BUSINESS

FEATURE | BANNER GROUPS

The banner group question

KEY POINTS

- The decision to take on a franchise must not be taken lightly because it is difficult and expensive to unwind.
- The best performing franchisees are those where the owner is engaged in the day-to-day process and operations of the pharmacy.
- The five key elements of niche retailers—location, communication, product, people, value proposition—should be considered when deciding whether to join a group or not.

TO JOIN A BANNER GROUP OR NOT—THAT IS A QUESTION ASKED BY MANY PROSPECTIVE AND CURRENT PHARMACY OWNERS, REPORTS **NORMAN THURECHT.***

Last month my JR Pharmacy Services business partner Mark Nicholson highlighted the need for owners to balance their values and vision for their pharmacy with the actual business model that they operate.

More than half of pharmacies in Australia are run independent of the numerous banners (franchises) that have significant presence throughout Australia. There are, however, more and more pharmacy names popping up throughout Australia with groups of owners believing they can deliver the services of other franchises for less cost and/or superior execution. The proof of this will ultimately be borne out via the customer/patient outcomes and pharmacy financial outcomes.

The Australian pharmacy franchise model cannot operate as a true franchise because the control of the store operations resides with the pharmacist and the franchisor cannot derive fees from the sales income of pharmacies because of the pecuniary interest rules. This contrasts to other franchise systems where the control resides with the franchisor and fees earned by the franchisor are commensurate with the revenues of the franchisee.

This quasi franchise model in pharmacy presents complications for both the pharmacy owner and franchisor alike. Therefore, the opportunity to take on a franchise must not be taken lightly because it is very difficult and expensive to unwind in the future.

In the March issue, Mark pointed out that no pharmacy franchise system in Australia is a 'turn-key' solution in itself. Each franchise system is subtly different with the best performing franchisees being those where the owner is engaged in the day-to-day processes and operations of the pharmacy. In other words, the franchisee in these cases uses the banner to bring the customer to the pharmacy door and then it is up to them to maximise the opportunity with the customer. There are differing levels of compliance to the models. Table One outlines the main franchise brands in the market and those that replied to a questionnaire forwarded by the *AJP*.

No longer is it possible for community pharmacy to be everything to everyone. We also know that the profitability of dispensing medicines will decline with the ongoing price disclosure. Therefore, understanding who your competition is, what your customer looks like and which franchise is most attractive to that customer demographic is vital because it is no longer the script but the customer that will drive profit.

So the question becomes 'To join a banner or not?' In answering this key question, I have focused on the five key attributes that niche retailers must use to differentiate themselves in the pursuit of customer attraction and retention.

LOCATION

Each of the pharmacy franchise models available in the market today rely heavily on the franchisee location being in the most convenient location, whether that be near the supermarket, medical centre and/or other convenience retailers. The best performing pharmacies are the most convenient for customers, highlighting community pharmacy is not a destination retailer. The downside of being conveniently located is that the rent per square metre (sqm) is often higher than other retailers.

Available space will force you to consider or eliminate franchise options—some will not work in a larger space while others need larger space formats to stock the entire range of the brand.

Size therefore does matter, but big is not necessarily beautiful. The more space a pharmacy has, theoretically the higher the retail sales should be. If you are not interested in retail sales outside of the health and wellness categories in pharmacy, larger format pharmacies may not suit you nor make any profit.

Further, the cost of larger space is more than higher rent. The additional labour costs can suffocate profit while more slower moving stock will also shrink returns. The key is sales per sqm. However, if competition is low and rent not excessive, owners can enjoy above-average sales per sqm and stronger than average returns to the owner. However, if competition and rents are higher than average, the return for the owner can be lower than average and extremely difficult to alter.

Priceline, Terry White and Amcal Max are examples of franchises

Table One: Franchise compliance

Franchise	Terry White Chemists	Chemmart	Amcal Max	Amcal	Guardian	Priceline	Soul Pattison	Pharmacist Advice	Discount Drug Stores
Wholesaler owned	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No
Preferred Wholesaler	Symbion	Symbion	Sigma	Sigma	Sigma	API	API	API	API

that generally have larger space requirements to house the complete offer (ie. greater than 300sqm). Returns in these franchises vary greatly because of the previously mentioned metrics. I am however aware that Terry White Chemists recently hatched a 'neighbourhood' model which suits a smaller footprint which will aid their growth and strip pharmacies looking for alternative banners.

Included in the assessment of location should be the in-store layout and its accessibility/usability by customers. From Table One, Chemmart, Amcal, Guardian and Pharmacists Advice do not have a grid-like layout and generally have gondola heights of 1.2 metres with easy sightlines enabling these formats to work in smaller formats (ie. between 120–250sqm) where overheads can usually be better controlled.

Size therefore does matter, but big is not necessarily beautiful.

It is imperative to avoid bottlenecks in all layouts and ensure customer traffic flows. Failure to address these areas will limit sales. Franchisors engage designers to assist with the consistent look and feel of bannered stores. However, as the franchisee, you should not abdicate your leadership role here and ensure your best interests are served. An example would be taking on modern and efficient dispensary layout to gain effectiveness in the dispensary with the changing profitability model.

PEOPLE

The difference between success and failure is often the culture of management and staff within a pharmacy. A key component of the environment is highly skilled staff.

While it is not incumbent on the franchisor to provide all training to the staff of the franchisee, each of the franchise operators in the market provide varying levels of training and assistance to franchisee staff, either through online or face-to-face programs. The level of training is directly proportional to the franchisors attempts to make the banner compliant across all locations. Each franchise provides new franchisees 'induction' support to ensure a smooth transition into the new brand. The effectiveness of the training is dependent on the owner's commitment to implement.

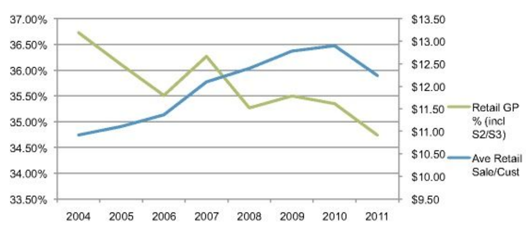
For example, Terry White Chemists, Priceline, Discount Drug Stores and Chemmart have online training academies which are stepped and generally provide significant contributions towards obtaining the annual continuing professional development requirements for owners and staff. Topics include employee induction, people management, self development and managing customer health conditions. This is a great way to formally manage staff progression within the pharmacy.

Based on my brief review of each of the programs, it appears to me that the focus on customer service, delivering services and focusing on the increased average retail sale per customer is not given enough emphasis in any of the training offerings.

Figure One is based on JR client base averages for the 2004–2011 financial years inclusive. It includes both bannered and independent pharmacies. While the blue line is average retail sale per customer, there are many bannered pharmacies pharmacy's achieving below average results. This highlights that there is either not enough emphasis provided to the franchisees on how to increase the sale per customer or, if it is provided, it is poorly executed within the pharmacy because of a pure product or transactional focus. This therefore causes the customer to have no 'real' reason to stay/return.

To take on a banner in order to drive customer traffic to the pharmacy, use that opportunity with the customer to leverage the dispensary skill sets, increase average retail sales per

FIGURE ONE: **Retail margins and ave retail sales**



Both internal and external communication must match the group values and promises.

customer and provide services to them which will, in turn, drive revenue per customer. Merely overlaying a banner on an existing pharmacy and not embracing the training/change management will almost guarantee below average performance compared to like-bannered pharmacies.

COMMUNICATION

Communication with the customer is critical. Both internal and external communication must match the group values and promises.

A major reason for declining retail margins in pharmacy (outlined in the graph above) is because most of any pharmacy's communication (marketing) is based solely on product at a price, generally in the form of catalogues. This helps to perpetuate the transactional environment for customers, versus the customer-focused experiential environment which can attract more spending within the pharmacy by focusing on desired health outcomes instead of product at a price.

Catalogue marketing has a place but they are not profit-generating activities. Therefore, when considering a franchise for your pharmacy, owners and managers need to consider how to use the brand's local area marketing support to differentiate their pharmacy on something other than product at a price.

In my letterbox each month I get four bannered pharmacy catalogues and two warehouse pharmacy catalogues. They generally arrive at the same time and, while comparing prices like many recipients, I note that there is no significant difference (which is why the decline in retail margins has occurred—see Figure One). This type of marketing is driving the customer to adjust their buying behaviour and encourages them to only shop in certain pharmacies when items are on sale, unless they are the most convenient pharmacy for them.

Customers are less 'loyal' to one pharmacy than in the past. Reasons for this include:

- **customer needs differ at different times during any given month;**
- **customers are generally convenience-driven when using pharmacy and so are happy to go to the nearest at the time of need; and**
- **customers will travel once a month to shop at a warehouse-style pharmacy on the basis that there are significant savings on regular items. They will, however, 'top-up' on these items elsewhere if needed out of convenience.**

Many franchisors connect the catalogue marketing with a loyalty program which is designed to retain customer loyalty to their brand/pharmacy. Priceline, for example, does this well with one of the largest loyalty membership bases in the country involving 3.7 million members. A loyalty card, however, is only as good as the data each store receives relating to their particular customers and how that information is used.

The advent of internet shopping has also had an impact on communication. Convenience pharmacy retailers (or any business for that matter) cannot ignore the retail internet experience. When considering joining a franchise, ask what internet services are offered to customers. The four options are:

1. **Yellow pages-style store locators/details.**
2. **Bannered website with information about condition and products,**

coupled with store locations and opening hours;

3. **Bannered website with the features of the first two points, but an option for customers to buy online and pick-up in store, thus allowing the franchisee to still obtain the sale from their defined market area and interact with the customer on their condition and purchase (transactional).**
4. **A full web experience where the products are delivered direct to the customer from the warehouse of the franchisor.**

The last option stands to offend the franchisee because sales are taken out of the franchisees trade area and offer little-to-no opportunity for the franchisee to interact with the customer.

A common issue for franchisor internet sites is the need for consistent pricing and control of supply (or making sure each store is in stock). It is up to the franchisee to embrace the brand's web offer if they intend to be a long-term member of the brand.

Discount Drug Stores has embarked on the third option above using the Pharmacy4U platform, so each store has its own website for the convenience of their local customer. Terry White Chemists will launch their offer later this year, but it will be a blend of points 3 and 4 above.

While total internet-based sales will only be 5–10% of total sales, it is another touch-point for your customers to interact with you and the banner.

PRODUCT

All pharmacy groups operate in a homogenous product environment. There are some exceptions to this such as Tony Ferguson Weight Loss in Terry White Chemists.

The meal replacement shake was not a new phenomenon in 2006 when it hit Terry White pharmacies. The specialised process and program wrapped around the product are what set it apart from just selling the shake.

There are, of course, other products and categories in pharmacy that could and do benefit from processes and programs to engage the customer and ensure their return visit. Examples of this include Chemmart's sleep apnoea category. The results through the membership base are patchy, which is due to each member's readiness to engage customer on this condition.

To become a health destination you must look like one. The core categories that contribute to the profit in pharmacy are those that require higher levels of service/engagement around health (Schedules, medicines etc). The large majority of front shop categories found in the pharmacy do not contribute to profit and are not contributing to the health destination.

Therefore, in making the decision to brand, look beyond the usual categories that can be found in every pharmacy throughout the country and understand what the banner is doing with those products to engage customers on a solution to their health needs/wants/problem.

VALUE PROPOSITION

Understanding what the customer wants is one of the most significant yet difficult issues facing pharmacy. Customers see value in two ways:

1. **Decreased price; or**
2. **Increased benefit where benefit is a combination of quality, service/s and health outcome.**

Whether deciding to banner your pharmacy or not, the above equation must be analysed in an attempt to attract customers. To date, most pharmacies have relied on convenience and regulation to attract customers.

When faced with heightened competition, most pharmacies respond by reducing prices in order to try and retain customers. However, the more correct response should be to lift service levels and services to improve the value to the customer.

When reviewing the different franchise offers, understanding which elements of the value equation stand it apart from the competition and how they use this to attract customers to your pharmacy is key.

THE ALTERNATIVE

There is a place in some markets for an 'everyday low price' model for pharmacy. We see some of these models offer franchise systems to pharmacy owners in order for the owner to compete in their own market. Examples of these include Goodprice Pharmacy, Cincotta's and Pharmacy4Less. While Chemist Warehouse does not have a franchise model, it does have junior equity participants in some locations.

Often owners get caught up in the 'bright lights' of the deep discount model without understanding the true operating metrics of a business like this. With significantly lower margins than others, the business must have significantly lower operating costs to make a profit.

While focusing on the same five key elements of niche retailers are important for these types of models, the background systems, logistics and supplier relationships are more important—you therefore need scale to make the model profitable.

CONCLUSION

Deciding to join a franchise is not easy. The five key elements of niche retailers must be considered and you must 'win' (beat your competition) on at least three of them from the customer's point of view, to make the customer choose you over anyone else.

Each franchise has its idiosyncrasies and the most profitable franchisees take what the franchisor offers, implements the programs and processes with superb execution using all resources available to them.

Balancing the interests of the franchisor with the pharmacy owner can cause conflict because the success of the franchisor is not inextricably linked to the success of the franchisee.

Therefore, independent pharmacists often use many of the systems and processes available on the open market (similar to those used in franchised pharmacies) to help them operate their un-bannered pharmacy in their local areas.

They can be very profitable in their own right but, depending on location and competition, a banner can often attract more customers that they may otherwise not see.

Questions to ask yourself when considering a banner change include:

1. **Will the franchise bring more customers than I already have?**
2. **What GP% will I achieve if I am a compliant member of this franchise?**
3. **What will my overheads look like and, therefore, what are the break-even sales required before profit is made? Overheads would include cost of joining, annual fees marketing costs and amortisation of fit-out costs.**
4. **What IT platform (including dispensary and point-of-sale systems) do they use/recommend?**
5. **Do they control pricing and stock order quantities?**
6. **What is the average retail sale per customer and how can you achieve higher than this?**

The franchisor must be able to articulate their plans for the next five years to continue to engage customers on something other than product at a price. With heightened competition in the pharmacy channel and reducing profitability in the dispensary due to continued price disclosure, the key to success will be generating more customer visits and more sales once in store.

You must decide whether you can go it alone or would be better with the support of a recognised banner. ■

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