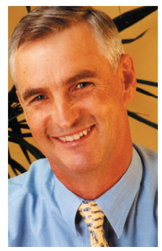

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Secure your business today

'Ultimately, the future direction of Australian [pharmacy] retailing will be determined by four major forces: changing consumer needs and preferences, changing Government policies and regulations, changing competitive structures, and changing technology.'[1]

INDUSTRY financial and individual business risk rapidly increases as debt levels and loan servicing outgoings continue to grow. Consequently there's less and less 'freeboard' available for individual pharmacies and the industry at large in which to absorb any further commercial hits dished out by:

- **government;**
- **changes in consumer behaviour;**
- **increased competitive pressures from lowest price pharmacy warehouses and supermarkets;**
- **different pharmacy supply channels afforded through technological changes; and**
- **the interest rate hikes expected later this year.**

The precarious financial position of pharmacies is graphically demonstrated by data extracted from the JR 2006 client base benchmark series:

1. **On average 50c of every $1 invested in assets is financed by long-term bank debt and the proportion is rapidly increasing each year.**
2. **Eighty per cent, or more, of new debt relates to goodwill and not 'hard' assets.**
3. **Resultant interest as a proportion of net profit before interest and tax (EBIT) has increased to 30 per cent!**
4. **After income tax and principal loan repayments only 14 per cent remains available for other purposes such as business re-investment, expansion, experimentation, 'freeboard' to absorb any of the hits mentioned above and proprietor drawings. Put another way, an average of only 1.2 per cent of sales remains left over which means absolutely nothing can go wrong.**

However, my greatest concern is that there's very little left over to invest in fixing the retail offer so community pharmacy can compete and grow net profit.

Withering surplus

A maxim of business is that surplus funds should be reinvested every year. This is to enable continuous business improvement and the development of new sources of profits for the future to replace diminishing PBS profits due to future government 'clawback' reforms, increasing competition, changes in consumer behaviour, new technology and so on.

The above figures demonstrate that community pharmacy's surplus funds have almost all gone into servicing huge debt levels. This leaves a question mark over the financial health of individual businesses and, perhaps, the industry at large.

If we look at Tesco (English supermarket company expanding worldwide) and Australia's Woolworths and compare the interest each paid in the 05/06 year, we find that as a proportion of pre-interest profits, they were 9.7 per cent and 15 per cent respectively. Neither has exceeded 15 per cent during the past five years.

That, combined with a strong asset base, has left significant capacity to invest in new store openings, experiment with new concept stores, improved in-store refits, IT and, of course, the huge investment in supply chain improvement. These initiatives made those companies even stronger in terms of increasing customer value, competitiveness, lowering product and overhead costs and growing the share price.

The Guild/Government Agreements continue to secure ownership regulation and profitable PBS dispensing. But these Agreements can't secure the customer base for individual pharmacies because consumers are interested in the competitiveness of the store offer compared with other retailers. The quality of the customer offer is up to the owners and their staff. As most retail offers in pharmacy are irrelevant to consumers, quick action is required in order to compete, reduce business risk and survive in the medium-to-long term.

High debt servicing

There are various reasons why owners aren't facing up to the necessary changes. And this includes the very high debt servicing requirements referred to above. So the status quo remains—a very dangerous situation for owners and the wider pharmacy industry.

Pharmacy owners must face up to revolutionising their business models to generate income from the retail space and leverage the script traffic. The 14 per cent surplus funds available from profits each year (as mentioned above) must be very carefully allocated to revitalise the retail offer.

With the latest PBS-legislated changes, the Guild has delivered its members with a window of opportunity—another four to five years for owners to make those necessary changes.

According to the PriceWaterhouseCoopers' *Retail and Consumer Outlook 2007*: 'Who emerges as the biggest winners and losers will depend on how participants manage and respond to the new conditions. However, one thing is for sure: there will be less money to go around as the Government seeks to rein in the long-term cost of healthcare.'

So if you wait until it's obvious that you need to fix your store's retail offer, then you will be too late. To secure a profitable future you must start today.

1. Gen Y Considerations for the Retail Industry. Australian Centre for Retail Studies. Retail Therapy. June 2007:1. ■