



The Pharmacy  
Guild of Australia

Pharmacy Guild submission to

Productivity Commission- Issues Paper:  
Relative Costs of Doing Business in Australia: Retail Trade Industry

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**National Secretariat**

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## Introduction

The Pharmacy Guild of Australia (the Guild) is pleased to provide a submission to the Productivity Commission's Issues Paper *Relative Costs of Doing Business in Australia: Retail Trade Industry*.

## The Pharmacy Guild of Australia

The Pharmacy Guild of Australia is the national peak pharmacy organisation representing community pharmacies. The Guild strives to promote, maintain and support community pharmacies as the most appropriate primary providers of health care to the community through optimum therapeutic use of medicines, medicines management and related services.

## Community Pharmacies in Australia

There are over 5,300 community pharmacies across Australia. Most of these are either small or medium sized businesses. Not only do they dispense over 250 million prescriptions annually, community pharmacies also retail health care items, over the counter medicines, cosmetics, toiletries and other items. Prescribed medicines account for approximately 70% of sales, whilst other controlled medicine, health and retail products make up the remaining 30%.

In addition community pharmacies operate as a primary health destination which customers will attend for immediate medical advice and health services. 94% of Australians will visit a pharmacy every year, and for those with chronic conditions visiting a pharmacy is part of their essential shopping routine.

Prescription drugs are exclusively available through pharmacies, and pharmacy staff have a range of professional obligations and a duty of care to their patients. This positions pharmacy as uniquely important for each local community, but also restricts the nature and options for the business.

Community pharmacies are a trusted network in Australia. The *Roy Morgan Image of Professionals Survey 2014* found that 86 per cent of respondents rate pharmacists highly on ethics and honesty – up two per cent on last year's result. This annual survey has confirmed that pharmacists are valued and respected. The community pharmacy network is Australia's most accessible health care destination where people can seek advice, services and lifesaving medication in many cases 7 days a week, after hours and without an appointment.

## Competition in Pharmacy

The over 5,300 community pharmacies operating in Australia are independently owned by over 4,000 individual community pharmacists, ensuring a competitive market for consumers.

Competition in the pharmacy sector has intensified over the last decade with the expansion of a number of community pharmacy groups operating under a discount model.

The vigorous competition between pharmacies has resulted in an invigorated, evolving, and industry perpetually innovating to remain competitive. With the rapid rise of discount pharmacies, many pharmacies have been forced to change their business models. To remain viable pharmacies have

had to differentiate themselves by providing exceptional and personalised service to their clients or through offering discounted prices.

## Inclusion of Pharmacy Retailing

The Guild believes the inclusion of pharmacy in the Productivity Commission's study is essential in establishing a broad understanding of the costs of doing business for the Australian retail industry.

Community pharmacy is a specialist retail industry. There is no "one size fits all" definition of the retail industry. The retail industry is a service industry and has many roles — it introduces consumers to new products and assists them to assess products and compare prices. It enables consumers to buy goods at convenient times and locations and in quantities they find appropriate to their needs, and can provide a range of ancillary services. Community pharmacies do this by selling products to customers at a range of locations and providing services to assist customers with their purchase. "Ancillary services" include the provision of specialised advice and counselling on medications purchased.

**The success of the pharmacy channel is integral to the health of the retail industry.**

Despite its primary health care role community pharmacy operates as a business and must survive in a commercial environment. Profitability is an essential part of that landscape and, as with any retail business, sales generated by pharmacies must outweigh expenses incurred. Unlike other retailers however community pharmacy is also required to respond to and manage government reforms relating to the sale of Pharmaceutical Benefits Scheme (PBS) medicines, and the impact those reforms have on the profit margins of business.

The pharmacy channel is the largest single retail channel in Australia with in excess of 5300 outlets Australia-wide servicing on average over 4,291 people per pharmacy in both metropolitan and rural areas. Pharmacies currently employ over 20,000 pharmacists and over 43,000 pharmacy assistants, as well as a range of staff in other roles including delivery drivers, administration and security. In total community pharmacies make a significant contribution to the Australian economy with an annual turnover of \$15.31 billion.

As such the Guild believes the inclusion of pharmacy in the Productivity Commission's study is essential in establishing a broad understanding of the costs of doing business for the Australian retail industry.

## Costs of Doing Business

### Present Situation for Pharmaceutical Retailing

Community pharmacies retail prescription drugs, other controlled medicines, over the counter medicines, cosmetics, toiletries and other items as well as providing associated services. Revenue associated with prescription drugs is governed by the Community Pharmacy Agreement (CPA), currently iteration 5 governing 2010-2015. A sixth CPA is scheduled to be established to govern 2016-2020. This agreement details the remuneration pharmacies receive for dispensing Pharmaceutical Benefits Scheme (PBS) medicines and for providing services to the community.

For PBS medicines the patient pays up to \$36.90 (or \$6.00 for concession card holders). The government reimburses the remainder of the cost of the drug to the pharmacy. Pharmacy

remuneration for PBS drugs is not like a normal retail transaction. For the most part there is limited pharmacy control over what is purchased by the customer (as it needs to be prescribed) and at what price it is dispensed (as this is set nationally by the government). Most of the gross margin results from specific fees and margins the pharmacy is entitled to claim from the government for the dispensing of each specific prescription. For this reason, trading profits on PBS medicine dispensed are restricted.

For a typical pharmacy the cost of goods sold (purchasing medicine and other stock to sell) costs about two thirds of their sales revenue. This remaining one third, the gross margin, is then required to pay for all operating expenses before a profit can be achieved for the business.

## Impact of Price Disclosure

All businesses must generate a sufficient level of profit from the sale of goods and services to offset expenses incurred. Retail businesses across Australia have been subject to increasing generalised pressure in their bid to do this. The impact on community pharmacies has been no different. In the past however community pharmacies have been able to mask these pressures through cross subsidisation from the sale of PBS medicines.

Until recently when a medicine was no longer on patent multiple manufacturers would enter the market and through competition offer increasingly lower prices to pharmacies to purchase the drug. As there was a fixed higher price set at which each drug could be claimed for reimbursement from the government, this allowed pharmacies to profit from the difference in trading prices. This profit margin has allowed services and expenses to be cross subsidised and has contributed to increases in business values.

Since 2007-08 the Federal Government has progressively introduced a cost-saving measure known as Price Disclosure whereby the prices at which pharmacies can purchase medicine are reported and periodically the official PBS price at which the government remunerates that medicine is reduced. This gradually nets out the margin pharmacy was previously gaining and in doing so reduces pharmacy profits and the ability to cross subsidise services and expenses.

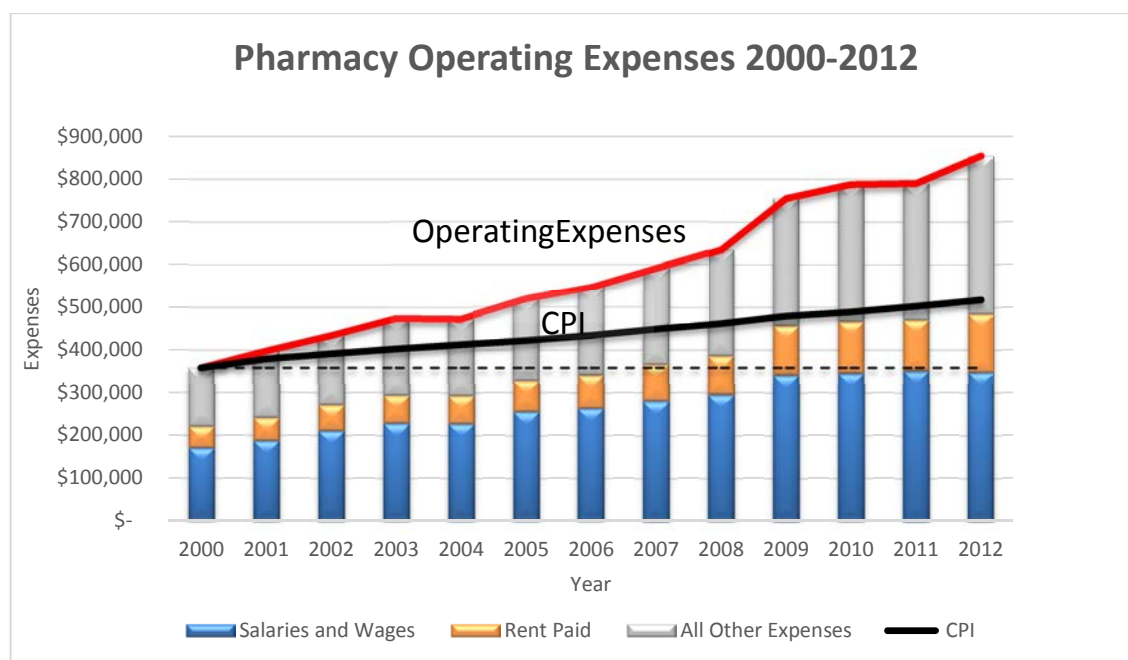
In August 2013, without prior consultation with the pharmacy sector, changes were announced to Price Disclosure which will significantly reduce the trading profit available to pharmacies from October 2014. These changes were a surprise to business and as such previous planning has not taken into account this additional impact. On average pharmacies which maintain their current cost structure are expected to have a total reduction from price disclosure in 2014-15 profits of \$90,000. The impact on some pharmacies will be much larger than that. Many pharmacies are being forced to reduce services, staff and availability to remain viable. This is not only affecting hard-working pharmacy professionals, but also importantly the communities they serve.

**Pharmacy expenses are unsustainable and threaten ongoing viability.**

## Increase in Operating Expenses

All retail businesses are subject to increasing operating expenses due to cost pressures across a range of business inputs. However the operating expenses of pharmacies are higher and are more difficult to offset than for other retail businesses, due to the need to meet various regulatory and professional requirements and pharmacies' core role of dispensing government subsidised medicines.

For the average pharmacy operating expenses take up three quarters of the gross margin (the revenue after deducting the cost of goods sold). Labour costs are the main expense, reflecting the requirement to employ qualified pharmacists and to provide service and advice with regard to most products that are sold, as opposed to the customer self-selection or low service models of many other retailers. Rent makes up the second largest cost and has increased substantially in both dollar and percentage terms over the last decade. The third largest set of expenses relates to financing and depreciation costs. These have increased in recent years with the growth in pharmacy business value which has put pressure on those establishing or purchasing a new business. However, with the Government's price disclosure policies increasingly impacting on pharmacies, these business values have levelled off and may now in fact be declining, making it more difficult for pharmacies to meet their financing obligations.



Pharmacy operating expenses have increased substantially, driven by higher per unit costs and increased business sizes. This growth has outstripped CPI and whilst other growth metrics have flattened in the last five years, operating expenses continue to go up. In the chart above *All Other Expenses* includes interest, superannuation, utilities, depreciation, equipment leasing, advertising etc.

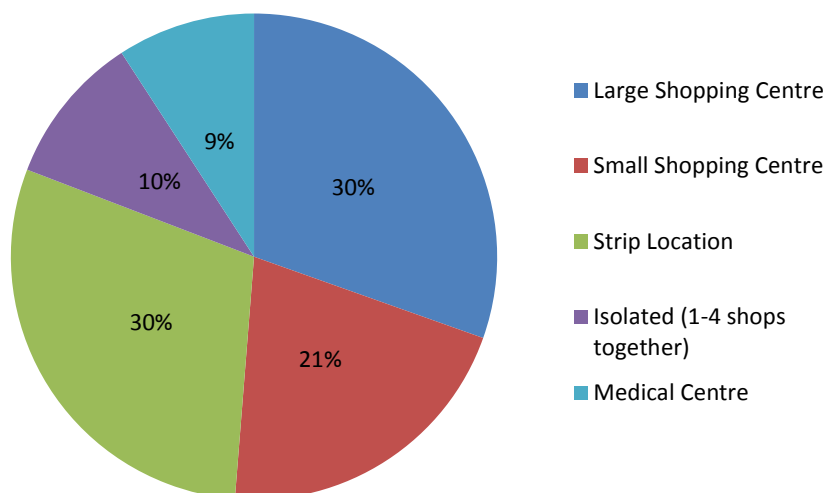
### Occupancy Costs and Rents

The retail environment for pharmacy is, as with the broader Australian Retail market, based around a diverse mix of premise locations with formats ranging from single building outlets through to highly sophisticated Super Regional Shopping Centres.

Pharmacies almost ubiquitously rent the property from which they operate. With an estimated 290,000\* (plus) retail leases across the Australian Retail market, the bulk of retailers are reliant on leased premises as the dominant commercial structure. Noting further that the minority of retail

businesses that do own their premises should also factor the capital invested as a cost of the retail business as well.<sup>1</sup>

The majority of retailers seek to operate in shopping centre environments as the preferred vehicle to merchandise their products, and it is safe to assume the consumer prefers on the whole this format as well. 51% of all pharmacies are operating in a shopping centre environment.



Source: Guild Digest 2013

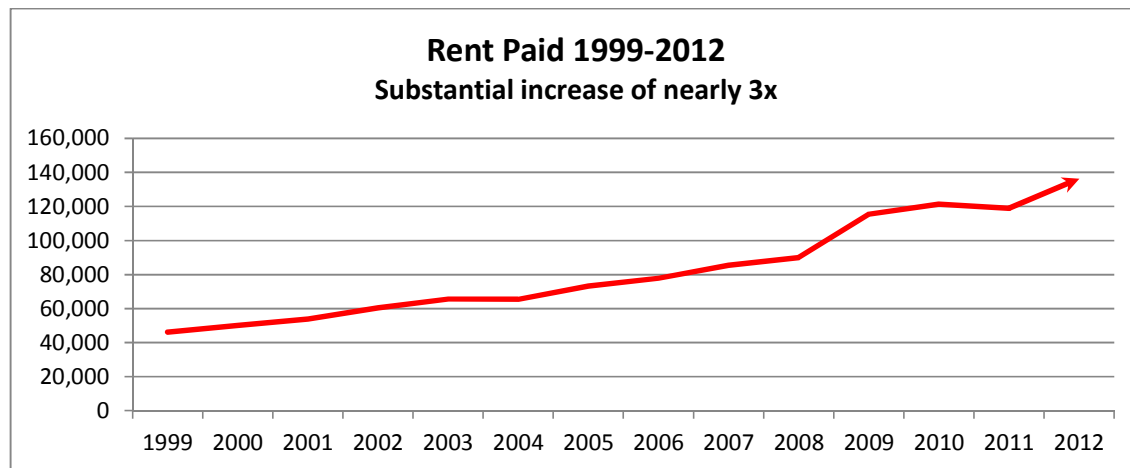
Therefore the relationship between Lessor and Lessee and the commercial considerations derived from retail leases becomes an important component of securing appropriate premises to conduct a retail business. A large percentage of these leases are formed as a result of negotiations between individual or small group pharmacies with large shopping centre groups.

When comparing costs for the Pharmacy Channel we have referenced the Pharmacy Guild of Australia annual financial surveys of members Guild Digest 2013, a report which has been produced annually for over 40 years and is recognised as the industry authority on both qualitative and quantitative financial data comparisons.

**Rental costs are outstripping other business costs and CPI.**

Rent has increased dramatically for pharmacy in the last decade. The average rent in 2012 was nearly three times that of 1999.

<sup>1</sup> PC Report No.43 31/03/2008



Of course over any given comparison period there will be increases in the dollar value costs and variances to other matrix such as premises size and turnover; however the one constant ratio for measurement of the relationship of real estate to retail outcomes is occupancy cost.

Occupancy cost ratio is equal to the gross rent as a percentage of retail sales. With a consistent business environment it would be expected that the occupancy cost ratio would remain flat.

In comparing the Guild Digest reports for years 2004 to 2013 a noticeable and significant shift in the occupancy cost ratio has occurred directly reflective of the changes in the cost of doing business for pharmacies in the same period. Taking the position for the majority of pharmacies in shopping centres with a turnover in excess of \$3.5 million an analysis clearly shows an *increase in occupancy cost ratio of 29.97%*.

	<u>2004</u>	<u>2013</u>
Occupancy Cost Ratio	3.47%	4.51%

The same analysis of average rental costs on a square metre basis reveals an *increase in gross rental/sqm of 37.99%*.

	<u>2004</u>	<u>2013</u>
Average Size	276 sqm	336 sqm
Annual Rent	\$163,096	\$262,202
Gross rent/sqm	\$591	\$780

This trend is likely to continue regardless of any market perceived softening in retail rentals as the Pharmacy Channel is exposed to increasing competition eroding retail sales growth from both bricks and mortar and online competitors (particularly in the areas of health/vitamin supplements and beauty/skin care products).

Coupled with the drive by retail property owners and managers to consistently achieve above inflation growth on investment returns and significantly increasing operating expenses, according to an international comparison by CBRE Research, three of Australia's capital cities were on the list of top ten international highest retail rental cities in the world.

Markets	Q1 2013 US\$ Per Sq Ft Per Annum	Q1 2013 € Per Sq M Per Annum	Q1 2013 Local Currency Rent/ Measurement
Hong Kong	\$4,328	€36,351	HK\$ 2,800 psf pm
New York	\$2,970	€24,944	US\$ 2,970 psf pa
London	\$1,053	€8,843	£ 1,100 ITZA pa
Paris	\$1,050	€8,820	€ 14,000 ITZA pa
Sydney	\$1,018	€8,549	AUS\$ 10,525 psm pa
Tokyo	\$895	€7,519	JPY 250,000 per tsubo pm
Melbourne	\$851	€7,148	AUS\$ 8,800 psm pa
Zurich	\$822	€6,905	CHF 8,400 psm pa
Brisbane	\$739	€6,209	AUS\$ 7,645 psm pa
Moscow	\$739	€6,203	US\$ 7,950 psm pa

Source: CBRE Research, Q1 2013.

## Previous Reviews

The Productivity Commission Report number 43 (31/03/2008) *The Market for Retail Tenancy Leases in Australia* has already provided comprehensive review and recommendations aimed at addressing disproportionate rental and occupancy cost ratios and growth in retail tenancy lease costs.

The PGA notes that comments at the time by the Commonwealth supported improving efficiency in the market in a way that did not increase the regulatory burden for business, particularly for small business. In particular the PGA was reassured of the support of the Commonwealth for:

- harmonisation of state and territory retail tenancy legislation; and
- improvements to information flow, transparency and disclosure.

The majority of the recommendations centred on improving the transparency in the retail lease/property market and repairing the imbalance in access to information for retail tenants. Unfortunately progress on implementing the recommendations from the 2008 PC report has been limited.

In the six years since the report recommendations were made retail industry stakeholders have continued to identify the need for a national approach to improve the information imbalance between landlords and retail tenants.

**There is an established need to urgently consider the recommendations from the 2008 Productivity Commission's Report *The Market for Retail Tenancy Leases in Australia*.**

The majority of these recommendations centre on improving the transparency in the retail lease/property market and repairing the imbalance in access to information for retailers.



Unfortunately it appears that none of these recommendations have been implemented by COAG who were charged with the responsibility of same.

Since this time industry stakeholders have resolved that there is a ground swell need for a national approach to improve the information imbalance between landlords and retail tenants.

## Labour Costs

Pharmacies currently employ over 20,000 pharmacists and over 43,000 pharmacy assistants. Pharmacies also employ a range of staff in other roles including delivery drivers, administration and security. Pharmacy has a very high level of female employment, with 62.7% of pharmacists and 88.2% of pharmacy assistants being female.

Labour costs are the main cost to pharmacies, and as a percentage of sales have increased from 11.63% in 2010-2011 to 11.75% in 2011-2012 – the highest percentage level in more than twenty years. These significant labour costs are due to a number of factors:

1. Pharmacies are required to employ qualified pharmacists. To qualify, all pharmacists are required to complete a four year full-time bachelor degree and upon graduation spend a year in an internship. In addition community pharmacists have a median twenty years of professional experience working in the role and 12% have postgraduate qualifications.
2. Pharmacies are also more heavily staffed due to the requirement to provide service and advice with regard to most products that are sold, as opposed to the customer self-selection or low service models of many other retailers.
3. Inflexible aspects of the modern award, particularly relating to penalty rates and minimum shift provisions.

The Guild has recently undertaken a national survey of pharmacies regarding their employment intentions over the next 12 months. 944 pharmacies responded to the survey, representing 17.6% of the total industry, including 24.9% from rural areas and 20% of the 425 single pharmacy towns.

**9,000 pharmacy jobs will be lost in the next 12 months, including 10% of the skilled pharmacy workforce.**

The survey results show that nearly 9,000 pharmacy jobs will be lost in the next 12 months, including 2,229 pharmacists and 4,400 pharmacy assistants. These figures do not include job losses that have already occurred with a separate Guild report showing that pharmacies have shed some 3,200 staff in the last 12 months.

### Estimate of Potential Jobs Lost

	Australia	ACT	NSW	NT	QLD	SA	TAS	VIC	WA
Pharmacists	2,229	32	755	12	443	177	56	525	229
Pharmacy Assistants	4,400	59	1,476	27	880	355	120	1,026	457
Other Staff	2,364	33	795	14	472	189	62	554	245
<b>TOTAL</b>	<b>8,993</b>	<b>124</b>	<b>3,026</b>	<b>53</b>	<b>1,795</b>	<b>721</b>	<b>238</b>	<b>2,105</b>	<b>931</b>

With 20,800 pharmacists and 43,000 pharmacy assistants, this impact equates to over 10% of the community pharmacy workforce losing their jobs. The survey results also show that more than half of all pharmacies will be reducing pharmacist hours and over two thirds will be reducing pharmacy assistant hours in the next twelve months.

The Guild is of the view that greater flexibility in the modern award would provide some relief from increasing labour costs.

Non-standard working time patterns are part of the retail sector, including community pharmacy sector, and enable community pharmacy to provide essential primary health care to the Australian community. These non-standard working time patterns have come about especially so in the provision of extended or continuous service to the public, particularly in health and emergency services provision.

In the community pharmacy sector, extended and seven day a week trading patterns are required to meet the expectations and health care demands of customers and patients. Data from the Guild's census shows that nationally, on average:

- On Saturdays 96 per cent of community pharmacy are open, with 61 per cent open for a full day;
- On Sundays 42 per cent of community pharmacy are open all day;
- On Public Holidays 35 per cent of community pharmacy are open all day;
- Late trading on a Thursday night occurs in 46 per cent of community pharmacy; and
- Late trading on a Friday night occurs in 42 per cent of community pharmacy.

**Cuts to PBS remuneration coupled with the inflexibility in the modern awards means jobs will likely be lost.**

The Guild shares the concerns of other retailers with regard to the impact of the penalty rates contained within the modern awards for retail, including the Pharmacy Industry Award 2010 (PIA).

The Guild strongly supports the need within the PIA and other retail awards for the facilitative capacity for employers and employees to agree to a minimum shift that is less than three hours.

## Opportunity for Service Expansion

Community pharmacies are a trusted network in Australia. The Roy Morgan *Image of Professionals Survey 2014* found that 86 per cent of respondents rate pharmacists highly on ethics and honesty – up two per cent on last year's result. This annual survey has confirmed that pharmacists are valued and respected. The community pharmacy network is Australia's most accessible health care destination where people can seek advice, services and lifesaving medication in many cases 7 days a week, after hours and without an appointment.

Governments in other countries are recognising the additional value community pharmacy can bring to their community – an opportunity that exists now in Australia. Governments of nations with similar patient needs and challenges in relation to ongoing community pharmacy viability are making greater use of community pharmacies and pharmacists. This is ensuring that the populations in those countries derive full value from this

**The opportunity to grow the role of pharmacy and provide extra and better services to the community is being placed in jeopardy by the cost pressures currently faced.**

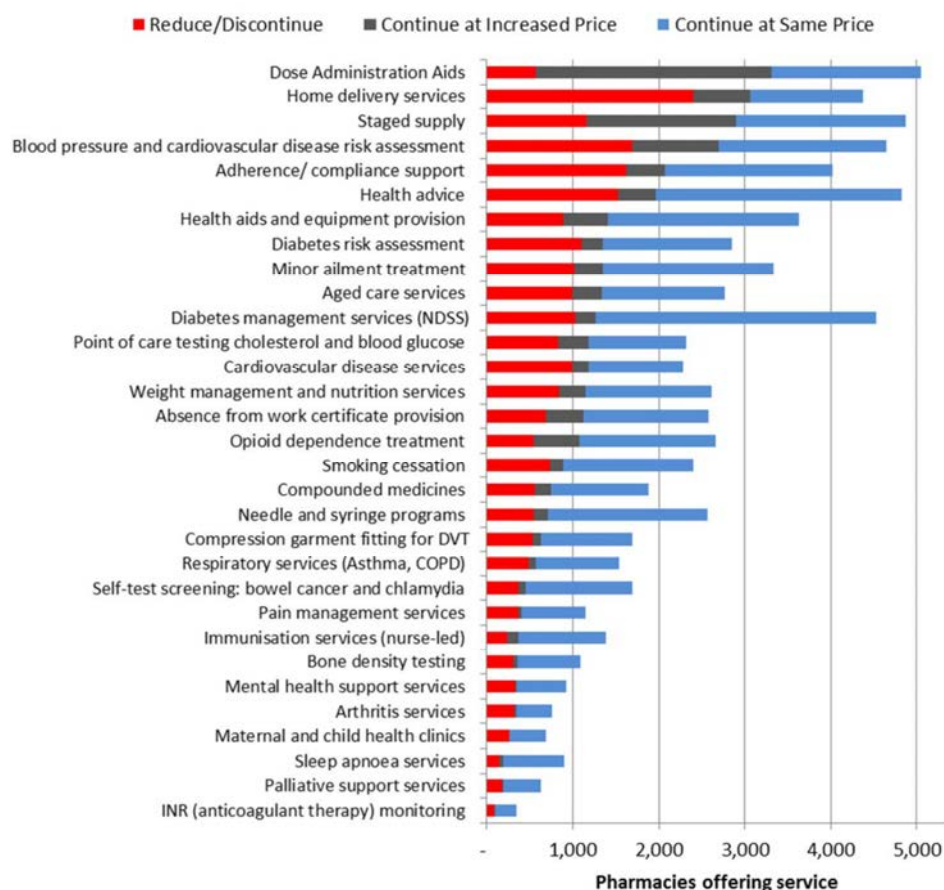
community-based investment and that the pharmacy network is utilised as effectively as possible in delivering better health outcomes.

However the potential for innovation by Australian community pharmacies in broader service delivery is being stifled, in part, by the ever increasing costs of doing business.

The Guild's *Pharmacy Services Expectations Survey* conducted in April 2014 with responses from over 500 pharmacies (10% of the industry) highlighted one in ten pharmacies will be forced to drop at least one trading day per week in the coming year. Further, a quarter of pharmacies will reduce opening hours; on average by 5.4 hours a week.

**Due to mounting financial pressures on pharmacy, 1 in 10 pharmacies are currently expected to be forced to drop at least one trading day per week. 1 in 4 are cutting hours, on average by 5.4 hours a week.**

Results from the *Pharmacy Services Expectations Survey* indicate the high level of services currently being provided by pharmacies to the community often free of charge or below cost. Unfortunately the results also indicate the high percentage of pharmacies that will be forced to reduce or discontinue services or have to increase charges for these services in the next twelve months.



The services most at risk of being stopped, reduced or increased in price are:

- Dose administration aids;
- Home deliveries and compliance support;
- Diabetes, asthma and chronic disease support services;
- Blood pressure and other health checks; and
- Staged supply of medicines

Reduction of services means a significant number of customers and vulnerable patients may face reduced access to the services they rely upon, and an increase in their costs. These services allow people to stay independent for longer, to remain living in their own home for longer, improve quality of life, and reduce the burden on the health system and aged care facilities.

## Conclusion

The community pharmacy network has a significant impact on the Australian retail industry. Community pharmacy is an essential, cost-effective and highly accessible health care destination and the provider of over \$15.31 billion dollars' worth of merchandise to its customers from over 5,300 outlets. Despite its primary health care role, community pharmacy operates as a business and must survive in a commercial environment. Profitability is an essential part of that landscape and, as with any retail business, sales generated by pharmacies must outweigh expenses incurred.

Pharmacy growth has declined in recent years due to lower sales growth, an increase in expenses and the impact of government reforms to the PBS. Unlike other retail businesses that can adjust their selling prices in response to market changes and cost pressures, pharmacy owners have a limited ability to pass on fixed underlying costs because prices are largely regulated. Yet pharmacies face untenably high operating costs. Rental costs continue to rise, outstripping other business costs and CPI increases. Labour costs have risen substantially, in part due to the inflexibility of the modern award system. As a result jobs are being put at risk and services are likely to be reduced.

The viability of many pharmacies within the network is being threatened. Pharmacy owners are being forced to cut costs and reduce services at a time when they should be pushing forward with innovation. The opportunity to grow the role of pharmacy and provide extra and better services to the community are being placed in jeopardy partly by the cost pressures currently faced.

The Guild calls for the recommendations from the Productivity Commission's report *The Market for Retail Tenancy Leases in Australia* to be urgently considered. Finally, enhanced flexibility in the workplace relations system is required to support efficiency in the operation of pharmacy businesses and the employment of staff.