Value judgements

Anne Hutchings advises on how independent pharmacy owners can increase the value of their pharmacies and cope with the funding cuts

There are many fundamental issues that can affect the value of your pharmacy. By conducting a financial review of your business, you can identify issues that will help you increase the profitability of your pharmacy and make it more attractive when you come to sell.

Firstly, make sure you have a proper financial management system in place. This should consist of a computerised bookkeeping system with data input by someone suitably qualified. We examine hundreds of sets of financial data every year while carrying out pharmacy valuations and the number of mistakes and the incorrect information we encounter is staggering. As an example, about 25% of the VAT returns we see have been incorrectly completed.

Once you have correct financial information you can use this to:

- Accurately measure how your business is performing and benchmark against others.
- Monitor and control your costs.
- Forecast ahead, and prepare budgets for forthcoming expenditure and allow for clawbacks like category M.
- Monitor progress: if you have set a financial target you can monitor the effectiveness of your efforts through your monthly financial data.
- Use your data for 'what if' scenarios, eg, how much will your gross and net profit increase if you: increase your OTC sales by 10% next year; increase your NHS items by 7%; reduce your staff costs by 5%; let the spare room at the back of the pharmacy to a chiropodist.

The two areas likely to have the biggest impact on your business are gross profit and staffing costs.

Gross profit

Start by reviewing your gross profit margin. You should know from your accounts what your gross profit margin is. However, not all accountants use the same format for calculating this. The standard and accepted method for calculating the gross profit of pharmacy businesses can be illustrated in the following example:

Turnover	£1,000,000
(from the pharmacy business)	
Less cost of sales:	
Opening stock	£42,000
Purchases	£649,000

	£691,000
Less closing stock	(£41,000)

	£650,000

Gross profit 35%	£350,000

In order to benchmark your pharmacy against other pharmacies, you need to compare like with like, therefore it is important that your gross profit is calculated in the same format as in my example. You should not have other items in the calculation. For example, your turnover should consist of the pharmacy business income only. It should not include other sources of income such as investment income. Your cost of sales should not include items such as locum costs, stock taking fees or other sundry costs.

Now that you have your gross profit figure do you have any idea how it compares with other pharmacies? Is your pharmacy underperforming by industry standards?

Generally gross profit margins have been holding up across the board. We have been seeing margins for independents at the 32%-35% level consistently for the last three years. If your margin is falling below this, it may be time to have a serious review of your stock control and purchasing methods with a view to improving the margin.

For example, on a £1m turnover an increase of 2% to your gross margin would give you an extra £20,000 pa in profit and could increase the value of your business by over £100,000 when you come to sell.

> "An increase of 2% to your gross margin could increase the value of your business by over £100,000"

Staffing costs

This is usually the largest business cost for pharmacy owners. So, it is important to get this cost at the right level. As a guideline, staff wages (excluding the pharmacist) should be around 6% of turnover and the pharmacist's salary should be a further 6% of turnover. This is a rough guide and won't apply to all pharmacies. If you carry out a review and think there is room to reduce staff hours, the options are:

- Wait for staff members to leave, which may be because they wish to retire or they find another job. This may turn into a long-term strategy.
- Consider reducing the hours of existing staff. With the pharmacy funding cuts biting it's understandable that you would review your costs and look to make reductions to keep your business viable. For example, a reduction of just 20 hours per week in staff wages at a rate of £8 per hour would result in an annual saving of just over £8,000. When you sell the business this could add another £50,000 to the selling price.
- The other alternative is to make staff redundant, which is always a difficult decision to take.

We recently worked with a health centre pharmacy where we set a target to reduce staff costs by just under £30,000 in the year prior to sale. Achieving this added around £200,000 to the value of the pharmacy.

Anne Hutchings is managing director of UK pharmacy sales agents Hutchings Consultants Ltd. She can be contacted on 01494 722 224 or via www.hutchingsconsultants.com