Use it before you lose it

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You can't change your destination overnight, but you can change your direction overnight. Jim Rohn[1]

I worry that many pharmacy owners are falsely comfortable with the current high prescription profitability levels. For the sake of their businesses and staff it's crucial to understand that this is not normal and won't last in the longer term.

Pharmacies can expect to lose some margin dollars by the end of the year when the government's price-cutting mechanism, weighted average disclosed pricing (WADP), starts clawing back more profitability faster than new generics can replace it. Therefore, this extra profitability should be used productively now to develop new and improved sources of profitability.

The current average income per script of about $14 comprises about $10.50 from the dispensing fee and mark-up and about $3.50 from generic and wholesale supplier trading discounts. Most of the trade discounts are ephemeral but now comprise, on average, more than 60% of pharmacy net profit before interest and tax (EBIT). This is what the government is pulling back into the budget coffers through WADP cuts.

THE COST OF CLAWBACKS

We all remember 1 April 2012 when about $360m was stripped from pharmacy net profits. But these cuts were more than covered by new generic discounts, particularly atorvastatin entering the market on the same day. So far so good.

However, with governments always trying to find savings, the established PBS cost-saving policy called Weighted Average Monthly Treatment Cost was employed to review and challenge drug costs in four condition categories: high potency statins (atorvastatin and rosuvastatin), anti-coagulant/atrial fibrillation, Alzheimer's/dementia and diabetes.

The result of the first review saw the 25% cut on 1 December 2012 to atorvastatin and rosuvastatin that reduced collective pharmacy EBIT by about $100-120m per annum. In effect, the cut pulled forward by 12 months some of the big WADP cuts that were always going to occur—on 1 December 2013. The anti-coagulant review has been recently announced with Pradaxa failing to be approved while the other two are underway.

Yet compared with PBS dispensing profitability (as at 30 November 2012) pharmacies are still ahead—new generic opportunities from patent expiry of Pariet and Xalatan helped hold profitability.

The offset game continues this year with big price cuts slated again for 1 April (eg. Pantoprazole/Somac), 1 August (eg. simvastatin, clopidogrel) and certainly 1 December 2013 (eg. atorvastatin) with new generic discounts possibly ameliorating the impact.

However, much depends on a trial judge's decision (handed down in February after writing this article) as to whether Astra Zeneca's Crestor (rosuvastatin) exclusivity should be maintained. If exclusivity was lost pharmacy will likely receive windfall dispensing income during 2013 that will help absorb the 2013 price cuts, thus deferring the big crunch until late 2014 or early 2015 depending on listing dates of competitor brands.

From all this I hope three messages are clear:

1. **Relying on generics as the single profit maintenance strategy is not sustainable.**
2. **The unprepared pharmacy owner will ultimately see the generics profit wave turn into a dumper early next year, or the year after depending on a judge's stroke of the pen.**

THE UNPREPARED PHARMACY OWNER WILL ULTIMATELY SEE THE GENERICS PROFIT WAVE TURN INTO A DUMPER EARLY NEXT YEAR…

3. **Now is the time to start preparing. Waiting until you're on the dumping wave will be too late.**
4. **PBS profitability should hold at about current levels until 1 December 2013 thanks to the avalanche of patent expiries and, perhaps, a little longer depending upon the Crestor decision.**

FOCUS ON HEALTH NOT TRANSACTION

Therefore, pharmacies should use the short-term generic largesse to invest in converting the pharmacy model from being mostly transaction-based to a customer-centric one that delivers valued health solution benefits throughout the pharmacy.

In my September 2012 AJP column I expressed it this way: 'Pharmacy has to be much more than a place to acquire merchandise and have scripts filled.

If pharmacy just fulfils a product need, it's transacting, not creating new types of value for customers'. And for most pharmacies value creation can't be price-based.

THE OPPORTUNITIES

It is up to the owner to challenge everything in the pharmacy and ask: 'Is there a better way?' Consider the answers from the following perspectives:

Premises: location, floor space, layout and design, quality; *Merchandise:* range, health focus, blockbusters, service value-adds; *People:* skills mix, roles, knowledge, complements above; *Communication:* what do you stand for that's different? *Why consumers come:* compelling reasons customers choose your pharmacy over another; *Information:* utilising data from POS and dispensary systems; *Cost of product:* alliances with suppliers built on mutual benefits.

The key to sustainability lies with how owners and their teams implement the initiatives and build productivity in the pharmacy. Any funds left over after investing in the transformation should be considered for paying down bank debt.

And finally, recognise that trying to maintain the status quo and failing to innovate is the BIGGEST mistake an owner can make. ■

1. Jim Rohn is a renowned US business philosopher. www.jimrohn.com