Johnston Rorke partner in charge of pharmacy services and AIPM Fellow Bruce Annabel

JOHNSTON RORKE JR
PHARMACY SERVICES

Mining for gold

PHARMACY product purchase costs won't fall in a meaningful way until the 'Bullwhip Effect' inherent in the industry's supply chain is ameliorated.

Dr Naren Agrawal of the Retail Management Institute, Santa Clara University explained to me this is the reason Australian pharmacy industry supply chain costs are high. The 'Bullwhip Effect' is the variance amplification that runs throughout the chain commencing at the retailer end. Variances occur in both over stocking (high cost) and under stocking (lost sales and customers), increased product costs and increased transport costs.

For example, freighting a product from supplier to retailer costs pharmacy about four times what it does Woolworths, not to mention Woolworths' product purchase costs being approximately 20 per cent less than pharmacy's.

Woolworths has excellent systems and co-operates with suppliers through data sharing and data interfaces to produce gold for retailer and supplier every day.

In its 2006 Annual Report, Woolworths claimed that Project Refresh had delivered cost savings amounting to 4.51 per cent of sales during the 2005/06 financial year and 'cumulative saving over the last seven years of $5.3bn'. Eighty-seven per cent of the savings were passed on to customers in as lower prices.

In the meantime pharmacy loses market share to grocery in open selling healthcare categories. Ten of the top 20 fastest growing grocery categories in the last two years were healthcare lines.

The reasons for the high costs in pharmacy are not entirely any party's fault because manufacturer, wholesaler and retailer are doing their own thing as best they can with purely their own objectives in mind. There is no cooperation over the total supply chain to achieve efficiencies and savings for all parties and the revolutionary improvement so desperately needed across the industry cannot commence.

Add to that the problem of high fixed costs the pharmacy industry continues to suffer with three mainstream wholesalers and a recent entrant—all with their own infrastructure costs, warehouses, trucks, etc. Rationalisation, merger or strategic alliances are essential if these duplicated costs are to be brought down.

...the Federal Government insists on policies aimed at savagely cutting PBS dispensing remuneration while...not permitting industry rationalisation which would drive down fixed costs

Compare that with the USA with a population of about 300 million where there are only two major pharmacy wholesalers. Also, Woolworths, with triple the turnover of pharmacy, has 11 distribution centres compared with the 70 or so warehouses used by the wholesalers plus groups meaning the economies of scale enjoyed by Woolworths are not available to community pharmacy. Yet the Federal Government insists on policies aimed at savagely cutting PBS dispensing remuneration while, at the same time, not permitting industry rationalisation which would drive down fixed costs.

While the duplicated industry infrastructure costs are a drag on product supply costs, even if these were reduced we are still left with the 'Bullwhip Effect' that will keep costs unnecessarily high.

Here are the reasons why:

1. Pharmacy pricing is characterised by high-low pricing (discounting) that leads to major fluctuations in order and sales volumes.
2. The bulk deal is still encouraged by many suppliers and wholesalers instead of an 'every day low price' based on a consistent predictable discount. Pharmacists magnify the problem by encouraging bulk deals, believing they save money when, in fact, it's costing them in other areas.
3. POS Min-Max reorder points are rarely used to order product or are incorrect and result in both over- and under-stocking creating lost sales, low stock returns plus confusion down the supply chain.
4. POS data is unreliable because owners aren't interested.
5. Pharmacy continues to be dominated by suppliers resulting in a product-push approach to merchandise selection, instead of combining with customer demand. That means pharmacies are order focused (getting product into the store) instead of sales focused, allowing improved demand forecasting.
6. There is no collaboration or co-operation between supply chain members, nor are their objectives aligned.

There are a number of things pharmacy owners should do, including:

1. Improve integrity of POS data.
2. Identify the good and bad sellers.
3. Find out which data is 'gold' and enhance the store offer.
4. Banner members agree on a plan to improve the offer.
5. Raise the subject of developing IT connectivity.
6. Be prepared to share your store's data with suppliers for the benefit of all.
7. Employ the skills.

It's time for pharmacy owners to stop paying lip service to this subject and stop making the usual range of excuses about why they can't or won't address the subject of data.

Go mining and find the gold. Your future depends on it.

Retail Trends: (Source: Australian Centre For Retail Studies—Retail Trends June 2006)

Retail Sales: August 2006 versus August 2005:

Total retail sales—Australia (all retailers)	5.6%
Pharmaceutical, cosmetic and toiletry	15.2% (recovery continues)

Reflects consumers spending tax cuts.
Growth expected to soften due to interest rates.

JR.bizlink