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PHARMACY SERVICES

Hung up on percentage

I would like a $1 for every time a pharmacy owner has said to me: 'Business is getting tougher because my gross profit percentage (GP%) keeps falling'.

In fact, GP% is falling and continues to fall in almost all pharmacies. However, most miss the crucial points that gross margin dollars (GP$s) are continuing to rise in most pharmacies, particularly those run by good operators with their eye on the ball, and that the falling GP% isn't caused by the Government cutting the remuneration formula.

Let's get fixated on the dollars because they are the critical thing. The key objective of pharmacy owners and managers should be to grow GP$s per square metre faster than overhead dollars per square metre.

Wal-Mart, the biggest retailer in the world, actually has a policy of reducing their gross profit percentage margin each year. I'm not suggesting that you do the same thing because their retail strategy is radically different to Australian community pharmacies.

However, I'm not concerned about falling total store GP%, provided the source of the cause is falling dispensary margins, because the remuneration level per item dispensed hasn't fallen and, in fact, is rising for those increasing their generic substitution rate.

So the reason for the falling GP% is, in most cases, simply due to higher-cost drugs being prescribed by doctors (that is, drug price inflation) rather than a cut in remuneration or a drop in prescription item numbers dispensed.

Certainly script number growth has tapered somewhat for various reasons as evidenced by PBS script numbers only growing by 2.6 per cent in 2002/03 compared with the previous year. But the evidence of the drug inflation impact on pharmacy dispense margins is that the cost of these items increased by 9.2 per cent! That is, PBS drug price inflation of about 7 per cent that emanates, by the way, from significant growth in concessional and general safety net.

Script numbers and GP$s

Therefore, the key to understanding the true performance of your dispensary is to look at growth in script numbers and GP$s (including supplier discounts and generic supplier incentives). My view is that real dispensary growth can only be assessed by gross profit dollars performance and not sales alone.

Unlike our clients, most community pharmacy owners don't understand the financial performance of the business. Here are two pharmacy examples for the year ended 30 June 2003 from our client base that demonstrate the value of having available accurate data:

Example One:
City neighbourhood community pharmacy.

		Growth $
Dispense Sales growth	13.7%	323,121
Dispense GP% 2003—ex discs	25.3%	
Dispense GP% 2002—ex discs	26.9%	
Dispense GP$ growth	7.2%	45,525
Script Number growth	5.5%	
Retail Sales growth	4.3%	47,784
Retail GP%—ex discs	35.9%	
Retail GP$ growth	15.5%	55,260
Overhead $ growth	(3.3%)	(6,135)
Net Profit $ growth	29.9%	$105,541

These figures clearly indicate that while dispense GP% fell by 1.6 per cent, GP$ grew by 7.2 per cent and script numbers by 5.5 per cent. Furthermore, net profit dollars grew 29.9 per cent because retail margins increased through clever pricing (percentage), category sales mix (stock turns) was improved, and overheads (staff productivity) were held.

Example Two shows a similar trend to Example One. The pharmacy grew dispense GP$s, again demonstrating the importance of monitoring dispense GP$ and script numbers. Retail performed reasonably well because more space and stock were allocated to the S2 and S3 categories that lead to a sales increase and higher GP%. However, net profit fell significantly because additional staff employed didn't result in higher GP$ compared with the wages cost (staff productivity fell).

Example Two:
Provincial community pharmacy

		Growth $
Dispensary sales growth	6.3%	144,008
Dispense GP% 2003—ex discs	24.2%	
Dispense GP% 2002—ex discs	25.1%	
Dispense GP$ growth	2.7%	15,595
Script Number growth	.4%	
Retail Sales growth	4.1%	40,732
Retail GP%—ex discs.	36.2%	
Retail GP$ growth	7.1%	24,932
Overhead $ growth	13.2%	79,954
Net Profit $ growth	(7.1%)	(35,276)

It can be simple

Any pharmacy owner can obtain these figures from the annual and monthly financial statements at no cost. However, the accounting system must be able to split sales and GP$s between retail (including S2/3) from dispense (including patient contributions and PBS safety net). If you can, it's simple.

But to be useful, the figures must be prepared on a timely basis, not months later. The success of your pharmacy relies on dollars generated by the business. Those hung up solely on percentage without getting fixated on dollars may end up disconnected.

The views contained in this column are those of the author and not necessarily held by the AIPM

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