retail management

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Going broke by saving money?

The trinity of management says that to run a business, no matter how small, you have to do three things beautifully:

1. produce a beautiful product;
2. market it beautifully; and
3. have beautiful financial management.

Sirolli, *AFR Boss* July '05

'BEAUTIFUL financial management' entails the production of accurate, timely and relevant results with which to manage the pharmacy business.

Results are the fourth of the five key pre-determinants of planning changes and new business strategies to ensure future financial viability. In the last three months I discussed the first three: competition, consumer behavior and dealing with regulation.

Unfortunately pharmacy financial management is generally anything but beautiful due to the poor quality of data produced and the paucity of skills to make meaningful use of them.

The business strategies of most pharmacies are founded on the platforms of regulation and location, with little regard for financial management. Their business success or otherwise comes from three basic operational axioms:

1. maximise script throughput;
2. minimise payments; and
3. apply clinical expertise.

This basic approach has become a default position because it has been 'easy' to rely on dispensary profits. Under these circumstances, perhaps it is not surprising that most owners focus efforts on buying product, minimising wages and other expenses while ensuring there is sufficient staff to get the scripts done.

But for owners (current and intending) who want to survive long-term, particularly those saddled up with massive debt, that attitude needs to change now. Government continues to pressure PBS dispense margins, including the increasingly important but also eroding generics profits. In the meantime, competitors take chunks of business while overheads (wages and rent) keep increasing.

So, two things must happen:

1. improve business (and dispensing) efficiency and space/stock/staff productivity; and
2. create and manage alternate sources of income from the retail healthcare categories.

To achieve that a massive improvement in owner attitude and pharmacy business financial management is required, including the data produced and the skills required.

Let's look at the two prime sources of data: financial statements and retail data systems.

Financial statements

Do any of the following comments made by pharmacy owners strike a chord?

- I'm too busy doing scripts to manage.
- I'm making too much money to care.
- I'm not making enough money to justify doing it.
- I do the books and BAS myself because I save money.
- The books are only required for my accountant to prepare tax returns and do BAS.
- Stock takes are too expensive and time-consuming.
- Rolling stocktakes take time and get in the way of operating the business.

If so, then your pharmacy is only being operated, not managed, and future profitability is dependent solely on external factors.

Accurate monthly and year-to-date profit and loss statements and balance sheet (financials) should be produced by the bookkeeper, supported by an accurate stock figure. Pharmacists' time should be spent delivering patient healthcare outcomes and managing the business, not trying to save money by doing the books. Many pharmacies go broke saving money.

The monthly financials, when combined with key statistics, provides key data including:

1. Retail and dispense GP%.
2. Sales per m^2.
3. Average retail sale/customer and retail items sold/customer.
4. Customer and script number trends.
5. Expenses.
6. Wages/GP$ (include working owner).
7. Profitability.
8. Stock turn—dispense and retail.
9. Return on assets and investment.
10. Liquidity.
11. Asset productivity (refer opposite —*Tigert's 22 Tiny Retailing Tidbits*).
12. Service and merchandise intensity (too much, too little, just right).

Then compare with stores in the group and relevant industry benchmarks.

From this information, which is easy and cheap to obtain, an expert advisor can tell how the business is travelling, what needs fixing, what doesn't and what opportunities exist. For example, if wages/GP$ is 50 per cent, that means the overall GP% is very low due to low retail sales or, as I commonly find, low retail GP%. But it often means either the staff are badly managed, a 'pig trough' effect exists, a substandard retail offer or just bad rostering.

There are many solutions. Don't simply cut staff. First have a look at service intensity and the store offer. Is the store hard to shop in and cluttered with irrelevant stock? Is average retail sale per customer (excludes PBS and patient contribution) and average number of retail items sold per customer greater than $10 and one respectively? If not, then in most circumstances, there is potential to increase retail sales and profits. A better customer service may even result.

These questions can only be posed and answered if you have the data.

Retail data systems

A mass of data is available from retail POS systems, including the dispensary system.

Here lies the gold! If accurate and utilised properly, the data drives the results and key performance indicators referred to in the previous section.

The key mechanism is asset productivity: 'The three most useful measures of the performance and productivity of a retailer are:

1. GMROS (gross margin return per square metre of floor space).
2. GMROI (gross margin return on inventory investment).
3. GMROL (gross margin return on full-time equivalent (FTE) employee).'

(*Tigert's 22 Tiny Retailing Tidbits*)

Big dollars are invested in these assets and must be constantly monitored.

Fortunately GMROS and GMROI can be measured at the store, department, category and SKU (GMROI mainly) levels. GMROS is the key because space (fitout, rent and so on) costs approximately nine times the cost of maintaining stock (interest rate).

Producing this data, combined with the analysis tools we use, tells owners and retail managers what's performing and what isn't.

To demonstrate: by using the data from a pharmacy we recently evaluated, many underperforming categories were discovered to which large amounts of very expensive space and stock were devoted. Of course there were several terrific categories too, but they had been strangled and obliterated by the former. For example, a cosmetics brand took up 22 linear metres and $8,456 of stock but only produced GMROS and GMROI of $279 and $0.71. Gifts (almost always overdone), occupying 32 linear metres, were worse.

Both are dreadful when compared with the store retail average GMROS of $2,552 and GMROI $3.65. But the poor performance is made more obvious when compared with analgesics GMROS of $3,159 from only 17 linear metres; cough and cold of $2,682 from 24 linear metres; vitamins of $1,548 from 25 linear metres.

The point is, if you have this data and the analysis tools, the merchandise categories can be radically altered to meet customer needs and drive up productivity. That, in turn, drives up profits and, if a strategic element is added, the pharmacy offer can be differentiated and customer relevance enhanced.

Owners who know what's going on and abdicate the old operational axioms will be in a position to manage significant change and ensure long-term viability. The rest seriously risk slowly going broke saving money.

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