

## **Purchasing and Inventory Control Case Studies**

### **Case 1:**

#### Inventory and Cash Flow

Pharmacy A: It is Friday, June 29<sup>th</sup>, the pharmacy owner realizes that he is out of a high-cost item. His wholesaler bills him at the end of every month. If he orders it today, he will have to pay for it by July 10<sup>th</sup> to get the cash discount. If he waits until Monday, he won't have to pay for it until August 10<sup>th</sup> to get the discount. Considering his patient population and whether it is likely that this medication will be needed on Saturday, he opts to wait and order it on Monday, July 2.

Pharmacy B: It is Friday, June 29<sup>th</sup>, the pharmacy owner realizes that he is out of a high-cost item. His wholesaler bills him at the end of every month. If he orders it today, he will have to pay for it by July 10<sup>th</sup> to get the cash discount. If he waits until Monday, he won't have to pay for it until August 10<sup>th</sup> to get the discount. The pharmacy owner decides to order it today. Better to have too much stock than not enough. Extra stock never hurt anyone. He also asks the technician to glance over the shelves and order anything else that is low in stock.

#### Discussion

1. Which owner probably has better purchasing and inventory control policies?
2. Based on these two situations, how can inventory control affect cash flow?
3. In addition to the cash discount, what other types of discounts should the pharmacist consider when purchasing drug products?

### **Case 2:**

#### Cost and Service Comparisons Between Two Wholesalers

You (an independent pharmacy owner) are trying to select whom your primary wholesaler will be. You have two options: Wholesaler A and Wholesaler B. You determine that these two wholesalers are offering you similar prices, based on your current purchasing volume. Both wholesalers suggest that you join a group purchasing organization (GPO). Below is additional information that you have collected about the wholesalers.

#### Wholesaler A Information

- Wholesaler A is committed to high service levels. It offers scanning and bar-coded technology and automatic substitution programs.
- Wholesaler A proposed the following cash discounts:  
Electronic payment every 7 days: 1.5% cash discount  
Electronic payment every 15 days: 1.25% cash discount
- Wholesaler A will offer a 6% rebate on all generic products.

- Will provide the computer hardware and software to the pharmacy
- Perpetual inventory system- Internet accessible- can send orders via the Internet, can see quantity on-hand at wholesaler in real-time
- Will provide inventory management reports
- Return goods policy: If the merchandise is saleable and returned within 180 days of purchase date, Wholesaler A will provide a 100% credit. If it is returned after 180 days, only 85% credit will be given. If unsaleable (e.g., damaged packaging, less than six months of good dating), 75% credit will be provided. Partial bottles, products that are three months after date of expiration, and other selected products are non-returnable.
- Next day delivery Monday through Friday, including C-IIs
- Deliveries scheduled before noon, emergency delivery provided

#### Wholesaler B Information

- Wholesaler B strives to provide the highest service level. They provide automatic substitution programs, backorder programs, and other programs.
- Wholesaler B offers the following cash discounts.  
Weekly Electronic payment: 1.0% cash discount  
Weekly prepay electronic payment: 1.20% cash discount
- Generic rebates are not available.
- Will supply computer hardware and software
- Will provides a perpetual inventory system-not Internet accessible
- Will provide management reports; including 80/20 report
- Next day delivery Monday through Friday, deliveries scheduled before noon
- Return goods policy: Merchandise originally purchased from Wholesaler B that is returned within 60 days of invoice date will be credited 100% of original invoice amount (assuming it is in saleable condition). If the merchandise is returned after 60 days and is in saleable condition, 85% of the original invoice amount will be credited. Returned outdated merchandise will be credited at 75% of invoice amount, depending on manufacturer's policy. Partial bottles, controlled/schedule II products, and other selected merchandise cannot be returned.

#### Discussion

1. Why do you think the owner decided to purchase products from a wholesaler instead of a manufacturer? Why do you think each wholesaler recommended that you purchase products through a group purchasing organization?
2. Although it is important to consider the pharmaceutical prices when selecting a wholesaler, there are several other factors that should also be considered. What are some other factors that should be considered when selecting a supplier, or in this case a wholesaler?
3. Which would you select as the wholesaler for your pharmacy? Why?

**Case 3:**

## Inventory Turnover Rate

Background: Because ABC Pharmacy has been allowing customers to charge significantly large amounts and they have not been prudent on collecting, the pharmacy is not able to pay its bills on time. Prescription sales continue to grow, but gross margin continues to shrink. The pharmacy has hired you as a consultant. Today you are reviewing the pharmacy's inventory management.

2001 Data for ABC Pharmacy

Sales: \$1,600,000

Cost of Goods Sold: \$1,300,000

Gross Margin: \$300,000

Total Expenses: \$280,000

Net profit: \$20,000

Average inventory: \$163,000

|                         | Range                                     | 1999  | 2000  | 2001  |
|-------------------------|---|-------|-------|-------|
| <u>Net profit</u>       | >20%                                      | 15.0% | 15.0% | 12.3% |
| Average Inventory       |   |       |       |       |
| Inventory Turnover Rate | >6<br>(2001 Digest<br>average was<br>9.3) | 8.7   | 8.4   | ?     |

## Discussion

1. Calculate ITOR for ABC Pharmacy for 2001. What does the ITOR ratio tell you?
2. How is the pharmacy business doing with respect to inventory control?
3. What recommendations would you recommend to improve inventory control?