Fool's gold and changing metrics

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W Edwards Deming said 'In God we trust; all others bring data', which certainly is relevant to community pharmacy—now more than ever and, in particular, from 1 April 2012.

BACKGROUND

According to the JR Pharmacy 2011 client series, about half of community pharmacy net profits (before interest and tax) are generated by supplier discounts, generic and wholesaler.

Pursuant to the Memorandum of Understanding (MoU) on 1 April 2012 there will be a cut of a minimum of 23% (weighted average) applied to all F2 drugs not currently in a price disclosure cycle. While we won't find out the extent of the cut until early next year my early ball park calculations indicate something between 80c and $1.20 per script (all scripts).

However, on the flip side the Lipitor patent expires in May and it's likely we will see new generic atorvastatin brands in the market at about the same time as the April cuts. After the mandated 16% ex-manufacturer price cut, the heightened discounts available may offset the aforementioned cuts.

In total there is about $1.2bn, dispensed value, of patents expiring in the 2012 calendar year and Lipitor will contribute about two thirds of this.

APRIL 2012

In summary, based on my estimates and assumptions community pharmacy for the 12 months commencing 1 April 2012 may see a net uplift in gross profit dollars of about 60c after taking into account the cuts offset by the new generic discounts flooding into the market.

So it seems to me pharmacy owners have little to fear in net profit terms from the 1 April 2012 cuts.

CHANGING DISPENSE METRICS

2012 events will have a significant effect on the metrics owners have become accustomed to as follows:

- **Average dispensed price will fall in 2012, commencing April, due to the 16% price cut automatically applied to the price upon patent expiry. Obviously, the atorvastatin 16% cut, which alone is about 8% of the total PBS/RPBS, will have the biggest impact of all the patents expiring in 2012. The minimum 23% cut applied to the F2 lines will also reduce the average dispensed price. So pharmacy will notice a fall in dispensary sales, on a steady state basis, compared with the previous year.**
- **Gross profit dollars (GP$) per prescription dispensed will increase because of the new generic discount dollars that will be injected.**
- **Dispensary gross profit % will increase significantly resulting from the twin effects of a lower sales base and higher GP $$.**

TABLE ONE: Summary of estimates

	Now	2012 estimate
Av dispensed price	$39.11	$37.40
Gross profit dollars/Rx	$13.33	$14.00
Gross profit %	34.1%	>37%

A summary of my estimates appears in Table One and applies to the total script file.

CHANGING PHARMACY METRICS

Because dispensary represents more than 70% of sales in a typical community pharmacy there will be a flow on effect to the metrics of the whole business. I would like to demonstrate this using a suburban strip pharmacy case study to which I have applied the 2012 changes discussed plus my modelled patent expiry and WADP cuts over the next three years. I assumed the pharmacy will achieve script volume and retail sales growth of 1.5% and 2% pa respectively, there will be no crazy discounting and overheads will grow by 4%, wages, and, other, 3% pa.

A summary of the case study appears in Table Two. Major take outs include:

TABLE TWO: Case study summary

	Current	2011/12	2012/13	2013/14
GP$ per script	$14.33	$14.62	$15.37	$14.82
Dispense GP%	34.53%	34.7%	37.8%	37.4%
Wages/sales %	14.6%	14.8%	15.5%	16.2%
Wages/ GP$ %	42.4%	42.7%	42.1%	44.3%
Net profit/sales	12.6%	12.5%	14.6%	13.3%

- **GP$ per script is now the key and less credence should be placed on GP%.**
- **Rely on wages as a % of total GP$ instead of wages/sales as the better indicator of wages spend. Sticking to wages/sales may lead to some owners fallaciously removing staff hours that will harm service levels and sales.**
- **I assumed in the case study that there will be no WADP deferral strategies so atorvastatin would suffer a big price cut on 1 December 2013. If that materialises the KPIs reported in the table tell us that the pharmacy will begin to see a reduction in net profitability in 2013/14 (almost back to current level) and wages are beginning to blow out.**
- **Don't think the next two calendar years will be normal and look through those years to 2014 and beyond.**

To redress the situation fundamental action will be needed to improve efficiencies and staff productivity if further deterioration is to be avoided. That is why I have been recommending owners start planning and implementing business model changes now.

Therefore, major changes are afoot to metrics and how pharmacies should be managed even though pharmacy bottom lines will be OK for the next two calendar years. It's after that many may regard the generic bonanza as fool's gold and begin to understand what has happened to community pharmacists in almost every country around the world compliments of generic price cutting. ■