Johnston Rorke partner in charge of pharmacy services, Bruce Annabel, bannabel@jr.com.au

JOHNSTON RORKE JR PHARMACY SERVICES

Race to the bottom

ANY pharmacy retailer can reduce prices but few do so profitably!

The appearance of more low-cost, low-price pharmacy stores appears to have caused panic among pharmacies located in the same market areas. Unfortunately the reaction of many to this situation continues to follow predictable lines: reduce prices in core high-margin categories because a few customers complain, a small percentage shop elsewhere and the competition sells for less.

One of the low-cost, low-price warehouses opened approximately 12 months ago near one of our client pharmacies, resulting in customer numbers dropping 6 per cent and script numbers falling 5 per cent. That wasn't catastrophic because the pharmacy stuck to its fundamental strengths of superior location, excellent customer service and a deep range of specific retail categories.

The client agreed not to reduce prices; they were, in fact, enhanced via improved supplier terms and increased generic substitution. At the same time staff productivity was improved. Hence, the result to 31 December 2004 revealed an increased net profit that was in line with the budget we set in May last year and retail gross profit margin remained at higher than 38 per cent.

The theory of lower prices is that higher volume will produce a net positive trade-off in gross profit dollars (GP$). In my experience, that simply doesn't happen in a sustainable way, with the exception of the aforementioned low-cost, low-price retailers. That's because customers don't primarily visit conveniently located pharmacies because of low prices and that means the necessary volume increase doesn't occur. From a profitability perspective, please be aware that the sales volume increase required just to achieve a neutral offset is huge. The following example (Table One) demonstrates the challenge of a successful discounting strategy. Note the increase in volume sales required.

Table One

	Now	Discounted
Sale price	$13	$10
Mark-up	70 per cent	31 per cent
GP$	$5.35	$2.35
Volume lift required		128 per cent

But, there is a critical point of divergence here that's essential for the pharmacy owner to understand and inform all pharmacy staff. That's to understand the difference between using low price as a strategy versus low price as a tactic.

In my January article ('Water can run uphill', p46, *AJP*, Jan 2005) I offered an example of how a community pharmacy used smart pricing with the top-branded baby nappies and formula to generate traffic, creating profitable sales growth in other high-margin categories. Similar tactics can be carefully adopted in many categories. An important by-product is that through smart pricing of 'signpost' items, you are telling customers that your store isn't expensive.

Several pharmacy retailers use low price as an integral part of their strategy. The best is a rapidly expanding low-cost, low-price pharmacy warehouse group which, by now, has probably realised that due to the width of the price differential, only a small budget on marketing and communication can be afforded. That's typical of these types of retailers around the world because when the price gap is 20 per cent or more, customers find out quickly and forsake convenience for price.

Herein lies another critical issue for pharmacy owners to understand and take on board. These retailers aren't discounters because they utilise the concept, 'every day low price', as a core strategy approach to pricing. Therefore, they survive on three fundamental strategies:

- low prices across the board, as already discussed;
- wide range—all pharmacy categories heavily stocked; and
- low costs—fitout, rent, wages, advertising and purchases.

Having said all that, many pharmacies are confused about these concepts and are reducing prices anyway. The greatest danger is in relation to pharmacies located in very high cost locations and employing a high cost retail model. However, I'm pleased to say that the majority of our clients haven't fallen into this trap, as supported by our client figures for retail margins in 2003 and 2004, which consistently averaged 37 per cent (discounts included). These pharmacies are representative of almost all state and territory jurisdictions, although primarily the five east coast states and territory.

The reasons are:

- we tell our clients on a regular basis what their correct retail margins are;
- we drill into our clients category results and benchmark against the category average and best performance margins, thus maintaining and maximising profitability; and
- we understand that most customers will pay more for convenience, time savings, accessibility, enjoyable format and perhaps a higher level of personal service. Traditional 'me too' community pharmacies don't do these well enough, with the exception of convenience.

Retail will be the salvation of pharmacy provided the offer is strong, relevant and differentiated enough. At the moment it's not! That's why many are joining the race to the bottom; they can't focus on strengthening their value proposition via any other component from the value equation other than price!

For those who do get caught up in the price spiral, please remember that the ultimate winner on low price will be the one that struggles to make a profit! ■

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