of a druggist trying to increase the profits of his store.

Unfortunately, this one determinable element affecting net profits is only one of three of these elements. Furthermore, experience indicates that for many items it is the least important of the three.

Also, it is well to remember that, of these three elements of profit, gross margins are the most easily recognized and understood. The effect of turnover and volume is harder to understand and, as suggested above, more difficult to measure.

The numerous and complex quantity discount and free goods offers available to druggists to-day make one wonder that it is possible for a druggist to keep even as much as 25 to 35 per cent of his merchandise stock in salable merchandise. The free goods offers which are currently available occupy page after page in wholesalers' listings. An examination of the advertising in drug-trade journals presents further

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evidence of the prevalence of a great variety of free goods and quantity discount offers.

One of the great difficulties in determining whether or not to accept a free goods offer is the difficulty in determining whether or not the discount or free goods offered are a sufficient inducement for a larger purchase. That is to say, will the extra gross margins compensate for the reduced turnover?

It is obvious, also, that consideration should be given to the selling possibilities of the merchandise. No matter how attractive the gross margins are on some items of merchandise, the purchase of them is a liability rather than a profit opportunity if the merchandise cannot be sold.

A detailed examination of one current free goods and quantity discount offer will make clear just why it is that there is so much difficulty in avoiding accumulations of undesirable or unsalable merchandise.

The manufacturer of a well-known item of toilet goods permits direct purchases by retail druggists when a gross or more of this item is bought at one time. The item lists for \$4.00 a dozen. A purchaser obtains on this direct order of one gross a discount of 15 per cent and free goods of a quarter of a dozen with each dozen.

If he buys this merchandise from the wholesale druggist, he gets customarily a 10 per cent discount and free goods of one-sixth of a dozen with the dozen.

Should he buy this merchandise directly from the manufacturer or through the wholesale druggist?

It is a complicated task to calculate, first of all, the net cost per item or per dozen of the merchandise bought in the two ways for purposes of comparison.

To do this, it is necessary to proceed in the following way.

A twelve-dozen purchase with a quarter dozen free with each dozen means that on an order for twelve dozen the retail druggist actually receives fifteen dozen. For these fifteen dozen, he pays \$48, less 15 per cent, less 2 per cent for cash. The quantity discount of 15 per cent is a saving of \$7.20, making the net amount of the invoice \$40.80. If the retail druggist takes, in addition, the cash discount of 2 per cent, he saves 82-cents more, making the net cost of the fifteen dozen \$39.98. Dividing fifteen into this amount to get the net cost per dozen shows the cost per dozen to be \$2.67 or about 22 cents each.

Buying from the wholesaler a dozen at a time, he pays \$4.00 a dozen less 10 per cent and 1 per cent for cash and receives a sixth of a dozen free with his dozen purchase. The net cost of the fourteen items is thus \$4.00 less 10 per cent, which is \$3.60, less a 1 per cent cash discount amounting to 4 cents making the net cost \$3.56. Dividing fourteen into this amount, the net cost of each item is about 25 cents each or \$3.00 a dozen.

The indicated saving in the purchase price direct as contrasted with buying from the wholesaler is thus about 11 per cent. Notice the rather elaborate calculations which are necessary to finally determine what the apparent saving actually is. Both purchases have to be reduced to a common denominator, which is either the cost per item or the cost per dozen, and this is not easy to do when free goods in varying amounts are given with purchases being compared.

One other important item remains to be considered and that is this. How long will it take to sell the merchandise? If 15 dozen (a gross plus free goods) can be sold in one month or even in two months it is to the advantage of the retail

druggist to buy at the lower price. On the other hand, if the purchase of 15 dozen means the purchase of a year's supply of the item, as contrasted with a $1\frac{1}{6}$ dozen (a dozen plus free goods) purchase being a month's supply, the advantage of the quantity purchase is considerably clouded. Why?

For the usual city neighborhood drug stores and for most drug stores in cities under 10,000 population, the cost of keeping merchandise in drug stores ready to sell, averages $2\frac{1}{2}$ cents a month on every dollar invested in merchandise. This is the share—the rent, heat, light, taxes, insurance, depreciation, etc., chargeable against the individual items in the store. Obviously, those items which remain on hand the longest have the greatest amount of carrying costs charged against them. (A person who stays all summer at a resort hotel pays more board than a person who remains only for one week-end.)

On the gross purchase it is obvious, in the case of a drug store which can sell only $1\frac{1}{4}$ dozen of the item in a month that extra carrying costs will be incurred. How much are they? Eleven-twelfths of the purchase will be carried two months. Ten-twelfths for three months, nine-twelfths for four months and so on until the last twelfth of the order, when, if all goes well and nothing untoward happens, as it frequently does, this last twelfth is sold at the end of the twelve months. The total of these extra carrying costs at $2\frac{1}{2}$ cents per month per dollar invested in merchandise amounts to \$6.36.

As shown earlier in this article, the net cost of the goods bought in quantities directly from the manufacturer is \$2.67 a dozen. Bought from the wholesaler in smaller quantities under the terms mentioned, the cost is \$3.00 a dozen. The apparent saving in purchase price of 33 cents a dozen, or 11 per cent, is thus more than wiped out by extra carrying costs which add 42 cents a dozen to the average cost of the quantity purchases.

Fortunately for retail druggists not mathematically inclined, it is not necessary to go through these elaborate calculations each time the relative advantages of a quantity discount or free goods offer are considered. Only one question need be answered with respect to the staple, salable and non-perishable merchandise. That is this: Will the quantity proposed to be purchased be sold within one to two months' time? The aim at all times with respect to staple, salable, non-perishable merchandise should be to order a quantity—no larger—and *no smaller*—than can be sold in one to two months' time.

DEMAND FOR PHARMACEUTICAL PRODUCTS IN INDIA.

There is a fair market in India for pharmaceutical products which should increase in the future. The tropical climate of India and the prevailing unsanitary conditions necessitate the use of large quantities of germicides and antiseptics. The prevalence of malarial and dengue fevers creates a large market for quinine, aspirin and other fever preventives. Toxin for vaccination against enteric fever, cholera, smallpox and other diseases are also widely used and many other medicines prepared primarily for use as tonics should find a favorable field.

The United States ranked fifth as a supplier of medicinals to British India during the fiscal year 1928-1929, having provided \$383,000 worth. The United Kingdom, Germany, Japan and Italy were the leading suppliers. (Consul R. Y. Jarvis, Calcutta.)