



Creating a commercial buffer

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CREATING A COMMERCIAL BUFFER DEPENDS ON MOTIVATING YOUR CUSTOMERS TO SHOP WITH YOU... AND KEEP COMING BACK.

There are fundamental shifts in the economy, consumer behaviour, technology and pharmacy supply that will impact on community pharmacy profitability and it's important that pharmacy owners build profitability now in order to build a commercial buffer to absorb future hits.

THE PERFECT STORM

A summary of the primary threats I see challenging pharmacy right now are summarised in Figure One: The perfect storm.

All these threats are based on external factors, except for excessive debt levels which are self-imposed.

The general response to these threats has been to price discount (below co-payment and private scripts, and retail), evidenced by store results data and the increasing use of the words 'save', 'discount', 'less', '50% off', 'price guarantee' and so on, in pharmacy names, signs and promotions. The impact was breathtakingly evident in the gross margins from scheduled medicines departments among franchisees in one well-known pharmacy group I reviewed recently. These had fallen from about 50% a few years ago to 35% now. Medicines are the most profitable of all departments and comprise about 8% of total sales, or up to 30% of non-dispensing sales. These cuts were being funded by higher generic substitution discounts available temporarily at these levels.

These excessive discounting policies are damaging profitability while the Green, Blue and Black threats mentioned in Figure One perpetuate. Such actions give away any financial buffer developed to absorb future profitability hits, particularly those resulting from increasing competition and upcoming weighted average disclosed pricing adjustments.

Evidence of this diminishing buffer was identified in the JR Pharmacy 2011 client benchmarking series (2009/10 financial year) that showed supplier (generic and wholesaler) dispensary discounts provided on average 53% of total pharmacy net profits (EBIT). This was higher for shopping centre pharmacies due to high overheads and lower in provincial pharmacies. Since then, as discounting has accelerated and the PBS online incentive removed, the reliance on discounts has increased.

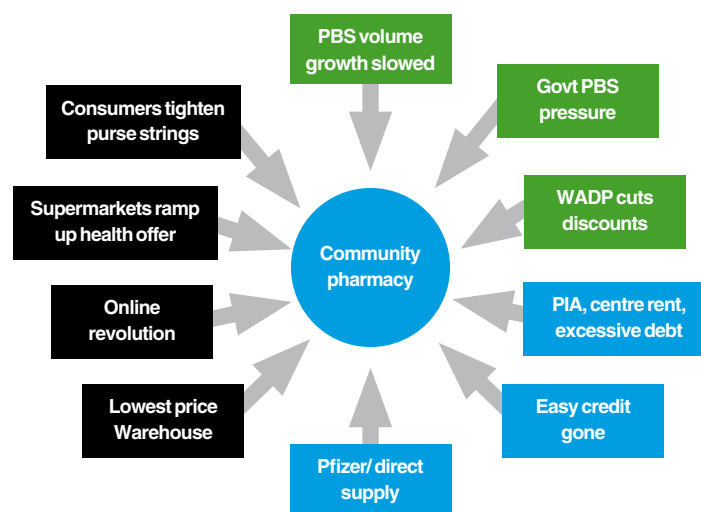
Fortunately, there are many opportunities available (summarised in my March *AJP* column) that can restore the lost buffer before it's too late.

It's all about redesigning the customer experience. The starting points to plan for this fall under four fundamental themes:

- **Renew focus on the in-pharmacy experience.**
- **Deliver on the health 'brand' promise.**
- **Embrace multi and cross-channel retailing.**
- **Connect and leverage social media.**

These boil down to strategies aimed

FIGURE ONE: The perfect storm



Green threats: future PBS dispensing profitability highly pressured.

Blue threats: reducing profitability now and increasing pressure on working capital.

Black threats: explains why community pharmacies are losing scripts, retail margin %, customer numbers and sales.

at retaining existing customers, gaining new ones and investing in new technologies and services—but avoiding more discounting. Unlike 'the perfect storm' threats, pharmacy owners have almost complete control over every one of these themes.

Your success in creating the financial buffer will be founded on how well your plan motivates customers to shop with you and keep coming back. The following list offers seven key reasons consumers choose not to shop at certain places.¹

1. **Proposition**
2. **Perception**
3. **Service**
4. **Price**
5. **Word of mouth**
6. **Habit**
7. **Apathy**

The objective is to develop the four pharmacy planning themes mentioned above to ensure these consumer reasons can be converted into motivating customers positively.

A survival strategy based on generics to hold up the bottom line and discounting to hold onto customers won't last and gives away the commercial buffer, or 'wiggle room', pharmacy needs for the future.

'With wiggle room you can enjoy, what we used to call in the old days, rude good health. I like the sound of that!'²

1. Price, D. Why people don't buy. Inside Retailing. 28 June 2011, page 1.

2. Ryan, P. Creating wiggle room. Inside Retailing. 30 June 2011, page 1.