Retail Pharmacy Report 2014
Pharmacy is unrecognizable from the profession my grandfather practiced. When he began trading in Waterford more than 60 years ago he divided his time between; caring for patients, mixing medicines, and recording dispensed prescriptions in handwritten logs. Technology has changed everything except the human interaction.

We’ve helped three generations of pharmacists adapt to changes in the market, from de-regulation and boom time growth to reimbursement rate cuts and financial consolidation. While the challenges have changed our approach has remained the same and the tailored solutions we continue to deliver reflect the nuances of the pharmacy sector.

Pharmacy is a unique profession that requires specialist advice.

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Stuart Fitzgerald
Fitzgerald Power

advising pharmacists for thirty years

Contents

1. Foreword
2. The challenges facing retail pharmacy
3. The effect of these challenges
4. Dealing with these challenges
5. Final thoughts

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1. Foreword


This year we have analysed the impact of three challenges that have created an environment more testing than pharmacists have ever faced. These challenges are:
- Reference pricing and reduced government spending
- Increased competition
- The emergence of alternative sales channels

The aim of this report is to assess the impact of these challenges and suggest possible solutions.

Clearly the last few years have been difficult for pharmacists with falling reimbursements from state schemes and poor prevailing economic conditions driving turnover and profits down. In our view, highly leveraged pharmacies are struggling to survive, with debt obligations accounting for an ever increasing proportion of earnings. Reference pricing will do nothing to ease this burden and in many cases may prove to be the straw that breaks the camel’s back.

The market is turbulent and the future uncertain but we feel that as a sector, retail pharmacy will rebound. There will be casualties, but equally as the sector deleverages there will be opportunities for pharmacists who are willing to innovate and improve efficiencies, possibly through expansion as acquisition possibilities become available.

We hope you find this report useful.

Stuart Fitzgerald
Business advisory director
Fitzgerald Power
A stated aim of budget 2014 was a €50 million saving on drugs from generic substitution and reference pricing.

2. The challenges facing retail pharmacy

(a) Reference pricing and reduced government spending:

On the 15th October 2013 the government presented Ireland’s seventh austerity budget. Under intense pressure from the Troika and Europe, public spending has been reduced across the board in an attempt to bring budget deficits in line with EU targets. Public healthcare has come sharply into focus with government spending on health decreasing from €15.4 billion in 2008 to a budgeted level of €13.2 billion in 2014. A stated aim of budget 2014 was a €50 million saving on drugs from generic substitution and reference pricing. It is estimated that if the government is to achieve a balanced budget by 2020, financial adjustments of €12.5 billion will be required.
Against this backdrop healthcare demands are increasing. This trend is set to continue as our population ages. In 2011 it was estimated that 532,000 people in Ireland were aged 65 or older. By 2026 that figure is expected to be closer to 850,000 (source - CSO “Population and labour force projections 2016 to 2046”). An inevitable consequence of an ageing population is an increase in age related illnesses. When this is combined with current and expected increases in chronic conditions caused by factors such as obesity, smoking and dietary deficiencies it is reasonable to expect Ireland’s healthcare system will demand more from pharmacists in the years ahead.

Figure 2 – population aged 65 and above
This additional demand will not necessarily result in additional income for pharmacists. At a time when government is attempting to improve healthcare with fewer resources, “efficiencies” has become the buzzword. These efficiencies have led to a series of cuts in government payments to pharmacists, reducing turnover and profits. Since 2009 these cuts have reduced average pharmacy turnover by 23%.

The cuts can be summarised 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%
- FEMPI 2013 (Implemented June 2013) - 2.4%

Figure 3 - the relative impact of recent legislation
EBITDA may fall by up to 23% after the first round of reference pricing cuts.

The last strand of the government’s current pharmacy payment cuts is the implementation of reference pricing. Reference pricing, which allows branded drugs to be interchanged with cheaper generics, reduces the reimbursement rates of certain medicines. Our studies indicate pharmacies with high generic penetration will experience turnover contractions of 4.3% with EBITDA falling by an average of 23% after the first round of reference pricing cuts (EBITDA is a measure of business profit. It is essentially the pre-tax cash flow of a business before loan repayment obligations).

Figure 4 - the effect of reference pricing
(b) Increased competition:

Since the deregulation of the market in 2003 the number of retail pharmacies in the Republic of Ireland has grown steadily. More than 1,700 pharmacies operate in Ireland today, a 31.6% increase on 2003 numbers. Ireland has the fourth highest number of pharmacies per head of capita amongst OECD countries.

Figure 5 - increase in pharmacy numbers
The emergence of the online pharmacy may well be the next big challenge community pharmacists will face. Legislative changes coupled with demand from increasingly tech savvy and convenience focussed consumers may move prescription business away from traditional bricks and mortar pharmacies. While Ireland has been a late adopter, legislative environments are changing across Europe with Germany and the Netherlands leading the way. In Germany online and mail order pharmacies are commonplace with more than 1,500 licenced contractors.

Once the regulatory environment in Ireland catches up the change will be significant and immediate. 15% of all retailing in Ireland is now done online (source Retail Ireland, 23rd May 2013) and 28% of all Irish people have made online purchases using their smartphone (Carat, April 2014). If this transfers to retail pharmacy, operators may experience a further reduction in turnover after a period of extreme uncertainty caused by reference pricing.

Online retailing isn’t the only technological change facing the sector. Successful remote dispensing machine trials have been completed in America, Canada and the UK. These advancements may become an increasingly important component of medicine dispensing in the years ahead.

Figure 6 – potential lost revenue due to online retailing
3. The effect of these challenges

Ireland is not the only country where community pharmacy is under pressure. In other developed markets, pharmacists are facing similar challenges with the following closures projected across Europe:

<table>
<thead>
<tr>
<th>Country</th>
<th>Projected Closures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greece</td>
<td>40%</td>
</tr>
<tr>
<td>Spain</td>
<td>10%</td>
</tr>
<tr>
<td>Portugal</td>
<td>10%</td>
</tr>
<tr>
<td>Sweden</td>
<td>10%</td>
</tr>
<tr>
<td>England</td>
<td>7.5%</td>
</tr>
</tbody>
</table>

A look at the retail pharmacy sector in Scotland would suggest consolidation in the Irish market is likely.

**Figure 7 – population levels in Scotland and Ireland**
(source National Records of Scotland August 2013 and CSO April 2013)

**Figure 8 – number of pharmacies in Scotland and Ireland**
(source Community Pharmacy Scotland and Pharmaceutical Society of Ireland)
It is expected that reference pricing will be fully introduced for the first 20 medicine types by mid-2014. This will effectively reduce the relative advantage that pharmacists achieve from the sourcing of generic medicines.

Our studies indicate that the first round of reference pricing cuts will result in a 30% reduction of the current advantage gained by pharmacists from the acquisition of generic medicines. In monetary terms this represents an average full year decrease in turnover and profits of approximately €64,250.

It is likely that the effect of reference pricing on advantages gained through generic medicine purchasing will mirror the impact of the FEMPI legislation where the profit advantage gained through settlement discounts was reduced by 70%.

If this proves to be the case average turnover and profit reductions of approximately €150,000 can be expected, with the full effects being most keenly felt by pharmacists with high levels of generic penetration.

In this scenario average pharmacy EBITDA could fall by 50%, bringing the sustainability of some shops into question.

**To survive pharmacists must:**
- Control costs within the pharmacy
- Become the front line point of care
- Maximise returns from the front of counter
- Develop a unique identity within the local community
4. Dealing with these challenges

(a) Control costs within the pharmacy:

Pharmacists are well accustomed to tweaking their business models to counteract the effects of governmental cuts. Further business model re-designs will be required to combat reference pricing decreases. Pharmacists must ensure that they;

- Purchase stock on the most competitive terms.

- Improve efficiencies in filling prescriptions. Our studies have shown that it costs an average of €2.50 to dispense one item. Improving this cost can only occur with greater economies of scale and / or investment in automated dispensing solutions. Economies of scale will become possible as the market consolidates and the number of pharmacies reduces.

The average cost of wages and salaries as a percentage of turnover was 16.75% in 2013 (15.21% in 2012)

- Control administration expenses. Pharmacists should strive to keep running costs in line with sector averages.

The average cost of rent as a percentage of turnover was 3.08% in 2013 (2.65% in 2012)

The average cost of other overheads as a percentage of turnover was 5.29% in 2013 (5.15% in 2012)

The typical change in pharmacy overheads as a percentage of turnover since 2008 is detailed below:

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2012</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wages to turnover</td>
<td>16.75%</td>
<td>15.21%</td>
<td>13.85%</td>
</tr>
<tr>
<td>Rent to turnover</td>
<td>3.08%</td>
<td>2.65%</td>
<td>1.85%</td>
</tr>
<tr>
<td>Other overheads to turnover</td>
<td>5.29%</td>
<td>5.15%</td>
<td>4.21%</td>
</tr>
</tbody>
</table>
(b) Increase front of counter sales

Our research indicates an ever increasing proportion of pharmacy receipts are coming from the PCRS while front of counter turnover continues to contract.

Figure 9 – PCRS & FOC receipts as a percentage of total turnover

This is further evidence of the impact of the recession on consumer spending power and suggests that average front of shop and OTC medicine turnover has decreased by 56% from 2008 levels.

Pharmacies with strong non-dispensing businesses will be better positioned to withstand the challenges currently facing the sector. We are entering a period where retail focussed pharmacists may come to the fore, and the facility and ability to sell a customer something else may be a key factor in determining success.

Pharmacists must ensure they understand their customer base. By defining the pharmacy role and communicating value and relevance within the store they will ensure customer satisfaction and increase front of counter sales. If necessary pharmacists should seek professional assistance with store planning, identifying strengths and missed opportunities within the current setup.
A pharmacy’s turnover profile is largely determined by the particular circumstances of its customer base

A further note on turnover trends:

A pharmacy’s turnover profile is largely determined by the particular circumstances of its customer or patient base. Our 2012 study pointed to a shift towards GMS medical card dispensing as disposable incomes continued to fall and fewer patients availed of the Drugs Payments Scheme. This is a trend that has continued:

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2012</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>GMS</td>
<td>54.92%</td>
<td>48.04%</td>
<td>41.15%</td>
</tr>
<tr>
<td>DPS</td>
<td>23.01%</td>
<td>25.86%</td>
<td>28.80%</td>
</tr>
<tr>
<td>Private Prescription</td>
<td>6.03%</td>
<td>5.68%</td>
<td>4.74%</td>
</tr>
<tr>
<td>Other schemes</td>
<td>1.12%</td>
<td>1.68%</td>
<td>1.71%</td>
</tr>
<tr>
<td>Front of Shop &amp; OTC</td>
<td>15.32%</td>
<td>18.74%</td>
<td>23.60%</td>
</tr>
</tbody>
</table>
(c) Become the front line point of care

The Scottish Pharmacy model is underpinned by a comprehensive range of nationally specified services supported by a pharmacy contract. This contract offers a remuneration system that encourages continuous improvement and quality healthcare services.

Under this model average fees per pharmacy are higher in Scotland than they are in Ireland.

Similarly, an overhaul of the Canadian healthcare system has led to pharmacists assuming a front line role in patient care. According to the Canadian Foundation for Pharmacy this has led to improved patient outcomes and a reduction in government healthcare costs. Services administered by Canadian pharmacists include; renewing and adapting prescriptions, medication reviews, administering injections and immunisations.
Fully implementing this type of model in Ireland may go some way towards repairing the damage caused by government cuts and a changing competitive landscape. Shifting healthcare services from GP’s and hospitals to community pharmacies is a logical approach for government with tangible benefits for the community and patients; particularly as the population ages and chronic diseases become more prevalent. Within this context it is important for pharmacists to be recognised as more than just dispensers of medication.

The following chart details the fee levels of some government sponsored pharmacy services in Alberta Canada;

![Figure 11 – income from some government sponsored pharmacist services in Alberta, Canada](Image)

(Source – Canadian Foundation for Pharmacy)
(d) Develop a unique identity within the local community

Pharmacy is essentially a local business. This creates huge opportunities to build individual brand identities which are often successfully focused around the owner-pharmacist. This approach cannot be easily copied by supermarkets striving for national or international recognition.

Strong brand identities focused on the local community resonate with customers and patients. Traditional differentiation strategies such as price or product range can be easily copied, but brand identity creates a lasting value greater than the other elements of a business.

In retail pharmacy, the identity of the owner-pharmacist and how they create a unique offering for the local community is central to the development of a strong brand. Customers and patients are the ultimate decision makers when it comes to the perception of brand quality. They expect their pharmacist to provide longer opening hours, shorter waiting times, better information on the medication they are taking and privacy during consultations. Striving to meet these expectations while promoting the perception of quality in the retail environment and providing a unique mix of products and services, will enable pharmacists to create a powerful brand that connects with customers and patients and is difficult to imitate.

A strong brand is more than just sleek logo design. The following are some suggestions to help pharmacists distinguish themselves from their competitors by creating a centre of convenience and expertise in their local community:

- Create a modern and appealing shop layout to enhance the buying experience.
- Incorporate a faster and more convenient service.
- Include a broader retail offering to cater to customer desires and lifestyle habits.
- Include a broader service offering that meets patient requirements.
- Avail of local promotional opportunities which can include; providing articles for local publications, sponsoring events, supporting / hosting educational initiatives, creating a monthly educational newsletter, participating in / organising local health events.
- Harness social media. Facebook, Twitter, Pinterest and Instagram provide opportunities for pharmacists to interact with their customers informing them of health tips, product & service offers and local healthcare initiatives.
There are opportunities to thrive, even in a market with margin and cash flow pressures.

5. Final thoughts

The retail pharmacy sector is facing a number of challenges, the most pressing of which is the continued reduction in PCRS reimbursement rates. In addition, pharmacists are faced with wider retail specific issues, including intense competition from supermarkets, the growing presence of internet operators, and poor prevailing economic conditions.

Established operators with small debt obligations appear to be well placed to face these challenges. This is partly due to their scale and low gearing ratios, but also their recognition that pharmacy is becoming more retail focussed and therefore services should be focused as such. For those independents that are able to recognise this and innovate, there are opportunities to thrive, even in a market with margin and cash flow pressures.

The number of distressed pharmacies is expected to increase and this creates opportunities for innovative operators with healthy balance sheets. The market post reference pricing may be an ideal environment to commence an acquisition strategy. Despite the introduction of reference pricing anecdotal evidence indicates a high demand for pharmacy businesses, which suggests that despite the short-term issues being faced, confidence remains in the long term future of community pharmacies.

This confidence is driven by the recognition that healthcare services will form a more significant part of pharmacy turnover in the future and that retail pharmacy can still be a profitable enterprise, albeit at a reduced level. When the debt burden is resolved, either through pharmacy trading or debt write down the market will again become reliable and sustainable.
French Church, Greyfriars, Waterford.

Fitzgerald Power’s head office is located opposite the French Church in Waterford’s Viking triangle. A statue of Luke Wadding, the Waterford-born Franciscan friar who persuaded the Pope to negotiate with Charles I on behalf of Irish Catholics stands at the entrance to the elegant ruin of the church. Hugh Purcell gave the church to the Franciscans in 1240, asking them in return to pray for him once a day. The church became a hospital after the dissolution of the monasteries, and was then occupied by French Huguenot refugees between 1693 and 1815. John Roberts, the 18th century architect is buried here.
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