PHARMACY JUNE 2010

JRx proficies

Welcome to the Winter edition of JR Proficies

With the 5th Guild Government Agreement now signed and the Government's Memorandum of Understanding deal with Medicines Australia shortly due to go before Parliament many Pharmacy owners have been left wondering what these changes actually mean for their business.

Beyond the regulatory change, price focussed competition for General patient prescriptions on products that can be priced at less than the co-payment is increasing while Warehouse Pharmacies are also starting to eye off the services opportunities connected to the new agreement.

On top of this the general retail environment away from Pharmacy is the worst many can remember. The neverending campaign of Sales in the major chains provides ample evidence of the situation while the newer fitouts of Coles and Woolworths only serve to highlight their ongoing focus on Health and Beauty categories.

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In this edition Bruce provides his summary of the agreements and what they mean for the future, while Norman delves into prescription pricing issues and Ian offers a timely reminder for those who may have the opportunity to vary down their July PAYG instalment.

Clearly, for those Pharmacy businesses who want to maintain or increase their competitiveness into the future, the need for accurate and meaningful data efficiently produced is greater than ever before. It is a timely reminder why we have spent the last decade developing our suite of systems – JR.Bizlink, JR.Spacelink and recently JR.Paylink (our roster planning and costing tool which integrates into payroll systems) – and supporting strategic advice to support you in the ongoing development of your Pharmacy.

Enjoy the enclosed commentary and as always we welcome any feedback. **Please call your JR adviser to discuss anything you would like further information on.**

Mark Nicholson

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Driving Customers Away

Most Pharmacy owners would be acutely aware that the rise of warehouse and discount pharmacies has seen an increase in the number of products used as traffic generators, including both retail and dispensary lines. In fact more and more items normally included on the PBS are being priced at less than the general patient contribution and treated as private scripts by those same pharmacies.

Not that long ago it was only a select list of items that a customer was price conscious of. Now, most items in a warehouse or discount pharmacy catalogue are working there way into a customer's consciousness. These are often referred to as 'known value items" or KVI's.

Take for example a generic 40mg statin listed on some websites for $24.99 vs the PBS contribution price for a general patient of $33.30 or Noten 50mg (30 tablets) that are priced at $6.50 at one of the warehouses, while many pharmacies are still at $15.15.

A retail example is Telfast 180mg packet of 30 tablets at $18.99 at a warehouse while some community pharmacies are pricing them at $35.99. Most customers expect a gap between warehouse and normal retail, but variances of over 20% can lead to permanent customer loss.

Current customer trends

In the current economic environment, we are witnessing a stagnation of customer numbers in community pharmacy. In fact, in some locations customer numbers are down for the first time in years. Certainly the public's purse is under pressure but the reality is people are still spending. They are just being more selective on where they spend.

In any market, these stagnant or negative customer results reflect a perceived indifference by the customer. That is they don't differentiate between retailers who essentially offer the same products where they can't identify a different experience or outcome. As a consequence the customer shifts their spending based solely on price. Examples of shifts to sophisticated warehouse offers outside of pharmacy include Bunnings in hardware and JB Hi-fi in consumer and home electronics.

JR.Spacelink benchmarking is providing us with further evidence of customers shifting away from purchasing general merchandise in pharmacy. The middle health area however is growing and represents an opportunity to become a greater focal point if coupled with the right merchandise, layout and pricing strategy.

The opportunity cost of losing a customer is highlighted as follows:

Average sale per customer including PBS (2010 JR pharmacy ave.)	=	**$37.74**
Average Gross Profit @ 34.31% (2010 JR pharmacy ave.)	=	**$12.94**
Average Customer visits p.a.	=	**14**
Average annual value per customer	=	**$528.36**
Potential annual lost gross profit per customer	=	**$181.28**

And this is the **average** customer – do the sums on losing your best customers !

Price matching may be a justified tactic in some circumstances but will not develop long term customer loyalty. Despite meeting the customer's expectations on one transaction, there can still be a level of discomfort from asking for it and/or the perception can still remain that the pharmacy is expensive. Therefore, it is essential to develop a clearly defined pricing strategy in both the dispensary and front shop that is well understood and can be defended by staff.

While we do not advocate community pharmacies matching discounters (especially when there are increased levels of service/s and convenience) it is clear that discounters are catching many owners napping and winning over new customers far too easily.

Fighting back means monitoring prices and keeping within reasonable parameters, using price as a tactic where appropriate and most importantly providing exceptional service using expert staff (ie Pharmacists) to create a difference that matters to customers.

Please talk to your JR Pharmacy partner about a strategy that is appropriate for you.

Norman Thurecht

Cash Flow Tight? Reducing July's PAYG Instalment ?

Those taxpayers who are part of the PAYG Instalment System will soon be receiving their June PAYG Statement which will be due in July 2010. As you may be aware, you do have the option in certain circumstances to vary the amount of the instalment.

This will most likely be possible if you had a less profitable year in 2010 than 2009. The reason for this is that the tax office calculates your June PAYG Instalment based on your 2009 income. Hence, if you lodged your 2009 tax return in the last 2 months, you may be up for an increased June PAYG instalment compared to previous quarters.

To determine if this option is available to you, consider the following questions:

1. Was your 2009 taxable income significantly higher than usual?
2. Has trading through 2010 been significantly slower than 2009 or have your overheads grown faster than gross profit?
3. Have your investment returns (excluding capital gains/losses) significantly underperformed through 2010 in comparison to 2009?
4. Have you paid additional personal superannuation contributions in 2010 in comparison to 2009?

If you answered yes to the above and are interested in reducing your June PAYG Instalment, it may be worthwhile speaking to your JR accountant. **Note, this should only be done where the reduction in income is expected to be significant as penalties can apply where instalments are reduced beyond reasonable expectations.**

Ian Wessling

5CPA and Govt/MA Memorandum of Understanding

On 3 May 2010 the Guild and Government executed the fifth Community Pharmacy Agreement (5CPA) followed three days later by the Government and Medicines Australia Memorandum of Understanding (MA MOU). Combined they are expected to deliver the Government $2.7bn of savings (including Chemo) over the next five years.

These savings mean 5CPA will maintain the viability of community pharmacy and validate the Government's business model of community pharmacy.

The Guild did a good job negotiating 5CPA under the difficult economic circumstances the world and Australia continues to face.

5CPA – Maintaining the framework

The Government has basically said if you want to keep your ownership and location rules, you have to give up some remuneration. It was an inevitable trade-off although not as painful as might have been expected.

The key elements of 5CPA that maintain the national framework of pharmacy are:

- Maintained location rules
- Mark-ups and fee structures retained
- CSO remains (indexed from 1 August 2011)
- $1.53 premium free fee retained (indexed 1 August)
- New services are THE key feature
- Patient service charter (CMI, offer premium free, counselling, patient compliance)

The 40c PBS online incentive (unindexed fee) was given up along with dispensing fee (currently $6.42) indexation which will resume 1 July 2012.

The cuts will be offset by some growth in Rx volume and generic substitution opportunities such as Clopidogrel. Positively, Plavix does not have a brand price premium attached so will attract the $1.53 premium free fee.

Finally the risk share offset was given up too which some say was a masterstroke.

Opportunity of services

5CPA includes a significant ramp up of services funding, largely the result of the compensation negotiated with the Government to offset some of the MA MOU impacts. These represent significant profit and strategic opportunities for pharmacies.

I say 'strategic' because professional services are a valuable part of your business if you combine them with your other skills so you have something extra & VALUABLE to offer customers.

Services help get add-on business in addition to prescriptions as they generate business through customer engagement. And most importantly a solution service-oriented approach that adds value to the customer's visit **will** help take the focus off price.

A summary of the major services is:

- Diabetes $12m (target low service areas only)
- HMR and RMMR bolstered – $122m
- MUR funded $29m – 2 yr trial (next stage of PMP)
  - In-pharmacy medication use review
- Clinical intervention programmes $97m
- DAA services $132m
- Staged supply $35m
- QCPP gateway – interventions, DAA, staged supply ($339m in total)
  - Patient charter mandatory – assessed with QCPP

QCPP accreditation (including satisfying the patient service charter requirements) permit access to the three programmes outlined. It's important to realise that these are not fee for service but will have two significant features:

1. Profitable
2. Prove pharmacist value in the health care continuum

Total value of these services is $507.9m over five years (plus additional funds for rural, indigenous, eHealth etc.) ie: $20,000 per pharmacy per annum on average. This is significant and those who ignore them will leave the opportunity for others to obtain the competitive benefits in the market place and a greater slice of the funding cake.

MA MOU – Impacts all sectors

There is little doubt the deal done between the Government and Medicines Australia is the real news when it comes to pharmacy dispensing profitability. However, as I write this article, the enabling legislation is stalled in Parliament so the window of getting it through by the 1 October proposed starting date is closing so it may be deferred to next year.

But, be that as it may, here are the key elements:

- Upon patent expiry the price will be cut 16% up from the current 12.5%
- From October 1, 2010 mandatory price disclosure applies to all F2 drugs
- Those F2 drugs not in price disclosure on 30 September 2010 will go into mandatory disclosure on 1 October 2010
  - 1 April 2012 – guaranteed 23% minimum price cut of these drugs
- 1 February 2011 price cuts
  - 2% F2A
  - 5% F2T

Every industry sector is impacted including manufacturers (generic and originator), wholesalers and pharmacy.

The impact on pharmacy will be lower mark up and discount dollars – generic and wholesaler. Critically pharmacists must understand that generic suppliers and wholesalers can't absorb these cuts despite heightened competition as each are limited by their business model and service level necessities. So trading terms will change and impact pharmacy profitability.

The Guild's estimate of the total MA MOU impact on pharmacy bottom line is $577m over the five years ending 30 June 2015 partially offset by the increased services funding as mentioned previously.

But, interestingly, the 23% F2 cut impact on pharmacy bottom line may be covered by new generic discount dollars and premium free fee opportunities compliments of two major patent expiries, Crestor (second half of 2011) and Lipitor (fist half of 2012). But, how long will the easy generic money pipeline last?

Mandatory price disclosure – the real kicker

Under the MA MOU price disclosure and WADP adjustments will be brought forward and all F2 suppliers **must** disclose. This means that Crestor price adjustments (and hence discount cuts) commence from the first half of 2013 and Lipitor late 2014. So those pharmacies dependant solely on generic discounts will get a nasty surprise as they watch their bottom lines shrink in 2014 and 2015 with only minor new patent expiries to fill the gap.

We can see therefore that script supply backed by a generic discounts business model has only four or five years at most left in it as a profit improvement 'strategy'. My modelling of a typical suburban pharmacy indicates rising net profits for the next three years followed by significant reductions assuming the pharmacy just continues 'business as usual'.

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And what about growth?

Going for growth is now more important to individual pharmacies than ever before and requires a fundamental change to pharmacy culture and management approach as the current business model is hopelessly out of date.

5CPA assumes script volume will grow at 2.3% pa on average during the life of the agreement as backed up by the Government estimates set out in the 11 May 2010 budget papers and the Price Waterhouse Coopers report. However, some say these are radically understated and growth will be closer to 7%.

Regardless, how much share of this growth will actually go through community pharmacies versus the hospital and oncology sector? During 2009/10 about half the 7.5% growth is going to the latter. And regardless of the total PBS volume growth, individual pharmacies growth will be dependant on how attractive their offer is to customers in their respective market areas. Warehouse pharmacies and those with an offer attractive to customers (not necessarily just price) are grabbing a larger share of the market.

Take away message

Only those pharmacies operating on the 'edge' and totally dependant on generics income in the long term will be impacted badly. They will have to lift the bar on their management practices to survive including changing their approach from a product to customer outcome focus. These include new ways of thinking on S2 and S3, addressing retail ranging, skill sets, services uptake and so on.

For all other pharmacies the message is go hard on generics now and use the easy dollars during the next three years to revolutionise their pharmacy business model. There are now so many opportunities, programmes, systems, initiatives, innovative ideas and services already available. You just have to do it.

Bruce Annabel

Consumer loyalty programs

Consumer loyalty programs, and in particular their associated tax status have garnered some attention in the press recently. The Australian Tax Office has previously issued various rulings and determinations to address in which instances the utilisation of rewards points will be assessable, from both an income tax and fringe benefits tax perspective.

In broad terms, a consumer loyalty program is one in which a person receives 'points' as a result of expenditure incurred, which can be redeemed for 'rewards'. It is the receipt of the reward, as opposed to the accumulation of points that may be subject to tax. These types of schemes also include supplier rewards programs, whereby a business receives rewards from a third party for entering into business dealings with a particular supplier.

Per Practice Statement LA 2004/4 (http://law.ato.gov.au/atolaw/view.htm?docid=PSR/GA20044/NAT/ATO/00001), the receipt of rewards will generally be taxable in the following circumstances:

1. The reward is received as part of an income earning activity and that there is a business relationship between the recipient and the reward provider and
2. The benefit is convertible directly or indirectly to money's worth or
3. The taxpayer is carrying on a business, and per s21A the reasonable value of the non-cash business benefit should be assessable for tax.

In addition, the utilisation of points earned by an employer to provide 'rewards' to an employee can be subject to Fringe Benefits Tax if it is received in respect of employment.

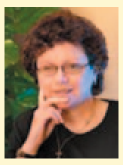
Contrastingly, the ATO has stated in previous determinations that rewards received as a result of private expenditure (ie Frequent flyer points earned by an individual through credit card payments for shopping or business expenses later reimbursed by their employer) will not be subject to tax, although they have the discretion to investigate further any consumer loyalty program that meets the following criteria:

1. The arrangement is contrived and has no commercial purpose other than to allow the receipt of rewards and/or
2. The rewards are being received in substitution for income earned and/or
3. The total points accumulated from a business relationship or business expenditure exceed 250,000 per year.

You should consult with your accountant to examine your particular circumstances and any potential tax consequences if you are redeeming points for rewards through programs as described above.

Stuart Gardner

JR Pharmacy Management



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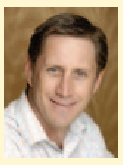

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