The growth imperative:

preparing for a changing tide in pharmacy profitability

BY BRUCE ANNABEL*

The future for the majority of pharmacies is in the hands of others unless they develop a coherent and relevant plan for growth.

I write this because, among the many pharmacy owners I meet, very few appear to truly understand the tide-like impact that PBS reforms such as weighted average disclosed pricing (WADP) and the changing paradigm in consumer behaviour will have on their businesses. And there are even fewer who appear to have taken appropriate steps to protect their businesses from the resulting and inevitable stagnation of profitability and growth.

My concerns were further validated following calculations I completed that demonstrate nil growth in the average income per script between now and the year ending 30 June 2015 (see Table One).

Many might discount this strong view because they're achieving strong returns on generics. Indeed, based on a variety of data including JR Pharmacy Services' clients, the average pharmacy now receives gross profit dollars per PBS script of about $14 on average compared with $10 five years ago.

With that sort of profit increase it is not surprising that pursuing growth strategies is not the top of everyone's agenda. This kind of growth has been simple to achieve purely by maximising generics buying discounts and substituting the originator brand.

However, the tide-like impact I wrote about above will be more like a tsunami for many pharmacies when taking into account the changing paradigm in consumer behaviour.

So let's take a closer look at the key challenges and why pharmacists should care about the impact of these challenges to their businesses.

WADP WILL REDUCE GENERIC $s

As mentioned above, because of the WADP generics measure, combined with further price cuts agreed to in a memorandum of understanding (MOU) between Medicines Australia (MA) and the Federal Government, the average income per script now compared with year ending 30 June 2015 is expected to be the same.

Between now and then it can be expected to grow because major drug patent expiries, such as Crestor and Lipitor, provide pharmacies with additional generics discounts.

This is a dangerous period for many pharmacy owners who might feel their comfort levels reinforced by this potential growth because the 'windfall' will be offset to some extent by 2011 and 2012 price cuts agreed to in the MOU that will impact principally upon generic deals.

Yet four or so years from now, pharmacies will see the Crestor and Lipitor generic largesse pulled back by the price disclosure mechanism beefed up in the MA deal.

Table One shows the increase/(decrease) in PBS dispensing gross profit dollars, between year ended 30 June 2010 and year ending 30 June 2015, for four different types of pharmacies (it assumes no growth in script numbers, S2 and S3 and retail, while retail margins are held at current levels).

TABLE ONE: **PBS dispensing gross profit dollars across typical pharmacy models**

Pharmacy[1]	2010 v 2015 GP$ growth[3]	Overheads increase[4]	Net profit Impact[5]	Rx growth break even[6]
City suburban strip	$30,000	$139,000	($109,000)	4.1%
City shopping centre	$72,000	$390,000	($318,000)	4.0%
Regional strip	$84,000	$240,000	($156,000)	3.1%
Rural/provincial[2]	($14,000)	$199,000	($213,000)	3.8%

1. Pharmacies selected from the JR Pharmacy Services client base.
2. Rural/provincial pharmacy substitution rate of 95% is at maximum now.
3. Factors in increasing substitution rate for existing generics, MA price cuts 2011 and 2012, wholesaler trading terms reduction and modeled price reductions caused by price disclosure rules.
4. 2009/10 financial year overheads increase by only 3% pa.
5. Represents between 33% and 50% of 2009/10 pharmacy total net profit.
6. Required prescription growth rate each year for five years compounded to ensure net profit does not fall during the next five years.

Therefore, unlike recent years, generics will not be there to rescue traditional community pharmacy bottom lines from falling customer and script volumes while overheads, as usual, continue to grow (particularly wages and rent).

And let's not forget: when profit falls so does cashflow—the lifeblood of any pharmacy business—particularly for those with large bank debt obligations.

Critically, lower profitability usually equates to lower pharmacy values and the value of the four pharmacies from Table One would fall by between $680,000 and $1,987,500 by changing nothing and not adopting a real growth plan.

So it's obvious that pharmacies should do whatever they reasonably can to continue to lift substitution rates without causing customer confusion or concern. But in the meantime, before the tide becomes a tsunami, pharmacies should aim for growth and begin implementing the backup plan. And this should happen right now! Becoming dependant on generics as the only profit strategy will end in fast-falling profitability and viability as my calculations demonstrate in Table One.

ATTRACTING CUSTOMERS

The other significant factor is shifting consumer behaviour and the impact this has on the market place. Although calculations in Table One assumes those pharmacies won't lose any business during the next five years, the reality is all but one of them has been slowly losing consumers, scripts and sales during the last two years.

Only a real growth plan will help achieve the required script volume growth of 3.1–4.1% per year for five years to cover rising overheads. And such a plan must offer consumers with reasons to come that are not price-based.

The starting point is understanding consumer behavior.

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The latest Australian Retailers Association Consumer Spending Confidence Report dated August 2010 suggests likely future consumer trends and the key elements of the survey results relevant to pharmacy are:[1]

- **61% of respondents are uncertain about the times ahead and 65% agreed that saving was more important than spending (hence the growing level of trading bank deposits);**
- **55% shop at a different store based on price rather than convenience;**
- **52% spent a lot of time researching prices online before buying;**
- **only 25% shopped online whenever possible and these were younger than 35 years;**
- **over past 12 months respondents reduced their spending across all retail categories;**
- **three-quarters report that over the next 12 months they would try to spend less or seek out sales or cut their spending drastically;**
- **over the last 12 months 34% reduced their spending on gifts and little will change in the next 12 months;**
- **OTC medications and vitamins should see little change during the next 12 months although an interest rate increase will likely lead to a significant reduction in spending;**
- **prescription medication spending will likely be maintained although there would be a minor drop in the event of interest rates increasing.**

And the rise of the mobile internet (smart phones/iPhones) means customers can research anything anytime and anywhere it suits them. Not surprisingly, smart retailers, including one warehouse pharmacy group, are extending their web systems with iPhone capability and advertising opportunities are developing.

And from *The Australian Financial Review* last month: 'Earlier this year PWC predicted the mobile online ad market in Australia would grow from $14m in 2009 to $26m this year and $219m in 2014.'[2]

These findings all add up to:

- **cautious and risk-averse customer looking to maximise their dollar spend;**
- **opportunity for low-price retailers—supermarkets and warehouse;**
- **online opportunity promoting what the pharmacy stands for plus an interactive service offer increasing convenience;**
- **new retailer/customer touch points that increase competitiveness of those who embrace them;**
- **achieving growth won't happen just by being there.**

So, assuming PBS script volumes grow at an average of 2.3% per annum during the course of Fifth Community Pharmacy Agreement (5CPA), how will your pharmacy secure it's share or even better?

Traditional community pharmacies will have to work not harder but smarter to attract and keep customers using new strategies that customers care a lot about.

CRYSTAL BALL

Fortunately the 5CPA, combined with the MA deal with the Federal Government, has provided pharmacy with a 'crystal ball' view of the future and time. But pharmacies have to want to look into the 'crystal ball' and not rely on the old ways of doing things, or rely on what others say about your pharmacy. The bottom line is that no-one else is as interested in your own pharmacy's bottom line than you!

There are three-to-four years available to get the real growth plan firmly entrenched and delivering growth well before the big price cuts kick in during 2013/14 and 2014/15 financial years. But it means starting now as going for real growth is today's imperative if community pharmacy is to remain relevant and financially viable. ■

1. Australian Retailers Association Consumer Spending Confidence Report August 2010 pages 7, 8, 9, 15, 16, 33, 40, 41.
2. Shoebridge N. 30 Seconds. Aust Fin Review; 4 Oct 2010; p41.

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What is 'real growth'?

Generating 'real growth' is vital to the relevance and financial viability of traditional community pharmacies. This is because warehouse pharmacies and the 'copy cats' are driving low prices and there is an over reliance on dispensing sales and generics largesse by the great majority of community pharmacies.

What I mean by 'real growth' is achieving sales and net profit (EBIT) growth delivered through growing:

- **customer numbers;**
- **script numbers;**
- **average retail (non Rx) sale per customer; and**
- **gross profit dollars faster than growth of overhead dollars.**

Last month I suggested in my regular AJP column, Retail Management, that the age-old traditional pharmacy growth strategies of lowering prices, catalogue promotions and even convenience are no longer enough to guarantee growth and certainly not profitable growth for the majority.

To achieve 'real growth' a robust and coherent customer focused strategic plan is required for each and every pharmacy comprising thought through strategies by you, the owner, and key staff. The elements of such a plan I have been writing about in this column for over eight years, discussing with clients and speaking about in conference presentations.

YOUR SAY

Couple evidence with sensible clinical reasoning

Editor,

I write in response to clinical updates offered within the emailed newsletter, *AJP on Friday*, by Professor Peter Carroll on complementary medicines.

It's time to recognise that pharmacy customers no longer believe all natural medicines are safe and they expect pharmacists to give them advice about the safety and effectiveness of complementary medicines.

A recently published survey confirmed that most pharmacy customers recognise there are associated risks with natural medicines while most people using them also feel they are effective.[1] As with all clinical decisions, the risks must be weighed against potential benefits to give customers the best healthcare advice.

As healthcare professionals, it is therefore imperative that pharmacists have accurate, up-to-date information about efficacy and safety issues relating to popular OTC complementary medicines. While Professor Carroll drew attention to some of the possible safety issues associated with herbal medicines, it must be pointed out there was no mention that the incidence of black cohosh inducing hepatoxicity is rare, as is allergy to echinacea.[2–4] This is important information as it helps pharmacists to put these facts into perspective.

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