Improving business performance through measurement – Part 1

There is an old business performance adage that says "what gets measured gets done" but before we can address measurement and performance appraisal, first we must ask, "what do we measure and how do we measure it?". In this article, Stuart Fitzgerald discusses the importance of measuring your business performance.

To really understand measurement, we have to understand our ultimate goals because the purpose of effective measurement is simply to link these goals to outcomes. If we measure the wrong things we may not get the correct outcomes. For example, if the goal is to be more profitable measuring sales and nothing else misaligns goals, measurement and outcomes where turnover increases do not necessarily create greater profits.

There are two types of performance measures - lead and lag indicators. Traditional KPIs are lag indicators. They are a measure of something that has already occurred and accountants love them. We love them because they are easy to calculate and because they provide definitive answers to specific questions such as how have gross profit margins performed over the last 12 months or what the year-on-year value change in turnover is. Using lag KPIs in isolation, however, does nothing to improve business performance; it just provides the final measure of success or failure. Lead KPIs, on the other hand, are more difficult to determine and calculate but are predictive in nature and allow business people assess the impact of their actions during a period of activity.

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When lead and lag KPIs are combined and used correctly as part of a five-step performance appraisal process, they can help deliver better results. This process is:

1. **Set clear, strategic goals.**
2. **Set targets. Completing these targets should result in strategic goals being achieved.**
3. **Determine the actions that will lead to targets being achieved.**
4. **Use lead KPIs to measure the impact of actions.**
5. **Use lag KPIs to assess ultimate success or failure.**

Understanding this relationship and aligning core objectives with actions and measurement leads to positive change. At first glance, this may appear to be an abstract and theoretical concept but in practice, the process is very straightforward. *Operation Transformation* is the perfect example.

When *Operation Transformation* participants stand on the scales at the end of the week, the measurement they read is a lag KPI. It is measuring something that currently exists. The scales give a certain reading and that reading cannot be immediately changed. However, if a logical process is followed, it is possible to achieve positive change. The strategic goal is clearly weight loss. The targets might be to exercise four times per week and to eat three nutritious, balanced meals per day. The actions are to join a gym, design a manageable exercise programme and engage with a nutritionist to develop a diet plan. The lead KPIs are calories burned and calories consumed. These lead KPIs allow participants to measure the impact of their actions. At the end of the following week, when participants stand on the scales, they will hope to have moved the dial on the lag KPI and to have created positive change.

Creating positive change in a business context is extremely important given the level of disruption in the Irish community pharmacy market since 2009. These disruptions include:

1. Changes to payment terms introduced under the FEMPI legislation and latterly through Reference Pricing.
2. Changing economic conditions and consumer sentiment.
3. Pressure on item number growth from factors such as prescription levies, DPS threshold increases and reductions in the number of medical cards in issue.
4. Price competition and the emergence of online channels for cosmetics and over-the-counter (OTC) medicines.

Of these factors, the impact of FEMPI and Reference Pricing is the easiest to quantify. The State extracted approximately €2.1bn from the community pharmacy sector between 2009 and 2015. €270m of these savings were contributed by Reference Pricing, which is far higher than previous government estimates and tends to be generally overlooked by the mainstream media. When viewed on a micro level, the effect of these cuts has been the steady erosion of pharmacy revenue bases with the average community pharmacy suffering annual turnover reductions of approximately €295,000 as a result of FEMPI and Reference Pricing.

The recent survey of the sector, conducted by Fitzgerald Power on behalf of the IPU, noted average turnover reductions of 4.1% across the market in 2014. We further noted that procurement margin gains are beginning to plateau, while controlling wages and rent remain key considerations as labour and property markets rebound.

When these legacy trading pressures are combined with current sectoral headwinds, such as further Reference Pricing cuts, possible changes to phased dispensing reimbursement conditions and the emergence of new pharmacy business models, it becomes clear that pharmacy owners will need to continue to develop and redefine their businesses if they hope to thrive in the future.

In recent years, we have seen evidence of this development as pharmacists increased the range of services available to patients and expanded their retail offerings. Retail revenue streams, to include OTC medicine sales, accounted for 28.5% of pharmacy income on average in 2014, while the volume of pharmacy-administered clinical services such as the flu vaccination continue to increase year-on-year.

While these developments are positive, a logical system of measurement is required to accurately assess their impact and their contribution towards strategic goals.

What then should we measure? There are dozens of KPI resources available online which are interesting and thorough but if you are using a large number of KPIs to plan and manage your pharmacy, you may be spending too much time measuring and too little time actually doing. Often, less is more.

In the second part of this article, which will be published next month, we will discuss three essential pharmacy lag KPIs and the targets, actions and lead indicators that can be used to influence them. We will also discuss developing systems for performance appraisal and the role this plays in delivering better business outcomes.

If you would like to discuss the matters raised in this article, please contact Stuart Fitzgerald of Fitzgerald Power at 051 870 152 or sfitzgerald@fitzgeraldpower.ie.