



# Innovate today or decline tomorrow

Bruce Annabel, pharmacy business adviser, bannabel@jr.com.au

**The critical ingredient is getting off your butt and doing something. It's as simple as that. A lot of people have ideas, but there are few who decide to do something about them now. Not Tomorrow. Not next week. But today....'<sup>1</sup>**

Last year the average retail sale per customer of traditional community pharmacy was just over \$11. It has increased barely by inflation over the years because the traditional pharmacy model has changed little in respect of the customer offer in both retail and dispensary departments.

Certainly the generics income boom is helping overcome many problematic issues including rising overheads, the out-moded customer offer, script erosion and customers defecting to warehouse pharmacies. Generics will always be important to pharmacy as they are in overseas jurisdictions. Nevertheless, mandatory price disclosure will slash generic supplier discounts in the longer term, just as it has around the world, because pharmacies in these countries lost their way: owners didn't innovate and payers came to see them as a cost centre instead of a value driver.

The Fifth Community Pharmacy Agreement (5CPA) services funding and a supportive government enables a transition from the traditional model that is dying, to a retail healthcare business featuring, and differentiated by, patient outcomes. This opportunity may never come again.

## NO FUTURE WITHOUT INNOVATION

Innovation strategies are aimed at improving competitive effectiveness (attracting new customers and scripts, reducing defections while increasing the average sale) and maintaining or increasing margins.

Unfortunately most pharmacy owners are stuck in the supply practice model and tend to avoid making the necessary innovative changes that would improve competitiveness now and lift long-term sustainability. Paradoxically, now is the time to innovate because the current high generic profits can fund the necessary investment. Because of the Federal Government's price disclosure policy locking generic prices into a downward spiral, the high-margin generics profits won't last so the window to act is now.

The traditional pharmacy innovators (referred to in my August column) are examples of pharmacies that have already transformed to a services and customer health outcome culture. Though very few in number, they have proved the competitive and financial benefits of the 'services' model and are leading lights for the rest of the industry.

Importantly, they changed the total culture of their pharmacies. And I mean the whole pharmacy, including layout and design, merchandise, dispensary, staff attitudes and roles (including requiring pharmacists to engage the customer/patient), quality 'services' (both funded and self-developed), high-level skill sets (particularly additional pharmacists), training, marketing, processes/efficiency and data management.

These pharmacies measure their success in traditional financial ways and, importantly, by improving customer health outcomes rather than just

looking at 'what margin did I make on that sale'. For example, how many gave up smoking, reduced potential for drug misadventure, got off type 2 diabetes medication, are no longer obese and improved medication compliance?

For the doubters or confused, let's acknowledge that the role of 'services' in pharmacy is transformational and not a silo.

Services are a valuable part of your business if you combine them with your other skills so you have something extra and valuable to offer customers. Services help get add-on business in addition to prescriptions generating business through customer engagement and a solution service-oriented approach.<sup>2</sup>

To be clear, I am not saying services income will ever supplant dispensing income; rather it's the addition and combination that counts.

## INACTION LEADS TO DECLINE

Those who choose inaction or prefer the status quo model must realise that such a choice or inaction will be detrimental to the business. In essence, they will be presiding over their own pharmacy's decline.

Here are the key reasons why innovation is essential.

### Competition

Traditional pharmacy today is being out-competed by sophisticated retailers, warehouse pharmacies and supermarkets, all with lowest price merchandise and widest range offers.

Some, including warehouse pharmacy, offer customers social and technology solutions, thus further exposing the pure bricks and mortar pharmacy operator.

### High margin low profit

Pharmacy is a high gross margin and high overhead business averaging, in relation to sales, 34.3% and 25.8% respectively.<sup>3</sup> This leaves only 8.5% (less in shopping centre and aged care)<sup>3</sup> on the bottom line so not much can go wrong as there is very little buffer available to absorb a hit. Such hits are already present in the form of falling retail margins, loss of script volume, higher wages and rent costs, rising interest rates and customers defecting to the sophisticated and lowest-price competition.

A combination of competitive, supplier and government pressures are and will continue to squeeze pharmacy gross margins and sales, and hence long-term profitability. Be assured there will be no let up.

### FATAL RESPONSE

The majority of pharmacy owners and groups have so far responded in a classic short-term and reactive way. They cut prices, fail to replace the lost income and automatically become price takers, an awful place to be. Those who manage to generate new business achieve profitless growth or worse. Most just go backwards a little faster.

Pricing structures are similar across pharmacy groups, regions and city suburbs. This simply reinforces a culture of 'sameness' and acts against the very important retail business principle of developing points of difference. Being a price taker is 'death valley' for community pharmacies unless, in the customer's opinion, something very valuable is added. Yet very few actually do this.

Instead, owners generally cover these losses by more aggressive

generic substitution, forcing higher margin private label over-the-counter lines on customers, cost-cutting and joining buying groups. These short-term actions may appear smart but, in the long term, relying on this approach alone won't reduce the likelihood of long-term decline in viability and competitiveness.

### GENERICIS

Generics are like the law of diminishing returns: 'to continue after a certain level of performance has been reached will result in a decline in effectiveness.'<sup>14</sup>

Dispensary gross profit margin is currently circa 35%. But without wholesaler and generic discounts providing 10% of this, it falls to circa 25% (includes mark-up, dispensing fee and \$1.53 premium free incentive—percentage varies widely depending on the cost profile of drugs dispensed). This is important because we know

the price cuts coming as a result of the Medicines Australia Memorandum of Understanding with the Federal Government (or whatever it morphs into after the Federal Election) will reduce discounts pharmacies receive from the wholesalers and generic suppliers over the next five years, thus impacting dispensary and total pharmacy net profit, which is only 8.5% to begin with. And that's before owner drawings, bank interest, loan repayments and tax.

### DOUBLE BARREL

Not all the discounts will be lost, of course, but those owners who decide to exclusively rely on generics to generate profits will suffer loss of profitability (margin) and continual loss of scripts and customers by not innovating their customer offer.

So the inaction of community pharmacies failing to innovate

by adopting new technologies, competitive business models and new customer 'touch points', will expose them regardless of what happens to dispensary generics profitability.

### WHERE TO NEXT

I hope owners will see how vulnerable their business model is and take steps suggested by me and others to develop a promising commercial future.

Quality pharmacy practice can only be delivered if the business is financially robust, competitively robust and delivered by a robust strategy. The traditional pharmacy model does not possess the last two whereas warehouse pharmacy and supermarkets do! Implementing change via innovative customer-focused strategies, taking into account long-term demands and competitive forces, especially those elaborated upon here, is essential for

traditional community pharmacies to achieve the three levels of robustness.

Remarkably and most fortunately for traditional pharmacy owners, there already exists so many programs, systems, ideas and resources that will deliver all these right now. But reinvention of your community pharmacy will only happen if owners and their teams do it themselves.

Over the many years I have observed and supported community pharmacies, it seems apparent that owners and pharmacists themselves are the greatest barriers to change to any community pharmacy. ■

1. Quote from Nolan Bushnell, a US engineer and entrepreneur who was named one of Newsweek's '50 men who changed America'.
2. A bigger generic elephant might still enter the room. *Australian Pharmacist* 29; Feb 2010: 85–86.
3. JR Pharmacy 2010 client base series.
4. [www.wordnetweb.princeton.edu/perl/webwn](http://www.wordnetweb.princeton.edu/perl/webwn).