Business | **Management**

Manage your 'Wrisk'

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REDUCING YOUR PHARMACY'S RISK TO PBS PRICE CUTS REQUIRES ACTION.

Working out the implications of future WADP (weighted average disclosed pricing) cuts on your pharmacy can offer a sense of how management should deal with it. This article discusses how to understand your particular pharmacy's WADP risk factor (I call it 'Wrisk') and the first steps in managing it.

Community pharmacies place a heavy reliance on the dispensary and dispensary supplier discounts to generate the great majority of their overall pharmacy net profit (EBIT, Earnings Before Interest and Tax). (*Read my past two columns along with this one to gain a full appreciation of the subject*.)

Good news for the dispensary is the failed AstraZeneca legal attempt to hold off Crestor (rosuvastatin) generic competitor brands. These are likely to appear early next month and will add around 60c (depending on specific circumstances) to income (gross profit dollars) generated per script (ie. across all scripts on average) and therefore help offset price cuts during this calendar year and perhaps even next year.

Although this offers pharmacy owners more dollars and time to develop more robust and viable business models, this is not a time for complacency or resting on tradition.

DETERMINE RISK LEVEL

Is your 'Wrisk' manageable or a major threat? Most community pharmacies have very high risk requiring significant adjustment. The first step is to accept this as a fact. Then develop and implement innovations that improve efficiencies and your relationship with the consumer, while generating new revenue streams. Those with debt (interest and principal), which absorbs large chunks of EBIT dollars, have a greater task.

A pharmacy's exposure to PBS price cuts, or its 'Wrisk', is calculated by determining dispensary supplier (generic and wholesaler as both are pressured) discounts and rebates as a percentage of net profit/EBIT. Not all dispensary discounts and rebates will be removed by WADP cuts, but they will be reduced significantly over time.

The resulting metric is an easy calculation, enabling comparisons with other pharmacies and offering a sense of the changes required to reduce risk and improve long-term viability.

Table One summarises JR Pharmacy Services client average discounts/EBIT% by location for year ended 30 June 2012.

Importantly, this data tells us:

- **Pharmacies with a higher EBIT/sales% are less impacted by price cuts regardless of retail/total sales% (which is only one determining element).**
- **Provincial pharmacies with the highest EBIT/sales% have the lowest risk factor due to a combination of higher margins and lower overheads.**
- **Each pharmacy is different requiring an individual calculation. Don't assume your position is the same as the 2012 JR averages.**

Nor is it a matter of turnover size as I know several small pharmacies with strong EBIT/sales%, hence a low risk factor.

Therefore, in working to improve EBIT/sales%, thus reducing the 'Wrisk', owners should focus on the three principal influencers, particularly the first two:

1. Retail/total sales%.
2. Overall gross profit margin%.
3. Overheads/sales%.

I've suggested many innovations and other tactics in this column over the past 11 years to improve all three. However, it's important to emphasise the trap of excessive price discounting that many pharmacies fall into and results in cutting EBIT/sales% and seriously increasing their 'Wrisk'. This approach is unaffordable because it's being funded by short-term generic discounts.

There is a smarter way to compete: adding consumer benefits can justify the maintenance of prices/margins and results in a lower 'Wrisk', as demonstrated by the pharmacies shown in Table Two. Their 'Wrisk' is much lower compared with Table One averages. This is because they avoided discounting after innovating their business models founded on a strategy of providing added customer health benefits.

Now is the time to work out your pharmacy's 'Wrisk' and manage your way to a more robust and less risky future. ■

TABLE ONE: Discounts/EBIT% average by pharmacy location

	Shopping centre	City strip	Provincial/ country	Medical centre	All pharmacy average
Retail/total sales%	38%	30%	33%	17%	33%
Overall GP%	34.7%	35.4%	36.1%	36.9%	35.2%
Overheads/sales%	27%	27.2%	24.5%	25.5%	26.1%
EBIT/sales%	7.7%	8.2%	11.6%	11.4%	9.1%
'Wrisk':					
Discounts/EBIT%	69%	67%	56%	59%	62%

TABLE TWO: Impact of maintaining EBIT/sales% on four pharmacies

	Shopping centre	City strip	City strip	Provincial/ country
Retail/total sales%	46%	30%	33%	25%
Overall GP%	39%	38%	41%	38%
Overheads/sales%	26%	23%	26%	20%
EBIT/sales%	13%	15%	15%	18%
'Wrisk':				
Discounts/EBIT %	45%	37%	37%	33%