

# 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.

## ADVERTISING AND SELLING PROBLEMS OF DRUG STORES.

### *Cut Price Problems and What Can Be Done about Them.*

BY PAUL C. OLSEN.

When a druggist buys a dozen of a dollar item for \$8.00, about the only thing he is sure of is that he will make a total gross profit of \$4.00, *if he sells all the merchandise*. In the preceding article in this series, I tried to emphasize the importance of that *italicized* phrase above. Even if merchandise is presented to a retail druggist, at no cost at all, he can't possibly make any money from it unless he sells it.

Even the \$4.00 gross profit is none too secure in these days of increasingly keen price competition, as many thousands of druggists will testify to their sorrow.

But of the three determinants of profit—margin turnover and volume—margin (gross profit) is the only one which is known in advance with any degree of certainty. Because of this fact, margin is usually considered to be the most important of the three determinants of profits earned from the sale of merchandise in a drug store.

Any one who doubts the truth of this statement needs only to observe a druggist's pleased smile of anticipation, when merchandise which he thinks he can sell is offered to him with larger than the usual gross margins.

In further proof of this widespread belief that margin is the most important determinant of net profits from the sale of drug store merchandise, one has only to listen to the enthusiastic salesman talking with red-faced earnestness about his line of merchandise on which it is possible to "double your money." What he means, of course, is that the gross margin on this merchandise, *if it is sold at the anticipated retail price*, is 50 per cent of the selling price.

Still further proof of this widespread belief is to be found on page after page of manufacturers' advertisements in drug journals. Look at this one, for instance.

"This package means more net profit. *Such and Such* gives you extra profit on a standard price of \$12.00 per dozen and only a single stock to carry.

"Not \$14.40 but \$12.00 per dozen. This price is \$2.40 less per dozen than what you pay for ordinary *Such and Such* and means a direct saving of  $16\frac{2}{3}$  per cent. Turning our *Such and Such* into profit you have \$9.60 from every dozen instead of \$7.20— $33\frac{1}{3}$  per cent more profit. Not including free goods.

---

\* Lecturer on Business, Columbia University and Philadelphia College of Pharmacy and Science.

"Not a sixth of a dozen free but a quarter of a dozen free. This amounts to \$5.40 more profit. With a \$2.40 less cost price and a quarter of a dozen free, you get \$7.80 more profit on every dozen when you sell our *Such and Such*. Even the occasional deals offered by competitors never touch this extra profit which is constant with us."

This emphasis on margin as a determinant of net profits from the sale of drug store merchandise results, of course, from the fact that it is the most easily determined of the three elements, margin, turnover and volume, which operate to produce profits. It is not very easy to see, for instance, that money invested in merchandise on which the gross profit is only 25 per cent actually may produce far more dollars of net profit than a like amount of money invested in merchandise on which the gross profit is 50 per cent.

However, a \$10.00 investment in this low gross margin merchandise may produce a net profit of \$1.00 within a month after the investment is made, thus releasing the money for further similar investments each month, making a total net profit in a year's time from the same \$10.00 of \$12.00.

On a gross margin of 25 per cent, the total sales made in a year from this \$10.00 investment in merchandise amount to \$160.00.

In the case of the merchandise on which the gross margin is 50 per cent, it very well may happen that six months elapse before all this merchandise is sold and the \$10.00 invested is thus free for similar reinvestment. Even if \$2.00 net profit is made from the sale of this merchandise on which the gross margin is 50 per cent, it will be seen that it is possible to earn such a profit only twice in a year's time, or a total from the single \$10.00 investment, of \$4.00 in a year. This is only one-third as much as was the case in the instance cited above. Profit *per dollar of sale* was twice as much in the case of the merchandise with the high gross margin, but the total amount of profit was small on account of the small volume of sales and the slow rate of turnover. Only \$40.00 sales resulted in the case of merchandise with the 50 per cent gross margin and the rate of turnover of the merchandise stock was only one-sixth as rapid as was the case of the merchandise with the 25 per cent gross margin.

All of the above is simply a theoretical explanation of how large net profits may be made (on account of rapid turnover and large volume) in the case of merchandise which sells readily and quickly even though the gross margins are not large. I hope this theoretical explanation makes the principle clear. This is, however, most decidedly a theoretical explanation and no druggist needs to be told that in the actual every day operation of a drug store the theory doesn't work nearly as smoothly as the hypothetical example cited above might lead an inexperienced person to think.

My purpose is to make as clear as I can how the various interactions of margin, turnover and volume actually do produce different amounts of net profits in the sale of drug store merchandise and, more important, to point out what steps a druggist can take, in view of this unavoidable situation, to assure himself of the greatest possible amount of net profits.

It is necessary, too, for all of us to recognize that there are some classes of merchandise which have to be stocked in a drug store even though there is little or no opportunity for profit in them, even if they are sold. Any druggist who has looked over his stock carefully does not need to be told that postage stamps and

drinking water are not the only items on which opportunities for direct profit are negligible. There is only one point to be kept in mind with respect to this class of merchandise: recognizing the negligible opportunities of profit, such merchandise should be stocked and purchased only in minimum quantities.

When I speak of merchandise on which the opportunities for profit are exceedingly small, some people may conclude that I mean to include in this category fast-selling proprietary preparations on which widespread cut prices have reduced the gross margin obtainable to very small proportions.

To contradict this impression, I call attention to the fact that an examination by the Druggists' Research Bureau of over 200,000 individual sales of proprietary merchandise sold at cut prices in retail drug stores showed that sales of this merchandise not only were profitable, but produced net profits which were above the average of the net profits produced by all sales in these drug stores. This I consider to be convincing evidence of the fact that volume and turnover are of greater importance than margin, as a determinant of net profits in the sale of drug store merchandise.

One reason that facts, such as these, are difficult to believe is the following: If all this merchandise had been sold at the full price, instead of at the deep cut prices at which it was, the profits earned would have been far greater. Retail druggists, therefore, naturally and rightly hesitate to cut prices until forced to do so. What I'm trying to make clear is that standard merchandise sold rapidly and in large quantities can be profitable, although not as profitable if the same quantities were sold as rapidly at the full prices.

Cut prices result from the desire of some druggists to attract business from their competitors, knowing very well the lure to consumers of a large and evident saving upon popular, standard merchandise of known quality.

The aggressive price cutter also knows that he can make money selling this popular, standard merchandise at cut prices if competition doesn't force him to cut too deeply. And there lies the great weakness of the cut price plan for selling popular drug store merchandise. It is so easy for the plan to be copied and so easy, in the stress of such competition, to force prices on popular standard merchandise lower and lower until there can't possibly be any profit from its sale. Obviously no profits can be earned directly from the sale at 24 cents of merchandise which cost 27 cents, no matter how much merchandise is sold, nor how rapid the rate of turnover.

Aggressive price cutters know, too, that once a price is deeply cut, it is virtually a merchandising impossibility to raise it again even to cost price, much less to a price which permits some profit.

Another unfortunate effect of the aggressive price competition which exists on popular standard merchandise in the drug trade is that such price competition naturally cannot be confined merely to aggressive price cutters but must affect necessarily also the sales of this merchandise in the stores of druggists who recognize very well the aggravating effects of steadily deeper cuts in the prices of popular, identified merchandise.

The matter of how far to go in meeting price competition on standard, identified merchandise is one which each druggist must decide for himself, after a careful consideration of his own competitive situation. The effects of price cutting, however, are more widespread than is sometimes recognized. The druggist who operates

a drug store on the steamship Leviathan may feel that if anybody is free from competition, he is so situated. Yet he has a golden opportunity to create good will and, indeed to increase his sales, if he asks no more than the usual, or so-called, full prices for the standard merchandise which he sells. On the other hand, no one would argue that a druggist so situated should carry this desire to create good will and sales to the point of selling his merchandise at prices comparable with those of the most aggressive price cutter in New York City.

Even in cities in which price cutting is particularly aggressive—Kansas City and Chicago are examples—druggists who do not aim to attract business on a price basis have found that they can maintain their usual volume of sales without dropping their prices on standard merchandise to the lowest levels reached by aggressive price cutters in those cities.

However, it is usually necessary for them to make some concessions in prices on standard, identified merchandise in order to avoid creating the impression that prices of all merchandise sold in these stores are inordinately high.

It is a fact, proved by detailed cost examinations by the Druggists' Research Bureau that, when necessary or desirable, prices on popular standard merchandise can be dropped to a level which is no less than 6 cents above the net cost of some such merchandise and still be profitable. Below this level, it is doubtful if popular, identified merchandise can be sold at any profit in a drug store, regardless of the amount sold or the rate of turnover. A gross margin of 6 cents above the net cost of popular, standard merchandise is believed to be, therefore, the lowest price to which such merchandise can be cut and its sales still produce some profit.

All of this discussion of cut prices and their effects on drug store profits must force once again the conclusion that drug stores which depend for most of their success upon the professional services which they render are far free from the frequently disastrous effects of cut prices than drug stores which make the bulk of their sales in popular identified merchandise. Thus is shown for the great majority of drug stores the economic, as well as the ethical importance of the professional side of pharmacy.

---

### PHARMACEUTICAL ENGINEERING.\*

BY ARTHUR F. PETERSON AND ROBERT J. RUTH.

During the last few years pharmacy has been passing through a transition from the combined prescription and commercial pharmacy to the ethical prescription pharmacy on the one hand and to the purely commercial drug or patent medicine store on the other. Colleges of pharmacy have lengthened their courses in pharmacy to meet the needs and demands of the modern prescription laboratory, to make the individual a better and more exacting pharmacist and to broaden his power of usefulness to the physician as bacteriologist or physiological chemist, and further to give him a broader cultural background.

While progressive changes have been taking place in retail pharmacy even greater progress has been made in the manufacturing pharmaceutical, biological and medicinal chemical field. Better trained individuals in greater number are

---

\* Section on Education and Legislation, A. PH. A., Miami meeting, 1931.