

Magic of sales per m²

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

IMPROVING PHARMACY BUSINESS PERFORMANCE TO MEET EMERGING CHALLENGES MEANS UNDERSTANDING AND MEASURING SALES/M².

Getting the metrics right is axiomatic in creating profitable pharmacies for a more competitive future. The most important place to start is sales generated per square metre of floor space (sales/m²).

OPPORTUNITIES AND RISK

This column has attempted to explain elements of a plan that every pharmacy can adopt to help transition into a more sustainable business before it's too late. Most realise the negative impact of price disclosure on PBS remuneration and that existing generic discounts are short-lived.

Pharmacies that make the most of these generic discounts and reinvest in change opportunities and/or cut debt levels will reduce their risk significantly. Fortunately, price-cut pain from price disclosure is gradual, offering time to adapt. Nevertheless, this industry is at the highest level of financial risk I have ever seen.

SALES/M² MUST INCREASE

Pharmacies that achieve high sales/m² are almost always more profitable, barring an inappropriate business model, completely ridiculous rents

and/or bad management. For the year ended 30 June 2011 JR Pharmacy Services clients demonstrate sales/m² on average of \$16,474, providing net profit/sales (EBIT) of 8.77%. This doesn't sound like much and it's not. That's why industry risk levels are so high—price disclosure will wipe out a sizeable chunk of that meagre bottom line without major improvements.

CASE EXAMPLES

Table One outlines metrics for four community pharmacies located in large, high-cost shopping centres with aggressive landlords.

CASE 1 pharmacy has a bank loan and can't survive—the problem is excess space given the sales potential available from the centre rather than the rent/m² in itself. The low sales per m² results in high overheads/sales, thus poor profitability—it's impossible to get reasonable returns on staff costs and the rent paid, plus the high cost of fixtures and fittings. Sadly Case 1 pharmacy is similar to many pharmacies I've seen in centres that, given the space offered, should never have been established in the first place. Yet this mistake continues to be made. The obsession has been

with the rent rather than getting the 'opportunity' offered by the space right so it fits the sales potential that the specific site offers.

CASE 2 is a better story, achieving double the sales/m² of case 1 despite paying double the rent/m². That's because the strong space performance drove lower overheads/sales%, hence much higher EBIT/sales%. Nevertheless, the bottom line is skinny and risk is high because more than all of it comes from supplier—generic and wholesaler—discounts so the owner and the banner group must do more to future-proof this pharmacy. The job is made doubly difficult because case 2 carries a high debt burden.

CASE 3 has the lowest sales of the four, yet delivers the highest EBIT/sales% and the second best EBIT\$. It clearly benefits from not having a ridiculous rent and occupies space that is more appropriate to the centre's sales potential. So overheads/sales are low, resulting in higher profitability, while supplier discounts represent only 34% of EBIT\$, meaning it is less exposed to the ravages of price disclosure.

CASE 4 delivers the highest EBIT\$ by far and generates the highest sales/m² compared with the others. But the rent is very high which is why EBIT/sales% is a little lower at 11.8% despite being 50% better than the JR shopping centre average. The high sales/m² has driven down overheads/sales% and

rent/sales% so Case 4 achieves good staff and floor space productivity. However, it has a higher risk than case 3 because supplier discounts comprise 42% of EBIT\$.

WHAT TO DO

1. Work out the sales/m² for your pharmacy. Check the premises lease for the size of your floor space and divide it into total sales for the last 12 months.
2. Decide if it's high enough by comparing it with the limited data here and industry benchmarks.
3. Recognise that pharmacies with excess space fill it with slow-moving lines that customers usually buy over the internet and from supermarkets.
4. Very high gross profit margin of, say more than 40% versus the average of 34% will mean a lower sales/m² figure—this can be tolerated provided it can be maintained in the face of competition and price disclosure cuts.
5. If your pharmacy's sales/m² figure is below the industry average, chances are you have some serious work ahead and will need to develop and implement a plan to lift it over the next 2–3 years.

For example, a community pharmacy I'm working with has \$16,115 sales/m² and is implementing strategies to lift sales/m² within two years to \$20,000 by targeting 11% sales growth per annum or, at worst, 7% per annum over three years.

The initiatives in this strategic plan are very similar to those I have outlined previously and encompass areas of untapped opportunity that can improve the bottom line and reduce risk by realising the magic qualities of sales/m². ■

TABLE ONE: Community pharmacies in large, high-cost shopping centres

Case	Size m ²	Sales	Sales/m ²	Overheads/ sales	Rent/sales	Rent/m ²	EBIT/ sales	EBIT\$
1	385	\$5,879,000	\$15,270	31%	8.3%	\$1,264	1.4%	\$82,000
2	360	\$10,982,000	\$30,504	28%	7.9%	\$2,407	6.9%	\$474,000
3	250	\$4,547,000	\$18,190	23%	6.1%	\$1,111	14.8%	\$674,000
4	278	\$8,547,000	\$30,743	23%	5.5%	\$1,679	11.8%	\$1,010,000