

DEPARTMENT OF BUSINESS MANAGEMENT

Conducted by Paul C. Olsen.*

COMMENTS, QUESTIONS AND SUGGESTIONS ARE INVITED AND WELCOME.

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THE MOST PROFITABLE WAY TO INCREASE TURNOVER OF DRUG STORE MERCHANDISE.

BY PAUL C. OLSEN.

Profits in a drug store, as indeed they are in any retail store, are determined by margin, volume and turnover.

By margin is meant the difference between the price paid for merchandise and the price at which it is sold. By volume is meant the amount of sales which are made. By turnover is meant the rapidity with which sales are made; that is, the time which elapses between the proprietor's purchase of merchandise and its subsequent sale.

Of these three factors margin receives the greatest emphasis, not because it deserves it, but because it is the most apparent and easiest to see. In a drug store this extra emphasis upon margin is illustrated by the following conversation.

"Here's some merchandise on which you can double your money—a tooth paste that costs you \$3 a dozen. You can sell it for 50 cents a tube because there is no price competition. What's more, we'll give you the exclusive agency for it in this locality. Why shouldn't you spend your time and effort in pushing this merchandise instead of merchandise on which you get a margin of only $33\frac{1}{3}$ or, with cut prices, even less than that."

What the guileful salesman has overlooked in the above sales talk is the fact that the alleged doubling of the money from the sale of this unknown tooth paste can come only when sales are made. If the merchandise isn't sold, the druggist makes and can make no profit, no matter what the theoretical gross margin is.

Furthermore, the longer such merchandise stays in the store the more it costs him to keep it there, just as the longer a person stays in a hotel the larger his bill will be. Furthermore, if a person has to wait a year to get a net profit from the investment of merchandise, it is obvious that four times as much net profit must be earned per dollar of sales as would be the case if the same investment produced those profits successively four times in a year.

Turnover is important, therefore, as a determinant of profits, because it is a measure of the rapidity with which merchandise is sold and, if the merchandise is sold at a profit, it becomes, also, a determinant of the rapidity with which profits are earned.

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Volume is likewise important. It matters little if a man can "double his money on merchandise" if, even with extraordinary efforts, he can sell only a few dollars worth of merchandise in a year's time. In contrast he may obtain, without such special efforts, several times the amount of sales on merchandise which is more popular.

It is gratifying to note the steadily increased interest with which the importance of turnover as a determinant of profits is being considered by retail druggists. A drug store has in its stock 8000 to 15,000 different items. In fact, many of the larger stores have stocks much more varied than this.

In a going business, merchandise is bought not in bulk but item by item. This means, in turn, that when a druggist decides to make serious efforts to increase the turnover of his merchandise stock, he undertakes to buy individual items in quantities which will produce the most rapid rates of turnover. By producing these rapid rates of turnover, he believes that, if the merchandise can be sold at a profit, it will produce profits with similar rapidity and release the money tied up in this merchandise for reinvestment in additional merchandise on which profits can be earned with similar rapidity.

It is well known that some merchandise in a drug store is much easier to sell than other merchandise. In fact repeated investigations indicate that two-thirds to four-fifths of the sales in most drug stores are produced by one-third to one-fifth of the stocks. In other words, a part of the stock, amounting to one-fifth to one-third of the total stock, sells two to four times as readily as the rest of the stock.

It is plain, therefore, that a druggist, recognizing the importance of turnover as a determinant of the total net profits of his business, would find it easiest to increase the rate of turnover on this relatively small part of his stock which produces the bulk of his sales. This merchandise already has proved its salability by the great frequency with which it has to be replaced in comparison with the rest of the stock in the store. Bear in mind, again, that when a druggist sets out to increase his turnover, he applies this general idea not to the stock as a whole but to the purchase of individual items of merchandise. The purchases he makes most frequently are the items which are readily salable, as the facts above indicate.

An extension of this practice frequently has led many druggists, particularly in the larger cities close to most of their sources of supply, to buy popular merchandise in quantities so small that they have to be reordered once and even twice a week. (I am speaking of course, only of the staple, non-perishable and non-seasonable merchandise.)

One of the most obvious difficulties when individual items of merchandise are bought in such small quantities that they have to be reordered once or more often weekly is that there is a constant risk of being out of merchandise which customers have indicated their willingness to buy by the very fact that it has to be reordered so frequently. Demands fluctuate from day to day; a small stock of popular merchandise does not permit a druggist to obtain the profits from unusual and sudden increases in demand. People, disappointed once or twice by being unable to buy popular merchandise at a drug store, are likely to transfer their business to a competing store and this is quite serious because of the loss

not only of sales of these items which were not in stock but, of many dozen other items which these customers might have bought at the store on their visits to it.

The second disadvantage is the extra work involved in reordering merchandise so frequently—the necessity of checking several orders instead of one and the necessity of verifying and paying several invoices instead of one.

To counterbalance these disadvantages, the theoretical advantages are, the savings in carrying costs and a greater return per dollar invested in merchandise.

Consider first the theoretical savings in carrying costs. In a typical city neighborhood drug store the carrying costs of staple, non-perishable merchandise are usually about four-tenths of one cent per dollar of sales per week. In other words, a druggist who takes the trouble to order popular merchandise in such small quantities that it has to be reordered within a week, saves on carrying costs of such merchandise the sum of four-tenths of one cent per dollar of sales, in comparison with buying such merchandise in quantities which would last for two weeks and thus overcome, in some part, the disadvantages of an exceedingly rapid turnover which are indicated above. Practically speaking, the savings in carrying costs in most drug stores are negligible when turnover at a rate of more than once a month, or even once in two months, are obtained.

Now consider the second theoretical advantage of a rapid turnover—increased rate of return on the money invested in such merchandise. It is true that, if a druggist buys popular merchandise in quantities to last a month or two, instead of only a few days, the theoretical return per dollar invested on such merchandise will be decreased.

However, consider the facts of the case. The bulk of the sales of drug stores are in this popular merchandise on which exceedingly rapid rates of turnover are possible to obtain. On the other hand, as mentioned before, two-thirds to four-fifths of the merchandise investment of most drug stores is in merchandise which is commonly classified as slow selling stock.

Therefore, the number of dollars which a druggist has invested in popular merchandise on which high rates of turnover and high rates of profit are obtained is small in proportion to his total investment. If a druggist puts most of his money into this merchandise of proved salability, he will decrease the net rate per dollar invested, but he will be able to invest so many more dollars that the total return will be greatly increased. After all, the total return is what interests a druggist most. Certainly there could be no better place for a druggist to invest his money than in merchandise of proved salability.

This means, in turn, that the merchandise now constituting the bulk of a druggist's stock investment, and producing only a small part of his sales, will decrease. This is a decided advantage for two reasons. One is, as suggested, the money released will go into popular readily salable merchandise. The other reason is that the money tied up in this merchandise which sells slowly will not be as large as before, however, the return on it will be much greater than before.

Consider carrying costs first. As mentioned above, the carrying costs of merchandise per dollar of sales in city neighborhood drug stores, for example, average about four-tenths of one cent per week.

Therefore, if slow selling merchandise, formerly bought to sell within one year's time, is bought in a quantity to sell in three months' time, thirty-nine weeks'

carrying costs are saved, a saving of 15.6 cents per dollar of sales, a sum which is considerably in excess of the usual net profits for most druggists per dollar of sales.

It is on this slow selling merchandise that the greatest savings are possible and practical in carrying costs. Even if such merchandise, when bought in minimum quantities, lasts for six months instead of a year the saving in carrying costs alone amounts to 10.4 cents per dollar of sales, an amount which easily can mean the difference between its profitable and its unprofitable sale.

Consider now the possibilities of increasing the rate of return upon money necessarily invested in a drug store in the slow selling merchandise which it has to have in order to meet the demands of its customers. If such merchandise is bought in quantities so that a turnover of this merchandise is possible four times in a year, instead of once, the effect upon the return from the merchandise investment is easy to see. Consider, for instance, the following example.

Merchandise sells for.....		\$12.00
Merchandise cost.....	\$6.00	
Selling cost.....	2.40	
Carrying costs 1 year.....	2.50	
PROFIT:		\$ 1.10

This is a specific example of some of the "double your money" merchandise which has sold so slowly that a year has elapsed before all the money invested in it is free for reinvestment.

Suppose, instead of the dozen purchase of this slow selling merchandise, a quarter dozen were bought, enough to last three months. Here are the facts upon the profitableness of that purchase.

Merchandise sells for.....		\$ 3.00
Merchandise cost.....	\$1.50	
Selling costs.....	.60	
Carrying costs 3 months.....	.16	
PROFIT:		.74

By the simple expedient of purchasing this slow selling merchandise in quarter dozen lots, instead of a dozen at a time, this druggist has changed a profit from the money invested in such merchandise from \$1.10, for a whole year to \$2.96 and, at the same time, has reduced his investment in this slow selling merchandise and consequent risks to one-fourth the former amount.

It is apparent, too, that even if there is a substantial quantity discount for the purchase of a dozen of such slow selling merchandise items at one time the theoretical buying advantage may be overcome easily by the greater profits to be obtained by buying so as to obtain a turnover of at least four times a year.

The Seventy-Ninth Annual Meeting will be held in Miami, Florida.