

federal government has been aware of this situation, and it is for this reason, I believe, that it is showing a greater interest in a means of making the state laws more effective. The Uniform State Narcotic Act, when its provisions are brought fully into play, would seem to afford all necessary machinery for dealing with the situation so far as the states are concerned.

I have discussed the matter in this paper, though somewhat briefly, so that the attention of the state agencies themselves might be focused on the problem, as well as upon the responsibility placed on them by the specific terms of the Uniform State Narcotic Act itself.

LAW, ECONOMICS AND BUSINESS IN BUYING A DRUG STORE.*

BY JOSEPH H. GOODNESS.¹

If we recognize that drug stores are purchased for economic reasons of income and profit rather than for the establishment of systematic charities, then we can accept the idea that no going drug business should be bought until a thorough investigation, economic, legal and business, is made, and that the income, the profit and economic security we desire are reasonably sure to appear. Before we venture into the discussion of what this investigation should be like, we must remember that there is no absolute guaranty, even after the most thorough investigation, of always gaining this economic goal.

An earnest investigation, however, will so materially decrease failure, that one who cannot afford to lose his investment must, in fairness to himself and family, investigate. Too many humans plunge into new ventures with hopes high and out of reason. Reality soon reduces such hopeful innocents to failure, all neatly classified under such technical headings as "Insufficient capital," "Inexperience," "Poor business location," "Poor management," "Competition" and a host of others.

A thorough investigation of a drug store consists of three parts: an economic investigation of the chances of future success, a business investigation of the enterprise to determine its worth, and a legal investigation to assure the buyer of limited liability and complete passage of ownership to him.

THE ECONOMIC INVESTIGATION.

The economic security and success we seek requires that we first examine the facts that may affect the future of the business.* This investigation rests upon the principles and laws of economics, and consists of predicting, as best we can, the future size and nature of the *demand* for the goods and services of the store, the *monopolistic advantages* of the business, and the *competition*, both present and future, that the business must or may meet.

To know that the average store needs about 2100 of population to support it is not enough. A study of demand for the goods and the services of the store must be more searching. It begins with the present. What do the annual sales of the

* Section on Commercial Interests, A. PH. A., New York meeting, 1937.

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store amount to? Is the stock complete? If both answers are satisfactory we can assume that the business is running at top speed, and the future demand will, at best, be the same as at present. On the other hand if the sales amount is smaller than average for a store of its size, or the stock is incomplete, then we must look for the failures in services rendered. We have often heard it said that success depends upon services rendered, but have seldom, if ever, seen a listing of what may be considered the basic principles of service. Briefly, I believe them to be: *First*, giving customers what they want, and *second*, making customers feel important. It must be remembered that what a customer wants is not to be limited to the product he requests. His want, or rather wants, when he asks for four ounces of syrup of hydriodic acid, include a want of a clean container, a clean label, an air of confidence in the pharmacist, cleanliness of the store and clerks, sufficient bright lighting and innumerable other things. In some cases he may even want what he does not know he wants. So, a store that truly serves, sells with its syrup of HI the unconscious forces of confidence, exclusiveness, popularity (advertising), dignity, cleanliness, politeness, proximity, air conditioning, neat wrapping, ramps rather than stairs, delivery service, the aid of clerks who talk foreign languages, bright lights and other special services. If the store under question misses these qualities or some of them, then the chance of increasing the demand of the store's future services is excellent, providing that competitors are not already supplying the community with them. If competitors are aggressive, the best that can be expected, statistically speaking, is an increase of demand by half the difference between the sales of the two stores. For, by the laws of chance, business tends to divide itself equally among competitors rendering equal services.

Demand should be viewed from another angle, namely, that of the continuation of its existence. Neighborhoods change, traffic is rerouted, industries fail, parking is forbidden, changes in zoning laws bring new competitors, and each brings with it a failure of demand that formerly supported the store. While we cannot know the future, we must know the *present* facts that may affect the future.

Making customers feel important, the second factor that builds demand, is so foreign to economics that it is not discussed here.

The future economic success of the store was also said to depend on the monopolistic advantages it possessed. To-day, because of the ever-increasing number of drug stores, good roads, cheap transportation, mail order houses, the chance of monopoly through location and absence of competition is almost a theory. But the drug store may have a different kind of a monopoly. It may have own-label products, those that it sells under its own trade-mark or trade name. The demand this creates is truly monopolistic, and assures the continuation of business even if it does not always assure an extra profit. A less important type of monopoly exists in the sole agency for particularly branded goods of a manufacturer. While this was exceedingly valuable in the past, its worth has decreased considerably because of the ever-increasing number of lines of branded goods that are available for such arrangements with retailers.

The final step of economic investigation has to do with competition. While the druggist may recognize but one type of competition—the competition of the other druggist—there are really three types that he must consider. A mere mention of each should suffice. There is, *first*, the competition created by every other

merchant who wishes to sell his products or services. (The income of the average man is limited. If he buys one luxury, with his small excess of cash, he must forego all others until another surplus appears.) This type of competition has grown particularly vexing to the druggist through the activities of instalment sellers and the race tracks. The second type is that created by other vendors of drugs or items that a druggist sells. And the third type, that which exists upon the shelves of the drug store—the competition of one product against all others on his shelves that are used for the same purpose. The pell-mell growth of new remedies and proprietaries will soon be the major problem of the retail pharmacist if it is not that already.

THE BUSINESS INVESTIGATION.

Having estimated the demand, monopolistic advantages and the competition, we then investigate the store from the business angle. A vendor of a going business has tangible and intangible assets to sell, minus the liabilities. Or, to be more specific, he sells the merchandise, fixtures, accounts receivable, the lease, and good-will, and from this makes deductions for unpaid debts, and outstanding legal and contractual obligations.

Our investigation, then, is outlined. We must see that assets are as valuable as they are claimed to be, and that liabilities do not exceed those enumerated in number and amount.

The merchandise inventory should be examined for its age, valuation, ownership and quantity. There can be no better way of acquiring information on all these points than by taking a physical inventory—actually handling every piece of goods present. Old goods should be discarded as of no value to the buyer, and the value of salable goods should be given its cost or market value, whichever is lowest. As to ownership, there is, of course, no way that consignment can be identified by examination. The question is then for legal investigation. As to amount of merchandise, it is a known truth that the average drug store is overstocked. Whether the store you are examining is over- or understocked can be determined by a handy formula as follows:

Two-Thirds of the Annual Sales Divided by Inventory.—As you may recognize, the formula determines turnovers in the store. The sales figure is reduced here by one-third of its amount so that it will represent the cost of the goods sold. If the answer to this equation is *less than 3* (turnovers), this shows a tendency for the store to *overstock*. This decision is natural, since the average drug store should be doing between three and four turnovers a year. If the answer is *greater than 5* (turnovers), then there is a tendency toward *understocking*. In buying a drug store understocking is the lesser evil, for while it may have kept some customers away from the store because of the "We're just out, but will have it to-morrow" explanation, the lost customers can usually be attracted again by a change in policy. Overstocking, on the other hand, produces the possibility of overinvesting if not discovered by the buyer. When overstocking is discovered in the investigation, the price offered for the business should not exceed that paid for a properly stocked store. One should not undertake the burdens of former poor management.

The fixtures of the store should be examined as to condition, book value and arrangement. Of these points, perhaps only the valuation needs any comment. Unless the business has been depreciating the value of the fixtures regularly they

will be listed at the original value, a value which cannot be recognized. The other point on value of fixtures is that, even if new, they should not exceed in value from 10% to 15% of the average annual sales. This figure is determined by estimating the life of fixtures to be 10 (or 15) years and then allowing the usual one per cent of sales per year for depreciation. It may be added that "forced obsolescence" which results in making even fairly new fixtures "old fashioned" because of changes in style (such as modernism) makes it advisable to restrict the value of new fixtures to 10 rather than 15 per cent of average annual sales. This formula should be modified to fit the conditions. If there is only one year of service left in the fixtures, they should not be valued over one per cent of sales. If two years, two per cent, etc.

The accounts receivable should not be purchased if this can be arranged. Customers of the old management very often feel a sense of resentment in having to pay new owners. If the accounts are purchased, they should be purchased at very much reduced valuations. As a handy rule, accounts unpaid under one year are grouped and valued at 50%, and accounts between one and two years, 25%, and no value for those over two years old. This formula may be of little value if the business has a disproportionate quantity of accounts of long standing or if the accounts were created during a short period of time. The law allows actions to collect debts of this nature for as long a time as six years after they are due, but legal and business rights are not identical. If the original owner of the accounts could not collect them, feel sure that the new owner won't, except at such expense and trouble as to make the entire undertaking not worth while.

The lease should be examined next, and there should be a lease present unless the pharmacist is also the owner of the building. To plan on the purchase of a drug store that is operating without a lease of the premises should be undertaken only if the landlord has agreed *in writing* that a favorable lease (with the terms specified) will be given the new owner.

The absence of a lease gives warning to two important points, *first*, the possibility of terminating the stay of the new tenant without more than a trivial notice, and *second*, the slight or non-existence of value of the good-will of the business.

If there is a lease, the buyer should inspect it closely for the following: *First*, the lease should be transferable. There should be no terms forbidding assignment, for an assignment is valueless and generally voids the lease if a transfer is attempted when forbidden. *Second*, liabilities as rent, repairs, rebuilding, etc., of the tenant should cease if the premises are made unsuitable because of fire or other causes arising through no fault of the tenant. There are of course many other points to look for as, for example, renewal rights, but the above two have caused the greatest losses to unobserving retailers.

Good-will is the last, and perhaps the asset most difficult to investigate and evaluate. Our first problem is to determine whether it is present or not, then, if present, our second problem is to find out the maximum price we can afford to pay for it.

Realizing that money can earn up to six per cent a year in first mortgages and other safe investments without unreasonable risk, we can come to the conclusion that any drug store yielding less than six per cent net profit on the invested amount has no good-will. Net profits over six per cent on investment are evidences of the asset.

The courts have defined good-will as "the expectation of continued patronage" which to the business man means "the expectation of continued net profits." The value of this expectation is dependent upon the length of time it continues. If net profits are reasonably expected to continue for five years, then the seller may be justified in asking for part of this profit as the price of good-will. Just how much he can ask, depends upon a multitude of facts. As has been mentioned, the absence of a lease cuts the assurance of the continuation of profit to nothing, a short-time lease to a very small value, etc. All the economic factors of the store's future affect the value: as changing neighborhoods, the appearance of competition, the non-transferability of an exclusive agency, all destroy part or all of good-will.

Each investigation is a case unto itself. This willingness to surrender part of the net profits, coupled with the test of the existence or non-existence of good-will, has suggested to me a formula for checking the value of the asset. I say "checking the value" rather than "determining" it, because the formula can be used only after a price has been asked. It follows:

The average net profit *minus* 6% of the investment price *multiplied by* the number of years that net profit will be surrendered to the seller.

To explain the formula:

The buyer says, "I'll give up three years of net profits (because I'm reasonably sure of getting six or more years of like profits), but since my investment deserves six per cent income from any venture, I'll subtract that amount from each year's net profit before I surrender it." The reasoning here is without fault. In an example, using round figures, the process of applying the formula would be somewhat as follows: The seller having \$6000 of assets in excess of liabilities, and making an average net profit of \$2300 a year, asks \$14,500 for the business. The buyer, after an investigation of the lease, economic demand, competition, etc., believes that the business can continue to produce the average net profit now being earned for six years more (the duration of the unexpired lease). The buyer is therefore willing to surrender three years' net profit after the subtraction of six per cent on investment from each year's net profit. His mathematics follows:

Three (years) *times* the difference between the average net profit and the six per cent on investment or

$$\begin{aligned} &3 (2300 \text{ minus } 870) \\ &3 (1430) \text{ or } \$4290 \quad (\text{The value of the good-will to the buyer.}) \end{aligned}$$

To this good-will price he adds the value of the other assets of \$6000, making the value of the business to him \$11,720. His maximum price would therefore be about \$12,000.¹

To conclude the business investigation comments, the buyer should avoid assuming, if possible, the unpaid debts of the business. If they are assumed, they should be specifically listed; and a written statement should explain that all unlisted debts are not to be assumed. This exclusion can save many headaches for a new owner.

THE LEGAL INVESTIGATION.

In the legal investigation of the sales transaction and the going business, the buyer, with the aid of a lawyer, should examine the lease for the terms already mentioned. He should have all agreements pertaining to land and future leases in writing, for without writings such contracts cannot usually be recognized by the courts. (Statute of frauds.) Agreements and contracts involving sizable sums, or

¹ The mathematics is incorrect in that the six per cent was calculated on the high asked price of \$14,500, and the offered price is lower, \$12,000. But since the method is only for approximation, the error is immaterial.

acts that cannot be completed by the parties within a year of the making of the contracts, should also be in writing for the same reason. But the most important precaution that a buyer must take is to follow to the letter the bulk sales law that exists in most states. Briefly, this law requires that when a business is sold in other than the usual course of trade (item after item to customers over the counter), the creditors of the seller must be notified of the sale a certain time before the sale is consummated. Unless this is done by the buyer, seller, or both, as the law requires in the particular case, the unnotified creditors can consider the sale of the drug store as void, which in non-technical language means, even if the new owner has paid cash for all the goods, the creditors of the old owner not receiving legal notice of the sale can lay claims to the goods of the store *as though they were still owned by the old owner*.

Finally, the buyer should make sure that he is dealing with parties having complete authority to sell. This is particularly necessary when purchasing from corporations, partners, estates or court officers.

These, then, are matters that should be of heaviest concern to the investor in a drug business. Many minor matters, some too obvious, others too particular for discussion here, must also engage his attention.

THE INTERNATIONAL PHARMACOPŒIA OF 1885.*

BY EDWARD H. NILES.¹

When the abbreviation P. I. appeared for the first time in the United States Pharmacopœia, IX—1916, it made American pharmacists definitely conscious of the attempt to establish world standards for many potent drugs and preparations. The abbreviation stood for Protocol Internationale, and its history can be briefly given.

In September 1902, there was held in the City of Brussels an important meeting, called The International Conference for the Unification of Potent Remedies. This conference formulated certain regulations for the strength of more than forty drugs and preparations. The delegates returned to their respective countries to urge that the various nations include in their pharmacopœias these proposed regulations. In 1906, representatives from nineteen countries, including the United States, met again in Brussels and formally signed the agreements proposed in 1902.

The above action ended a forty-year struggle to provide an international Pharmacopœia. But it is interesting and may be a surprise to some to know that at one time a complete International Pharmacopœia was prepared by an authorized commission, and a copy wholly in Latin was submitted to an international congress for ratification.

The advantages of an international pharmacopœia were long recognized, but the matter was brought to formal notice at the first meeting of the International Pharmaceutical Congress, held at Brunswick in 1865. While it was agreed that a Universal Pharmacopœia would be a good thing, no steps were taken to carry out the project.

* Read before Section on Historical Pharmacy, A. P. H. A., New York meeting, 1937.

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