# Managing the Pharmacy Inventory

Efficient Inventory Management (EIM) is essential to the profitability of your pharmacy. Don't let profit sit on your shelves or expensive brand name drugs go out of date due to improper inventory levels. Inventory is the amount of stock or merchandise that is available for sale to present and future clientele. Adequate inventory is generally defined as basic stock + safety stock. Too much inventory is a major cause for insufficient cash flow. You'll have to tap into your credit line or pump more of your own cash into the business to meet financial obligations, especially in the case of the wholesaler and rent payables.

EIM results in better cash flow, good customer service, good relationship with suppliers, good return on investment and accurate prediction of future needs of inventory. Find the right balance between Inventory Turns (IT), Adequate Gross Margin (AGM) and customer services to establish proper inventory levels. This may vary for each pharmacy location. Be careful, for inventory "eats cash" in many different ways. Including, but no limited to, property taxes paid on inventory investment, insurance premiums paid to protect the investment, the cost of capital (most important) and income taxes paid by the pharmacy on reported net income.


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**Managing the Inventory "Speak"**

- Inventory turns - the number of times per year inventory is sold and replaced at cost.
- Procurement costs (ordering costs) - include but are not limited to the costs of placing the order, receiving goods, and processing payment.
- Carrying costs - all costs associated with carrying maintaining inventories.
- Gross Margin Return On Investment (GMROI) – measures the operational profitability of a pharmacy.
- Basic stock - is the amount of inventory carried to meet an average demand level.
- Safety stock - the amount of inventory carried to account for fluctuations in demand and in order cycle times.
- Order cycle time - is the amount of time that elapses between the placement of an order and the receipt of the merchandise.

Slow turning inventory (your greatest capital asset) is sitting on your shelves and is not earning anything for your pharmacy. With pharmacy gross margins nearing 22% as reported in the 2008 NCPA Digest, sponsored by Cardinal Health; it is unacceptable to have money tied up unproductively.

Monitor gross margins along with inventory levels often as your pharmacy's operational profitability depends on adequate gross margins. When you calculate your pharmacy's inventory productivity relative to its gross margins it is known as the Gross Margin Return on Investment (GMROI). Surveyed NCPA members GMROI as measured through financials provided in the 2008 NCPA Digest, sponsored by Cardinal Health was 305%. Don't get too smug though because even with a relatively high GM for prescriptions dispensed, slow turns will tie up capital for too long a time.


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Tip – review inventory levels every quarter to adjust for seasonal dispensing trends in your community.

Tip – Assign and incentivize pharmacy technicians to manage a pharmacy bay for slow movers, short or outdated drugs and return them to manufacturers promptly to free up cash.

Tip – Don't be afraid to ask the patient to assist you in keeping expensive and rarely used drugs off your shelves (i.e. RA or HIV therapy). One pharmacist enlisted her patient to remind her one week before refills were due so the medications could be ordered. Be creative, sometimes a good patient – pharmacist relationship is all it takes to help manage the inventory.

**Pharmacy Inventory Cost = Acquisition Costs + Carrying Costs + Procurement Posts + This Out of Stock (TOS) costs.**

-Acquisition cost is the net amount the pharmacy pays for the product.

-Carrying costs include all costs associated with carrying maintaining inventory. They include such costs as obsolescence (outdates), deterioration, storage, inventory taxes, and insurance. The problem with high carrying costs is the lost opportunity to use the capital invested in inventory elsewhere.

-The **opportunity cost** of any investment is equal to the amount that could have been made by investing in the next-best alternative of comparable risk.

Carrying costs are usually expressed as a percentage of average inventory value. Most sources estimate annual carrying costs to be between 20% and 30%. So, for a pharmacy with an inventory valued at SR 225,000 inventory-carrying costs would amount to SR 45,000 to 67,500 per year.

-Procurement costs (ordering costs) are costs associated with actually ordering and receiving goods. They include the costs of placing the order, receiving goods, and processing payment.

Tip – improved procurement/ordering technology and next day deliveries should limit the size of orders and keep carrying costs down


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-This Out of Stock (TOS) costs are the costs associated with being out of an item a customer needs or wants. The size of TOS costs are difficult to estimate. At minimum they represent the embarrassment and frustration of explaining to a customer or prescriber that the pharmacy is out of what is needed. At maximum they represent the cost of losing all of a customer's future purchases or, in the case of **life-saving** emergency drugs, causing **physical harm** to the patient.

Final Tip – all wholesalers are not alike. Monitor the order cycle time carefully because big fluctuations in order cycle times often cause pharmacies to stock more inventory than desired. To limit TOS further see if the wholesaler will deliver twice a day.

I can't say it any clearer than this, control the inventory which represents the pharmacists biggest investment or face business failure.

**Suggestions on managing inventory are for discussion purposes only. Contact a qualified professional to manage inventory in a manner that addresses your individual or business requirements. IN NO EVENT SHALL NCPA OR ITS AGENTS OR OFFICERS BE LIABLE FOR ANY DAMAGES WHATSOEVER (INCLUDING, WITHOUT LIMITATION, DAMAGES FOR LOSS OF PROFITS, BUSINESS INTERRUPTION, LOSS OF INFORMATION) ARISING OUT OF THE USE OF OR INABILITY TO USE THE INFORMATION PROVIDED.**


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