Better the Data You Know

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The importance of data to business for improving relationships with customers and ultimately improving performance is certainly a topical one. Just last month, Business Review Weekly (BRW) magazine featured Big Data both on its front cover and with a feature article. The same article focused on how big retailers are using data from many sources to gather customer insights and incorporate them into the development of their offer as well as their marketing and loyalty programs.

Interestingly the article discusses how an adult nappy manufacturer used data insights from the old Ninemsn (now called Mi9) to more directly reach their target market online and through mobile advertising.

Community pharmacists occupy a unique space in retail and generally both understand and embrace their position as health practitioners operating in a complex retail environment. Up until the turn of the century the industry was largely left alone by mainstream retailers while it developed a strong foothold in consumers hearts and minds for health related products and advice. From about 2000 onwards however technology and other sophisticated resources which come with size have assisted large retailers in developing a greater understanding of their category opportunities. As a result non Pharmacy retailers have been able to attract and redirect customer spend from Pharmacies to themselves.

While Pharmacies still of course enjoy the benefit of regulation that ensures they are the only retail businesses capable of dispensing medicines, the consumer and competitive retail environment in which we all participate is changing our expectations and the way we shop at an increasing rate and on a global scale.

It seems much longer but the iPad has only just turned three years old while the iPhone is a very grown up six years old. Between the two of them and their cousin Androids and Tablets they manage to delight consumers and trouble retailers who have been slow to broaden or deepen their engagement with customers.

The speed of take up of these devices has occurred with the assistance of technology previously unknown to the average consumer but now mainstream in our vernacular. These technologies include Wi-Fi, 3G, 4G and of course the slowly transitioning NBN or National Broadband Network. The opportunities and benefits stemming from NFC or near field technology will also begin to appear over the next few years as consumers allow retailers to push through information to them when they are located in the immediate vicinity.

With the improvement of network speed and the increasing take up of Smart TV's it will not be long before using the family TV to shop or watch YouTube while at the same time as catching up with Facebook and Twitter feeds becomes part of mainstream usage rather than for just those at the front of the technological curve .

But the devices and technologies are simply the enablers of the retail revolution that is enhancing the reach and understanding of retailers as well as the influence and experience of consumers.

Insights are gained and offers promoted via social media networks such as Twitter and Facebook while QR(Quick Response) codes are now a standard form of information delivery for general retailers and manufacturers. And of course the YouTube phenomenon continues unabated.(It is interesting to note that Google bought YouTube in 2006 for $1.6bn and seven years on now receive $3.6bn per year from advertising revenue which is growing at 20% pa.)

Just like the world did not necessarily understand what Google knew or at least believed in 2006 regarding YouTube's potential then at a business level the same may well be said in few short years about the impact of Google Analytics.

Google's business units now cover Media (Youtube) Advertising (Google Adwords), Books (Google Books), News (Google News), Data Storage (GoogleDrive), Digital Photography (Picassa), social networking (Google+), operating systems (Androids), computers (Chromebook), /Browsers (Chrome), mobile banking (Google Wallet), phones (Nexus), telecommunications (GoogleVoice) and of course the just announced Calico – Google's fledgling Health business project that is intending to initially target decreased mobility and mental agility that comes with age and life threatening diseases.

Clearly there is a "chicken and egg" business cycle for businesses willing to invest in the use of technology to collect data then interpret and translate it into improved customer experiences.

It has been reported by IBM that 90% of the World's data has been created within the last two years with Walmart and Amazon leading the way on the International stage. Walmart now globally collect two petabytes of customer data per hour – that is the equivalent of 50 million filing cabinets of paper per hour.

Anyone who has shopped digitally with sophisticated retailers will understand exactly how consumer analytics translates into targeted recommendations. Amazon themselves have reported that about 30% of their sales are generated from their recommendation engine while McKinsey Global Institute's study of the US retail sector found that Big Data could improve retailers' Gross Profit dollars by up to 60%.

Many of these data insights are not immediately obvious and can often surprise, but once known will influence the merchandising decisions of those retailers. One quirky example is Osco Drug in the US who learned that nappies and beer were consistent common purchases in their stores during the evening.

Of greater relevance and much closer to home, Woolworths recently purchased a 50% interest in a data analytics company called Qantium while Coles relaunched Fly Buys in 2012 and now reaches out to 7 million members. These efforts mark a clear move beyond just tapping credit and loyalty card data to track consumer habits. With greater data and analysis these retailers are seeking to improve promotions and marketing by increasing their level of personalisation.

Part of this ongoing development sees also sees companies like Woolworths sharing their customer data with manufacturers – at a cost no doubt - so they too can improve product development and customer engagement at a branded product level.

Woolworths is in fact in many respects starting to resemble a technology company as their 2014 IT project budgets exceed planned refurbishment costs - $603m vs $472m. A key component of their spend is an upgrade of their Point of Sale systems to allow customers to connect at store level via their electronic devices (I assume one example would be in-store scanning apps etc for customers) while also allowing for easier integration of data into their Enterprise Management System.

Back overseas and Nieman Marcus the US department store is now able to enhance a customer's shopping experience by allowing you to use your smartphone interactively while shopping in-store. This occurs by the customer being able to check-in via the app which will notify a store sales assistant of their location, what they look like, their prior purchases and preferences before they even get approached.

There is no doubt that the pace of change in the general retail and consumer environments is greater than it has ever been in the past. (At a Pharmacy level in Australia Priceline could lay claim to leading the way with gathering customer data given the 3.9m members in their Sister Club loyalty program and their ability to enhance the information with Point of Sale data also managed and controlled by head office.)

Regardless though of how well placed any Pharmacy Group is in relation to customer data collection all will readily acknowledge that as critical as data analysis is in helping develop strategies to improve customer engagement and sales, it does not of itself automatically guarantee great financial results to all group members.

Historically Pharmacy businesses have prospered due to:

- Regulation of product and
- Regulation of location and in recent years
- Ability to substitute generic medicines

Regulation has not been enough however to stop the impact of the warehouse disruptors who have both highlighted and contributed to the changing value equation for consumers.

As a result our own community Pharmacy data highlights the following trends:

- Overall sales growth is now in decline due to price disclosure reductions despite script numbers increasing
- Retail sales and customer numbers are flat to declining for most community pharmacies due to the previously mentioned reasons
- Expenses continue to increase largely due to rent increases outstripping inflation
- The negative impacts from the previous points have been masked by the increased short term profitability that has come from the industry's outstanding success at delivering increased substitution rates

Based on our own client data, gross profit per Rx has risen from $10 in 2005 to $14.52 for 2013 and up until December 1 for many Pharmacies was over $15. But as I have written about in various Pharmacy publications, December 1 only represents the beginning of the descent from the summit of Gross Profit per prescription.

The evidence for this is best illustrated by considering the price cutting cycle that has occurred with the 40mg version of Lipitor and its generic equivalent. From a dispensed price of around $80 in 2012 through to now under the general co-payment and then down to an expected $12 or less by October next year. At this point Pharmacy owners will be receiving less remuneration for an Atorvastatin prescription than they were in 2007 before Lipitor came off patent.

Fortunately, since 2006 Pharmacy's financial performance has been bolstered by a continuous flow of drugs coming off patent ensuring that to date a single drug's price reduction has not been felt in an overall sense.

Driven by both the impact of price reduction on Atorvastatin and Rosuvastatin and the lack of new blockbuster drugs in the pipeline we started advising our clients in January 2013 year to begin planning for an expected loss on average of at least $2 per script by late 2015. For the average Australian Pharmacy dispensing 45,000 scripts per year this equates to a $90,000 loss and has in recent months been confirmed by the Guild's own communications.

Pharmacy businesses are often valued for around 5 times their earnings which means an average size Pharmacy will decline in value by $500k. In fact, given that Purchasers buy future business profits business values should already factor this in. This point is of importance to owners and employee Pharmacists as their ability to generate higher wages is inextricably linked to business performance – hence all Pharmacists need to understand what is required to deliver value to customers and in turn the business.

Pharmacies are accessible to all Australians across all different types of retail locations. Examples include medical centres, suburban strips and of course shopping centres. It is in the latter where exposure to these changes is at its highest. This is because rent is at its highest in Shopping Centre Pharmacies and therefore profit as a percentage is at its lowest. In essence shopping centre Pharmacies will on average lose a greater percentage of their net profit due to price reductions than other types of Pharmacies.

The analysis of our own client base results indicate that rent in non shopping centre Pharmacies is less than 3.5% of sales while shopping centre Pharmacies (on average) represent 7.5% of sales. More importantly the component dedicated to retail costs almost 18% of retail sales. This ultimately results in shopping centre Pharmacies' retail space losing almost $1,200 per sqm.

The headline data is a good start to understanding where an owner's energies should be focussed but is insufficient by itself to diagnose problems and create solutions. All Pharmacies should understand their headline financial statement metrics and know their category performance metrics before formulating business improvement strategies.
Analysis of our own client category performance data highlights that once wages, rent and other expenses are properly apportioned most Pharmacies lose money on their retail space while the health categories generally generate a profit.

Script volume growth is now minimal to negative in many Pharmacies due to the increasing number of scripts falling in price to below copayment threshold – i.e. Atorvastatin 40mg, 30's which are being sold by "Warehouse" to general patients for $14.99 compared to the Lipitor equivalent of $24.99.

The Government's PBS data in fact recently revealed that the Government had funded 17% fewer scripts for the six months ended August 31 which is reflective of scripts falling out of the PBS as well as potentially less scripts being written.

While some of the facts are quite confronting for Pharmacy owners they can be offset by placing a Pharmacist in a permanent customer engagement role to support scheduled medicine. Our analysis has shown that medicine sales can increase by between 10 and 15% across the Pharmacy's highest profit margin product lines where this strategy is successfully implemented.

Further comfort can also be found in the fact that Pharmacies which specialise in the provision of healthcare and services are able to generate a profit from their non-dispensary space. This is because the space is skewed towards health products and solutions which are coupled with advice and services.

Equally we know from Guild Scriptmap reports that despite many Pharmacies achieving an average substitution rate in line with the industry average of circa 78%, there are many opportunities being missed on a molecule by molecule basis. Again the data detail reveals significant profit opportunities to replace what will be lost through ongoing price reductions.

Moving to a health solutions delivery model is not as simple as it might seem though, as there are numerous road blocks to overcome. These include,

1. Changing from the historically successful business model which is built on maximising the number of scripts for the minimum labour cost (without sacrificing patient safety!). Success under this model is usually defined by Pharmacists minimising patient facing time – this is highlighted most when a Pharmacist owner will tell you how many scripts he can get done in a day!

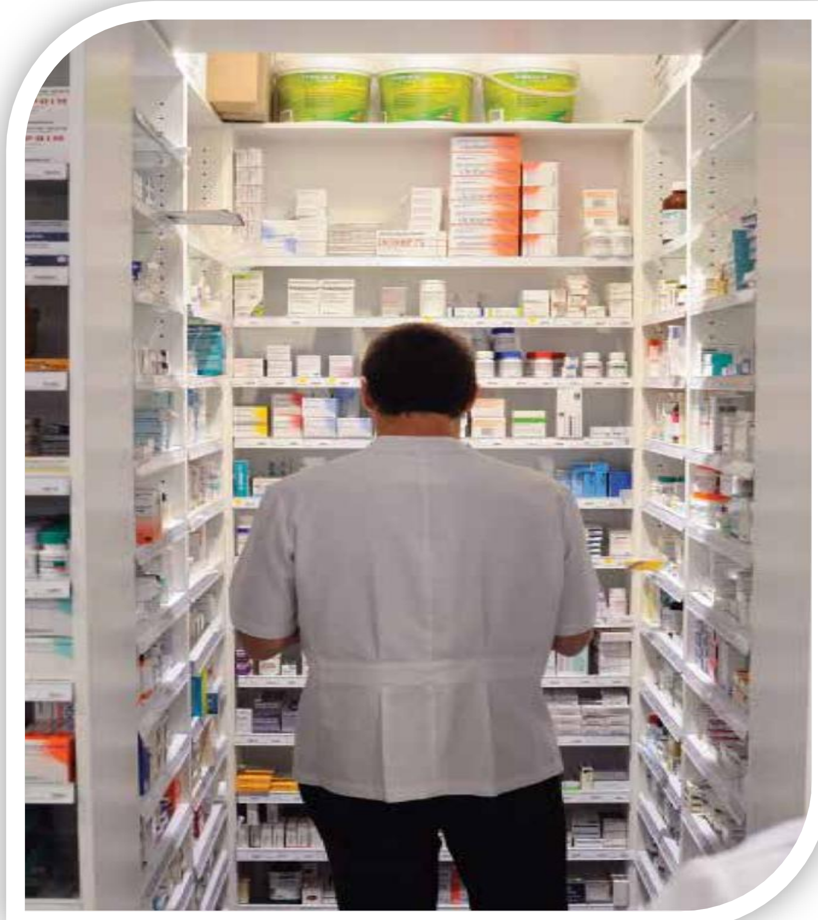
2. As such the alternative services model is in conflict as it revolves around increasing customer facing time by Pharmacists - albeit still with the business emphasis on increasing revenues.

3. Inherent in this shift is changing the common culture of the Pharmacist where the historical preference has been to not be customer facing unless required. Those who seek to defend the historical model will often decry the lack of profitability in delivering services. But this view of course overlooks the fact that services income and the cost of delivery cannot be viewed in isolation. The real business benefits that flow from a services model is that improved patient outcomes usually come when a management and prevention component is connected to the use of a medicine. Hence the combined solution involves retail products, increased customer satisfaction and therefore ongoing loyalty.

In addition to the cultural change required physical change is often needed as Dispensary and Pharmacy layouts can work against a services delivery model as many have been designed to protect the Pharmacist from customers so he/she can maximise dispensing time.

And finally changing a model requires significant training and leadership from management to guarantee a successful transition.

A picture often speaks a thousand words and the picture to the right depicts the road blocks at work. The shelving is inefficient when it comes to stock retrieval and delivery by comparison to alternatives such as gravity fed shelving, roundshelves and robots. While the Pharmacist is seen here retrieving stock which could be done by a technician allowing the Pharmacist to engage with the customer and focus on valuable health outcomes.



Changing behaviour is assisted and reinforced by focussing on the right metrics. For all Pharmacies these should include:

1. Sales per square metre
2. Gross profit dollars per script
3. Gross profit dollar growth
4. Script and customer growth
5. Wages as a percentage of GP$ and other income – note here that the inclusion of other income is important as Pharmacists should be increasingly spending their time generating services related income as well as product sales
6. Gross profit per space which is measured down to category level

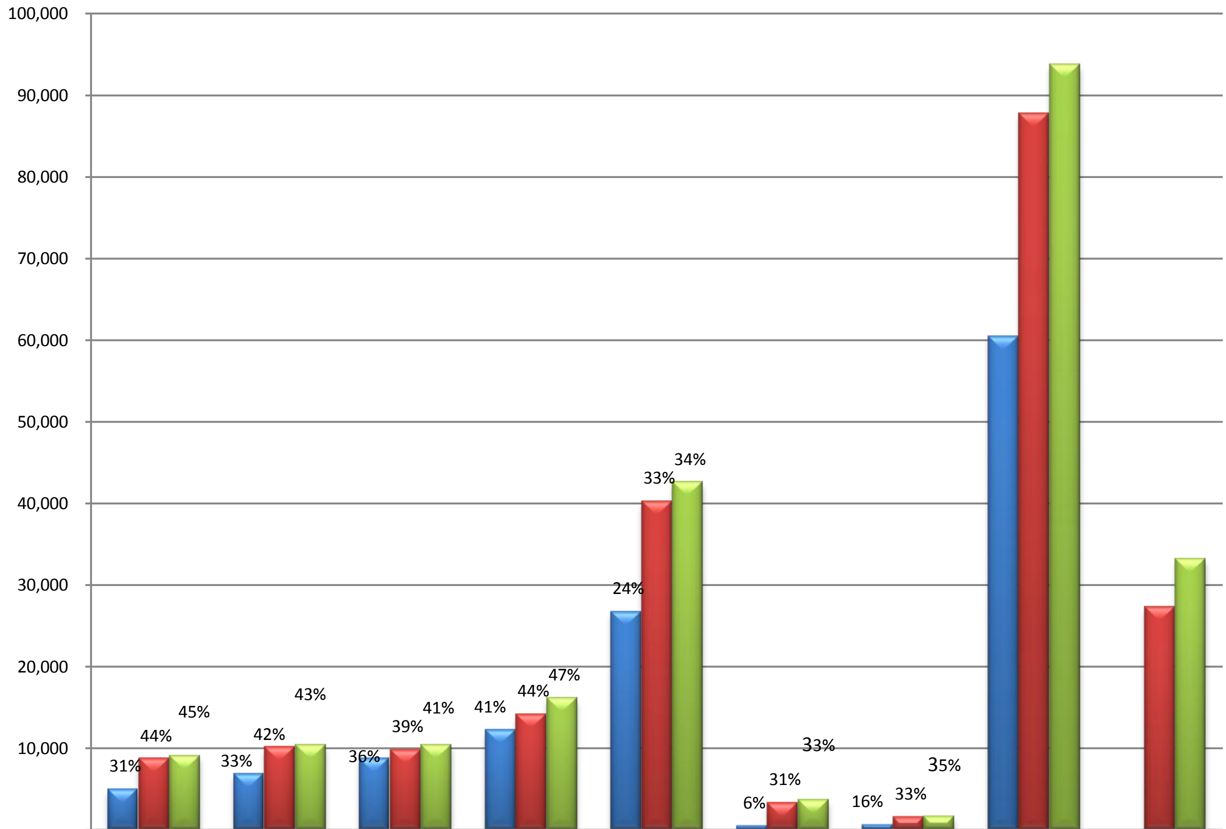
The change process is not simple and is never complete but the Pharmacies we assist with the process understand that as much as there is a need to find a competitive point of difference from Warehouse pharmacies they are actually responding to market demand and that is :

- There is growth in an aging population and with it a growth in related medical conditions
- Customers want help and studies have shown that there is a clear preference of better before cheaper and
- There is a government expectation as well as a financial benefit from commercialising services and programs

By way of support, the Government's own forecasts show that the number of people with Diabetes receiving benefit from NDSS totals 1.2million and is forecast to grow at an amazing 9% per annum. This one condition alone and the related problems that are attached to it reinforce why Pharmacy will continue to be presented with growth opportunities well into the future.

But as much as future growth opportunities exist by developing expertise and solutions around specific conditions there are simple opportunities that exist in many Pharmacies that can be converted immediately. The attached graph is one I recently produced for a small pharmacy client comparing the category performance from seven key health categories. When compared with the averages from our client database the underperformance in GP across these categories was due to being too aggressive with pricing decisions and totalled approximately $30,000 pa.

Margin Opportunity



	Cough & Cold	Sinus & Allergy	Stomach & GI	Analgesics	Natural health	Weight Mgmt	Skin Care	Total GP	Difference
JR 'client' Pharmacy	4,977	6,867	8,696	12,177	26,725	451	604	60,498	
JR Average	8,650	10,087	9,809	14,171	40,264	3,299	1,520	87,801	27,303
JR Group Average <$2.5m	9,074	10,327	10,380	16,096	42,547	3,660	1,630	93,715	33,217

While it was easily fixed , the causes for underperformance are not always simply due to pricing decisions. Buying terms, merchandising and staff skill sets can all contribute but ultimately only proper data analysis will provide both the necessary insight and the call to action to chase opportunities.

Clearly our view at JR.pharmacy is that both short term and long term opportunity exists in the majority of Pharmacies across Australia and as such we remain optimistic about the future despite the impending loss of profit from price disclosure. Those with high debt and rent levels are certainly most exposed. For all Pharmacies though there is a need to address the ongoing industry changes while also withstanding the changing capabilities of bigger retailers via data analytics, social media and the internet.

Achieving growth and optimising business performance for community Pharmacy - and the majority of retailers for that matter - is ultimately about being able to engage the customer on something other than price. For Pharmacies this is about Pharmacists using the existing dispensary traffic to leverage Professional knowledge into Health categories. To do this efficiently, many Pharmacies still need to address procedures and workflows within the engine room that is the dispensary.

Greater insight is available by simply using the data that already exists in the Point of Sale systems and financial statements. The challenge though is to convert this data into meaningful information which can drive actions and deliver meaningful customer outcomes.