Retail Pharmacy Benchmarking Study 2012
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Since 2009 the retail pharmacy sector has experienced unprecedented turbulence.

Overview

Pharmacists face unique challenges. Poor prevailing economic conditions coupled with continuing cuts in government reimbursement rates have eroded profitability. In an era of declining profits the short term goal for many operators is financial survival.

Fitzgerald Power and Touchstore Pharmacy Management Systems have consulted with and studied a cross section of Retail Pharmacies in 2012. This report presents the findings of our study and details the challenges that lie ahead, while offering practical advice that will help restore stability to the sector.
Bencharking study

The benchmarking study incorporated data from a wide ranging cross section of pharmacies. These pharmacies varied in size from shops with 6 employees and turnover ranges of less than €1,000,000 to shops with 18 plus employees and turnover ranges of greater than €3,500,000.

Key findings:

- Average pharmacy turnover decreased by 21.28% over the period 2008 to 2012. This change is the result of weakened consumer spending power and governmental reimbursement rate cuts.

- The governmental reimbursement rate cuts were directly responsible for an average reduction of approximately 20.58% in pharmacy turnover.

- Typical sales mix changed as customers with reduced spending power moved from the Drugs Payment Scheme to General Medicines Scheme medical cards reducing margins within the sector.

- Decrease in disposable incomes negatively impacted on non-dispensing sales during the period. Sales of front of shop items and over the counter medicines fell by an average of 38.54% during the period.

- Although legislative changes eroded dispensing margins during the period pharmacists were able to reverse the decline through improved purchasing. However, while average gross profit margins grew from 38.14% to 38.40% the actual value of average gross profits decreased by 23.50% from 2008 to 2012.

- Cash generated by retail pharmacies decreased by 35.49% during the period as external market forces impacted on sales mix and volume.

- While the value of wages and salaries decreased during the period of the study the proportion of sales spent on staff costs actually increased. Wage levels increased from 13.85% of sales in 2008 to 15.21% of sales in 2012.

- The study noted individual cases of pharmacists achieving rent reductions since 2008. However, in general rents have increased as a % of turnover from 1.85% in 2008 to 2.65% in 2012.

- Pharmacists responded to falling turnover levels by cutting other administration expenses by 3.62% during the period reviewed. However, as noted above in relation to staff costs, other expenses actually increased relative to sales. In 2008 4.21% of all sales generated by pharmacies were spent on other administration expenses. By 2012 this had risen to 5.15%.
“Governmental reimbursement rate cuts were directly responsible for an average reduction of approximately 20.58% in pharmacy turnover.”

Challenge: Maintaining sales
Based on our study and knowledge of the Retail Pharmacy sector Fitzgerald Power and Touchstore Pharmacy Management Systems recognise the challenge pharmacists face maintaining sales. Given the sales profile of the sector and the power of government agencies this is a challenge that may seem insurmountable. However, in our experience there are always opportunities to increase sales and pharmacists must try to be innovative in their approach.

Challenge: Maintaining margins
The study demonstrates the excellent performance of pharmacy gross margins as pharmacists searched for bonus stock offers and better value generic products. With the inevitable introduction of reference pricing approaching it is of critical importance for pharmacists to avail of bonus stock and generic product offers while the opportunity exists.

Challenge: Reducing costs
Staff and rental expenses are the principal cost centres for most retail businesses and pharmacy is no different. Reductions in these expenses in euro terms achieved by pharmacists during the period were a necessary response to decreasing turnover. Management of staff levels and pay rates together with continued rental negotiations with landlords will be a key challenge for pharmacists for the foreseeable future.
Practical recommendations

Retail Pharmacy is changing. With so many external factors affecting the long term prospects of the sector it is important for pharmacists to manage the viability of their business through efficient and effective practices. We recommend the following:

- Offer patient care services. This will open an additional revenue stream and help to further improve your relationship with your customer.

- Consider online sales channels. The shift to online selling has changed the face of retailing. E-commerce websites are becoming an integral component of pharmacy operations. Offering your customers online purchasing facilities for non prescribed medicines will help you to retain their business.

- Dedicate a definite time period each week to purchasing and stock control. An investment in time spent hunting for bonus stock offers and price discounts together with an investment in software to monitor and develop your purchasing strategies could repay you handsomely. This is one of the most important areas of modern pharmacy management.

- Monitor staff levels constantly. The number of staff you retain must be justified in terms of turnover and items dispensed.

- Negotiate rent reductions. If landlords wish to keep properties let they must be flexible on rental rates. To control this cost centre you must be willing to negotiate improved terms.

- Be clear on your future strategy.

For every challenge faced by the sector an opportunity emerges. The ability of pharmacists to respond to market changes with innovative business practices will help to secure the long term viability of the Irish Retail Pharmacy sector.
Introduction

Fitzgerald Power has provided advice to pharmacists for more than 25 years. We are recognised as the leading provider of financial services to the retail pharmacy sector in Ireland.

Our client base covers a broad cross section of pharmacies in terms of size, location and sales mix. Our tailored advice helps these clients address the ongoing challenges they face.

Touchstore Pharmacy Management Software was founded by a pharmacist. We have been at the forefront of the retail pharmacy sector for ten years offering unrivalled systems and customer support services.

We believe in product and service excellence and pride ourselves on our knowledge of retail pharmacy. At Touchstore Pharmacy Management Software we understand the systems pharmacists require to grow and prosper.
This is the most challenging business environment retail pharmacists have faced in living memory. Turnover and profit margins are declining in the face of governmental cuts and a virtual collapse in consumer confidence. The time for action is now.

Pharmacy is a unique retail sector. It is unique in terms of day to day operations and in terms of the role pharmacists play in the communities they serve, but from a business perspective the biggest single difference is sales. No other retail sector in Ireland relies so heavily on one large customer and the bargaining power this customer holds casts a long shadow over the sector's future.

The cuts to reimbursement rates imposed by successive governments since 2009 have led to an average reduction in turnover of 20.58% in pharmacies throughout Ireland, and it hasn't stopped there.

Wholesale Mark-up and fee structure changes introduced during the same period were expected to reduce pharmacy gross profit margins by an average of 5%. The reductions did not discriminate and have been felt by operators up and down the country, in rural and urban locations, by independent retailers and by large multi-store chains despite the introduction of scaled fees.

These cuts would have represented significant challenges for pharmacists in buoyant economic conditions. Unfortunately our economy is far from buoyant. The cuts have coincided with a sustained period of depressed economic activity. Emigration is on the increase and consumer spending power is at an all-time low as the country struggles with the burden of boom time debt.

The combined effect of these external forces has been the slow but steady erosion of pharmacy valuations. In our view pharmacy valuations have decreased by an average of 50% since 2009.

In light of these economic difficulties, Fitzgerald Power and Touchstore Pharmacy Management Software have conducted a benchmarking study of the sector. This study was designed to quantify the effect of falling turnover and gross profit margins on the sector and to identify how pharmacists are fighting back.
Fitzgerald Power and Touchstore Pharmacy Management Software aim to build on this review by expanding the number of participating pharmacies and conducting the study on an annual basis.

Every Irish Retail Pharmacy will be invited to partake in our 2013 study. Those that participate will receive a tailored report comparing their results to national and regional averages.

This report compiles the results of our 2012 Retail Pharmacy benchmarking study, includes our thoughts on the main challenges facing the sector and presents the practical business management procedures we feel pharmacists should adopt to protect the value of their investment.

The Retail Pharmacy sector has clearly experienced significant change in terms of financial performance and operational developments since 2009. Against this backdrop it is essential for pharmacists to maintain the delivery of excellent patient service while adopting best in class business practices. Addressing these key pillars of long term business success will ensure your pharmacy is positioned to meet the challenges facing the sector.

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Benchmarking study

Our study runs from 2008 to March 2012, reviewing the period since the introduction of the government spending cuts.

It covers pharmacies within a turnover range of €500,000 to €4,500,000 in rural and urban locations, with high GMS turnover in some cases and high DPS turnover in others.

The financial data was analysed to a detailed overview level comparing the effect of Department of Health cuts and cost centre management initiatives for individual pharmacies against national results.
Findings

The study looked at the following areas:
- Impact of Department of Health cuts
- Impact of the decrease in consumer spending power
- Impact on profitability and cash generated
- Reaction of overhead expenses

The sections that follow present our findings in each area:

**Falling turnover levels:**
The study indicates that average turnover levels have decreased by 21.28% since 2008.
The study shows that average turnover has decreased by 20.58% as a result of governmental reimbursement rate cuts. This may be attributed to the recent legislation as follows:

- **FEMPI 2009 (Implemented July 2009)** - 8.8%
- **IPHA agreement (Implemented February 2010)** - 4.3%
- **APMI agreement (Implemented October 2010)** - 6.2%
- **FEMPI 2011 (Implemented June 2011)** - 1.3%

**The Relative Impact of the Recent Legislation**
Review of Gross Profit Margin
The findings of our study indicate the typical gross profit margin achieved in the sector pre FEMPI 2009 was 38%. Expectations were that margins would fall to 33% as a result of the legislative changes to reimbursement rates. However through improved purchasing that has seen a shift towards generic items and parallel import goods pharmacists have managed to reverse the impact on profit margins of continued governmental cuts. In some cases operators actually experienced an increase in gross profit margin during the period reviewed.

Average Gross Profit Margin

<table>
<thead>
<tr>
<th>Year</th>
<th>Margin (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007 / 2008</td>
<td>36%</td>
</tr>
<tr>
<td>2008 / 2009</td>
<td>36.5%</td>
</tr>
<tr>
<td>2009 / 2010</td>
<td>37%</td>
</tr>
<tr>
<td>2010 / 2011</td>
<td>37.5%</td>
</tr>
<tr>
<td>2011 / 2012</td>
<td>38.5%</td>
</tr>
</tbody>
</table>

It should be noted that while profit margins have remained relatively stable decreasing sales mean pharmacies now generate less gross profit in monetary terms. With this in mind the effective management of overhead expenses is an essential component of long term financial sustainability.
Impact of the decrease in consumer spending power

The study highlights a change in pharmacy sales mix. The turnover profile of a pharmacy is largely determined by the circumstances of its customer base. Pharmacists will continue to experience a shift towards GMS medical card dispensing as disposable incomes continue to contract and patients availing of the Drugs Payment Scheme decrease. The typical change in retail pharmacy sales mix since 2008 is demonstrated below:

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>GMS</td>
<td>48.04%</td>
<td>41.15%</td>
</tr>
<tr>
<td>DPS</td>
<td>25.86%</td>
<td>28.80%</td>
</tr>
<tr>
<td>Private Prescriptions</td>
<td>5.68%</td>
<td>4.74%</td>
</tr>
<tr>
<td>Other local schemes</td>
<td>1.68%</td>
<td>1.71%</td>
</tr>
<tr>
<td>Front of Shop and over the counter medicines</td>
<td>18.74%</td>
<td>23.60%</td>
</tr>
</tbody>
</table>

Decreased consumer spending power is the principal contributor to the fall in non-dispensing sales. Over the last thirty six months front of shop turnover has decreased by 38.54%
Impact on profitability and cash generation

In any retail sector the ability to generate cash is essential. Cash generation underpins financial stability, influences borrowing and expansion decisions and is the key determinant in wealth creation as business valuations are based on the ability of the pharmacy to generate future cash flows. In this context the 35.49% decrease in the ability to generate cash suffered by the sector is a major concern (please note non-cash items such as depreciation are excluded from these calculations).
Reaction of administrative expenses

Controlling cost centres is a key element of financial survival during periods of uncertainty. Pharmacy overheads can be broadly split into three categories:

- Wages and salaries
- Rent
- Other overheads

The study identified the following reaction of overheads during the period:
In 2009 13.85% of sales achieved by pharmacies were spent on wages. By 2012 this figure had risen to 15.21%.

Wages and salaries fell in € terms during the period as pharmacists reacted to reduced turnover and profit levels. Savings were achieved through cuts to general wage rates and reductions in staff numbers. On average two staff members per pharmacy have been made redundant since FEMPI 2009. While the monetary value of wages has fallen the study demonstrates that wages as a proportion of sales has actually increased since the first FEMPI cuts. In 2009 13.85% of sales achieved by pharmacies were spent on wages. By 2012 this figure had risen to 15.21%. This reflects the changing nature of the retail pharmacy sector where the number of items dispensed continues to grow while turnover falls. This is leading pharmacists to reassess their expectations regarding staff costs and salary levels of 15% of turnover are now recognised as a sustainable industry benchmark.

Some pharmacists reported rental savings during the period as landlords bucked the trend and reassessed lease agreements downwards. This flexibility has enabled operators to maintain rental expenses at 2.65% of turnover which is essential for long term sustainability.

The percentage of sales allocated to other administration expenses has increased steadily throughout the period as pharmacists struggled to find savings that matched the decreases suffered in turnover and profitability. On average other administration expenses run at 5% of turnover which is considered sustainable.
Summary of results

Without question Retail Pharmacists have faced unparalleled challenges in the last three years. The following table charts the response of the sector to these challenges:

<table>
<thead>
<tr>
<th>Retail Pharmacy results 2012</th>
<th>Pharmacies with average turnover &lt; €1.7m</th>
<th>Pharmacies with average turnover &gt; €1.7m</th>
<th>Sector Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decrease in turnover – %age change</td>
<td>24.65% decrease</td>
<td>18.94% decrease</td>
<td>21.28% decrease</td>
</tr>
<tr>
<td>Decrease in turnover - € change</td>
<td>€360,000</td>
<td>€570,000</td>
<td>€446,500</td>
</tr>
<tr>
<td>Impact of cuts – percentage of turnover lost</td>
<td>20.20%</td>
<td>20.80%</td>
<td>20.58%</td>
</tr>
<tr>
<td>Impact of cuts - € lost</td>
<td>€295,000</td>
<td>€629,000</td>
<td>€430,000</td>
</tr>
<tr>
<td>Gross Margin performance – %age 2008 v’s 2012</td>
<td>37.35% v’s 38.11%</td>
<td>38.69% v’s 38.58%</td>
<td>38.14% v’s 38.40%</td>
</tr>
<tr>
<td>Gross Margin performance - € change</td>
<td>€126,800 decrease</td>
<td>€223,800 decrease</td>
<td>€166,000 decrease</td>
</tr>
<tr>
<td>Cash generated - %age change</td>
<td>44% decrease</td>
<td>31.3% decrease</td>
<td>35.49% decrease</td>
</tr>
<tr>
<td>Reaction of wages - %age change</td>
<td>16.24% decrease</td>
<td>11.38% decrease</td>
<td>13.58% decrease</td>
</tr>
<tr>
<td>Wages - % Turnover 2008 v’s 2012</td>
<td>15.3% v’s 17.01%</td>
<td>12.85% v’s 14.04%</td>
<td>13.85% v’s 15.21%</td>
</tr>
<tr>
<td>Rent – % Turnover 2008 v’s 2012</td>
<td>2.16% v’s 3.13%</td>
<td>1.63% v’s 2.35%</td>
<td>1.85% v’s 2.65%</td>
</tr>
<tr>
<td>Reaction of other administration expenses - %age change</td>
<td>6.28% decrease</td>
<td>0.01% decrease</td>
<td>3.62% decrease</td>
</tr>
<tr>
<td>Other Administration expenses – % Turnover 2008 v’s 2012</td>
<td>5.4% v’s 6.71%</td>
<td>3.38% v’s 4.14%</td>
<td>4.21% v’s 5.15%</td>
</tr>
</tbody>
</table>
What’s next for the Retail Pharmacy sector? Some practical advice

Like every other business person the retail pharmacist is looking to the future, trying to predict market trends as they endeavour to survive this period of economic turmoil.

Recent indicators suggest there will be no further Department of Health cuts in 2012. What does seem likely is the introduction of reference pricing as forecasted by the ESRI in January. If you stand still the best you can hope for is to be left behind as the value of your business quickly deteriorates. Be prepared for future changes:

- Take every opportunity to increase your turnover.
- Take every opportunity to boost your margins.
- Take every opportunity to cut your costs.
Increasing turnover

**Online selling:**
Over the last ten years online shopping has become a mainstay of modern retailing. As a sector retail pharmacy has been slow to react to this opportunity as current legislation does not allow prescribed medicines to be sold over the internet, but this regulation does not affect front of shop sales. Everything from fragrances and skin care products to vitamins and supplements can be sold online. Pharmacists who have embraced this new sales channel have boosted revenues and margins while reinforcing their pharmacy’s brand.

**Patient care services:**
Pharmacists are ideally placed to bridge the gap between GP’s and patients by offering care services to new and existing customers. While these services may not generate direct sales, pharmacists that have introduced patient care facilities and services have reported increases in shop sales and improved customer relationships.

Increasing margins

**Improved purchasing functions:**
The most important aspect of retail pharmacy management for the foreseeable future is purchasing and stock control. A senior staff member should be responsible for setting strategy and managing the purchasing and stock control function on an ongoing basis. This role should include searching for discount and bonus stock offers and reviewing purchase invoices to ensure the prices charged by suppliers match expectations. There are now software options available which automatically identify the best prices on all medicines. The importance of this role cannot be overplayed. Bonus stock can improve average gross profit margin by 8 – 10%. Allocating an employee to fulfil this function might be the best investment you make this year.

Cutting costs

**Controlling staff costs:**
Inflated wages and salary levels have a detrimental effect on bottom line profitability. There are two factors to consider in relation to this cost centre:

a. Staff head count: Does the number of items dispensed justify dispensary staff levels? Does the volume of non-medicine sales justify front of shop staff levels? If the answer to either of these questions is no it might be time to reduce staff head count. Monitor activity in your shop on a weekly basis. Be proactive. Be willing to make tough decisions if a change in the nature or volume of your business indicates reducing staff levels is necessary. Be creative in your approach. Job sharing or restructuring the working week may allow you to make effective staff level reductions without making anyone redundant.
b. Wage rates: Are your wage payment rates in line with sector norms for shop and dispensary staff? If you are above average rates it might be time to consider wage reductions.

**Negotiating improved rental terms:**
Today’s commercial rental market may be entirely different to the market that existed when you signed your lease agreement. The simple reality in the vast majority of cases is that landlords would struggle to re-let the property you currently occupy. Contrary to perceptions prevalent in the media our study indicates that landlords are realistic and willing to work with sustainable tenants. Your rental expense should be no more than 3% of turnover. If it creeps above this level it’s time to sit down with your landlord and negotiate.

**Be clear on your future strategy**

**Where is your business going?** Do you have you a logical roadmap? The initiatives you adopt to sustain and grow your business should form part of a clear strategic plan. This doesn’t need to be sprawling 200 page document, but your goals and objectives should be clearly defined and every element of your operation should contribute in a meaningful way towards what you want to achieve.
Final thoughts

In conclusion, this report has presented the findings of our Retail Pharmacy benchmarking study, outlined our views on the challenges facing the sector and identified practical action items for pharmacists to consider when meeting these challenges head on.

Driving turnover and gross profit margins, managing cost centres and planning for the long term sustainability of your business in a clear and straightforward manner are the tools you need to meet these challenges.

Irish Retail Pharmacy has experienced a period of unprecedented upheaval but a changing market place offers new opportunities. When opportunities to enact revolutionary business practices or open new sales channels present themselves you must be ready to act. As you prepare yourself for action knowledge is key.

Know how your performance relates to other businesses within the sector, know how the changes that affect your business impact on bottom line profitability and most importantly know where the market is going.

The time for action is now.

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