

FUN WITH PHARMACY FRONT END

A COMPREHENSIVE GUIDE FINDING
PROFITS AND SUCCESS, THROUGH
MARKETING, MERCHANDISING, AND DATA



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INTRODUCTION

Independent community pharmacies consistently get top marks in consumer satisfaction surveys. Patients seek out and return to these pharmacies because of positive experiences with pharmacists, pharmacy technicians and other staff, and because of the right balance of health care and front-end retail. Growing a community pharmacy practice requires applying good business principles. Business is brutal. Profit margins on prescriptions and the front end are pinched more every day. Competition has never been more severe than it is right now. And it is coming from all sides.

The information in this article comes from years of observation and active work with independent pharmacies across the country. Most pharmacies with a front end carry products that enhance and sustain good health and allow patients to treat minor ailments and injuries. A well-maintained and merchandised front end assists the pharmacy practice by meeting the

needs of existing patients and attracting new patients. Pharmacy staff, who are trained to assist with product selection but also recognize when someone should speak to the pharmacist about their injury or ailment, reinforce that pharmacies provide health care. That said, sometimes it is a non-health care aspect of the front end that brings a new customer in the door. Pharmacy owners need to cater to both.

In-depth evaluations of employee-customer interactions, observations made while walking through the store, and a pharmacy's online presence can provide a clearer picture of the strength of its front-end strategy. The goal here is to assist you in understanding general appearance, merchandising, employee/customer interactions, employee/employee interactions and more. Ask yourself how often you evaluate these factors as you read through this eBook.

CHAPTER 1

MAKING BUSINESS DECISIONS WITH DATA

The one place in your pharmacy where you have complete control of product mix, merchandising, pricing, www.ncpa.org/ap 53 and appearance is your front end. Regardless of the size of your front end, it needs to contribute to your bottom line. This section discusses making better decisions by understanding key financial data and what it means.

Key front-end metrics

Gross profit and gross margin: $\text{Gross profit} = \text{total sales} - \text{cost of goods sold}$
 $\text{Gross margin} = \text{gross profit} \div \text{total sales}$

Gross margin measures the amount of gross profit generated as items sell. Example If your sales are \$500,000 and your cost of goods sold is \$300,000, your gross profit is \$200,000 and your gross margin is 40 percent. As you will see from the data in the tables in the discussion section, this measure alone does not provide you with a clear picture of whether your front end is healthy. The net profit is also critically important because it factors in payroll and other operating costs. A pharmacy could have a solid gross margin, but if costs such as payroll or rent are too high, there might not be much net profit on the bottom line.

KEY METRICS CONTINUED

Inventory turns: Inventory turns = cost of goods sold ÷ average inventory value. Measures the number of times you sell through your inventory during the year

Example: If your cost of goods sold is \$300,000 and your average inventory value is \$150,000, then your inventory turns is $\$300,000 \div \$150,000 =$ two turns.

Benchmark Currently, a pharmacy's average turns for its front end is approximately four. This is significantly lower than the 11.75 times reported for the entire pharmacy operation. One could argue that anything less than 12 turns, at least one turn per month, is hardly something to celebrate. The takeaway here is to increase your front-end turns to more than once a quarter. There are certain front-end categories that may have less than one turn per year such as cards and gifts.

Gross margin return on investment (GMROI)

Calculation $GMROI = \text{gross profit} \div \text{average inventory value}$ Measures the amount returned on every dollar invested in inventory.

Example: If the pharmacy's gross profit is \$200,000 and the average inventory value is \$150,000, then $GMROI = 1.3$. This means that for every dollar invested in inventory, the return is \$1.30.

Benchmark Currently, the drug store marketplace has an average GMROI of 2.7.

DATA DISCUSSION

Currently 89 percent of independent pharmacies utilize a point-of-sale system. If you do not have one, the calculations above become far more difficult, and you are flying blind on managing your front-end product mix. For most, your POS system contains a vast wealth of information and using it is key.

Most POS systems allow you to categorize your items using a combination of department, category, and/ or fine line codes (FLC). Using this feature gives you tremendous advantages when analyzing POS data. A well-planned structure allows you to run broad reports first and drill down with more finely-tuned reports to investigate trouble spots. The categorization you use depends on the size of your front end and your product mix and may need to change from time to time. The average independent pharmacy has 911 square feet dedicated to front-end merchandise. Let us look at a possible example.

Department -the broadest categorization of product.

- Over-the-counter
- Health and beauty aids
- Durable medical equipment
- Gifts
- Seasonal

FLC – narrowest categorization of product.

- Under OTC
 - Antacids/laxatives
 - Cough & Cold
 - Pain Relief
- Under HBA
 - Oral Care,
 - Hair Care
 - Skin Care

DATA DISCUSSION CONTINUED

START WITH REPORTS BY DEPARTMENT

Using the key metrics (gross profit, gross margin, inventory turns, and GMROI), let us analyze some real data from an actual pharmacy using the department and FLC structure defined previously. **Table 1** (Below shows the gross profit and percent margin and is sorted by gross profit:

Department	Sales	Cost	Gross Margin	% Margin
OTC	64794.58	34289.71	30504.87	47.08%
HBA	40531.29	21194.72	19336.57	47.71%
Gifts	43205.81	24786.42	18419.39	42.63%
DME	28430.19	15487.24	12942.95	45.53%
Seasonal	12109.95	9166.71	2943.24	24.30%
TOTALS	189071.8	104924.8	84147.02	44.51%

If this is the only information you have, you might conclude that your OTC department is your best department and seasonal is your worst. This might even lead you to conclude that you should consider eliminating the seasonal department.

DATA DISCUSSION CONTINUED

Gross margin analysis by itself does not give you the full picture of how your front end performs. Inventory turns and GMROI are two figures that are much more important and meaningful.

However, for your POS system to calculate this valuable information, you must actively manage the on-hand quantities in your system. The next two tables show the valuable information available when keeping track of your inventory on your POS system. This additional information may lead you to completely different conclusions about your best performing departments.

Table 2 adds the daily average inventory value and turns, and is sorted by inventory turns.

Department	Sales	Cost	Gross Margin	% Margin	Average Inv Value	Turns
Seasonal	12109.95	9166.71	2943.24	24.30%	1437.81	6.4
DME	28430.19	15487.24	12942.95	45.53%	2884.91	5.4
HBA	40531.29	21194.72	19336.57	47.71%	5746.69	3.7
OTC	64794.58	34289.71	30504.87	47.08%	18462.16	1.9
Gifts	43205.81	24786.42	18419.39	42.63%	28789.15	0.9
TOTALS	189071.8	104924.8	84147.02	44.51%	57320.72	1.8

Adding inventory turns to the analysis changes the initial conclusions. Now, seasonal is the best performer. OTC, which is the most profitable, is the second to worst when it comes to inventory turns. Gifts, which was in the middle based on profit, is now the worst. The store total of 1.8 turns is also well below the industry average due to OTC and gifts.

DATA DISCUSSION CONTINUED

Table 3 adds one final column, GMROI, and is sorted by GMROI.

When evaluating your front-end merchandise, GMROI is the most important number as it factors in both profit and average inventory. This gives you the truest picture of how your front-end business performs. After looking at Table 1, we would conclude that OTC is our best department because it generates the most profit. However, it only generates \$1.65 for every \$1 invested. DME, on the other hand, generates \$4.49 for every \$1 invested.

Department	Sales	Cost	Gross Margin	%Margin	Average Inv Value	Turns	GMROI
DME	28430.19	15487.24	12942.95	45.53%	2884.91	5.4	4.49
HBA	40531.29	21194.72	19336.57	47.71%	5746.69	3.7	3.36
Seasonal	12109.95	9166.71	2943.24	24.30%	1437.81	6.4	2.05
OTC	64794.58	34289.71	30504.87	47.08%	18462.16	1.9	1.65
Gifts	43205.81	24786.42	18419.39	42.63%	28789.15	0.9	0.64
TOTALS	189071.8	104924.8	84147.02	44.51%	57320.72	1.8	1.47

Now look at the gifts department. While it is generating \$18,419.39 in profit, you only get 64 cents for every dollar invested – bad deal! It is time to take a closer look at this department to see what changes can be made to improve the GMROI (or host a clearance event).

DATA DISCUSSION CONTINUED

DRILL DOWN TO THE FLC AND ITEM LEVEL

Once you have reviewed the reports by department, if you find an underperforming department (like the examples shown previously), you can rerun the report. But this time, you should look at a detailed report that shows you all the FLCs in the underperforming department. Every system varies on how to do this, but it is a basic feature most POS systems should be able to accomplish. In the example above, you should drill down in the gift department and analyze the OTC department to see which of the FLCs were underperforming. From this point, many systems allow you to drill down to the individual item level to further refine your search for underperforming items. Items with a GMROI below 1 should be evaluated for their price point and store placement, then monitored for improvement for a period of time before getting them out of your store. This is imperative to improving your cash flow and will positively affect your GMROI.

DATA DISCUSSION CONTINUED

BOTTOM LINE:

If your overall GMROI is less than 2.7, your pharmacy is performing below the industry average. You need to closely evaluate areas where you can improve. As you look at your individual departments, keep in mind that if your GMROI is below 1, you are receiving less than \$1 for every dollar of inventory you invest. This occurs when your gross margin is too low to sustain the amount of inventory you carry.

For those of you who are not running inventory control on your POS system, you limit your access to valuable data that allows you to make more informed decisions on managing your front-end merchandise. With that said, if you report front-end sales, front-end cost of goods, and front-end inventory to your accountant, the accountant should be able to provide you with the calculations at least annually. While this does not give you a clear picture by product categorization, it at least tells you how your front end performs overall.

Remember, before you make decisions using this data, first see what is driving the numbers, especially if a category or product is performing poorly. Is it pricing, placement, or store image? Using data without asking these questions can be dangerous. The next section dives into how merchandising can affect your front-end sales and metrics.

CHAPTER 2

HOW MERCHANDISING AFFECTS SALES

In her article, *The Art and Science of Retail Merchandising*, Kate Eby writes, “Retail merchandising is subtle. When customers walk into the store, they do not consciously think about the sensory experience. Rather, the colors, sounds, smells, temperature, and the way the merchandise feels combine to deliver an experience to the customer psyche that they may not even realize. Retail merchandising is an art and science. Decades of customer research, driven by the overwhelming economic importance and growth of the retail industry, arm retailers with actionable data for effective merchandise strategies and best practices.”

Merchandising’s goal is to generate revenue for the retailer and value for the customer. Many pharmacies only think as far as planograms and end caps when considering their merchandising approach. However, a solid merchandising plan includes everything from in-store design, selection of merchandise that matches the needs and desires of your target market, the physical display of those goods and services, and the regular promotion of new and seasonal items. A visually appealing front end has a significant impact on sales. In her recent research, Dr. Iana Castro from San Diego State University found, “People were less likely to buy the products when only a few products were left, and they looked messy.” This brings us to the science of visual merchandising.

MERCHANDISING CONTINUED

While you can perform an internet search for “visual merchandising” and find no shortage of material, Eby discusses it succinctly: “Visual merchandising is part of a sound retail merchandising strategy. It guides the planning and activities responsible for how customers see your physical and digital stores, and the goods and services visible within. Visual merchandising applies to everything from the exterior of your retail store to the well-lit entryway all the way through to the well-placed furniture, fixtures, and promotional displays. It helps create customer value by making the shopper journey efficient, unique, and memorable.”

As you create your merchandising strategy, it is important to understand that there is a measurable affect between what a person sees and how they feel. In the retail world, that affect begins in the parking lot and continues throughout the customers’ visual experience inside your pharmacy. Colors, cleanliness, lighting, signage – visual appeal makes a difference.

MERCHANDISING CONTINUED

In his book, *Retail Marketing Strategy: Delivering Shopper Delight*, author Constant Berkhout explains that shoppers are “unconsciously attracted by pleasure and a feeling of reward.” Your merchandising strategy must include this understanding.

Berkhout offers tips based on neuromarketing research. Below is an excerpt from Eby’s article that references Berkhout’s suggestions:

“In *Retail Marketing Strategy*, Berkhout offers a summary of practical suggestions. He gleaned this information from his time with neuroscientists who were trying to understand the brain activity that accompanies the ideal shopping experience. He also cites research from *The Buying Brain: Secrets for Selling to the Subconscious Mind*, by Dr. A.K. Pradeep.” Eby provides a list of the visual merchandising tips that Berkhout adapted from this neuro research. They include observations on how to turn insight into retail solutions:

MERCHANDISING CONTINUED

Signs point the way: Shoppers are scanners. They routinely look for changes in familiar retail environments (or on landing pages) and use visual stimuli closest to their point of entry. Place signs closest to the customer's entry point and guide the shopper journey with images instead of text to avoid overstimulation.

Display images: The images retailers use for instore displays or online stores should have a left-right orientation. (The picture should appear on the left, and the associated text should appear on the right.) The "shopper's eye," according to Pradeep, delivers observations more effectively in this way. It takes more effort for scanning shoppers if the text appears on the left, and the image appears on the right.

Aisle attraction: Aisles that end with rounded gondola displays entice customers more often. These round-end caps should help the shopper navigate by providing clues to what they will find on the rest of the aisle. The ideal length of an aisle is approximately 20-22 feet, and, halfway down each aisle, there should be some "visual interruption," such as special lighting or a floor display, to attract the shopper.

Show off consumption: Visual displays that show off consumption of goods and services prompt more action. If the display features people, it should always include imagery of smiling, happy customers. For example, if you wish to promote the breakfast items on your menu, it is better to show a person consuming said items instead of the product by itself. If your merchandise is apparel, it is preferable to show that apparel in action.

MERCHANDISING CONTINUED

Material matters: Shoppers (and their brains) enjoy touching round, soft items. Place such items at eye level, and design merchandise displays with “touch moments” in mind. Also, the material of the shelving and displays matters to the customer’s visual perception of value. Wood gives the impression of “real, authentic, and organic,” but shoppers may perceive a higher price point for items displayed on natural wood shelves.

As you consider your merchandising strategy, visit other retailers. Look at what major retailers are doing both inside and outside their stores. Look at a wide variety of retailers, not just pharmacies, to get ideas that you can incorporate into what you are doing. Large retailers hire experts to help design their merchandising plans, so you might as well benefit from their research. Use the best ideas that fit in your market and your community. Now evaluate your pharmacy from the eyes of a consumer and start outside in the parking lot. Use the questions listed at the beginning of this article to assist in your evaluation. Use the neuroscience discussed earlier to analyze how visually stimulating and pleasing your pharmacy appears. Be honest with yourself.

Cross-merchandising solutions: Retailers should cross-promote solutions with visual merchandising. For example, position batteries next to electronic devices, stage merchandise kits next to core products (for example, socks, shoelaces, and shoe cleaner), and place unrelated (but logical) products on display with profitable merchandise.

MARKETING & ADVERTISING CONTINUED

Website Continued:

If someone were to search online for pharmacies near them, would your store show in the search results? Double check that your store website, hours, and contact information are correct on search engine profiles.

A recent study found that subconscious thought drives up to 80 percent of customer purchase behavior. A fun, visually stimulating website can drive new customers in your direction, so show your personality. Show pictures of your pharmacy and your staff. Look at your site and ask yourself (and others, more importantly) if this makes you want to shop here

MARKETING & ADVERTISING CONTINUED

Online presence

If you do not think having an online presence is important, think again. A recent Google/Ipsos survey showed:

- Seventy-four percent of shoppers who searched online before going to the store to shop said they searched for something in-store related such as the closest store near them, locations, in stock near them, hours, directions, wait times, and contact information.
- Forty-six percent of shoppers confirm inventory is available online before going to the store.
- Seventy percent of shoppers say the ability to shop in person/in a store is important when deciding which brand or retailer to buy.

These statistics show how important it is to maintain an online presence and showcase the products and services you offer.

MARKETING & ADVERTISING CONTINUED

Online presence Continued...

Managing an online presence is much easier than you think and does not mean you have to maintain an e-commerce site. In January 2020, Google announced the acquisition of Pointy, a solution which helps shoppers find products in a physical store near them. The service is free, and while many top-tier POS systems integrate with Pointy, Pointy offers a solution for systems that may not. If your POS system does not integrate with Pointy, it offers a device that plugs in between your scanner and your POS that sends sales information to Pointy. Using Pointy helps to ensure that when a consumer is searching for an item near them, if you sell it, they see it! And they see your location and store hours. It does not get much easier..

MARKETING & ADVERTISING CONTINUED

Email and Direct Mail

The average open rate for email in the health care vertical is 21 percent, and retail is 23 percent. While email is inexpensive and 58 America's PHARMACIST | October 2021 immediate, more than 70 percent of your audience is not looking at your communications. Now consider that all generations say they like physical mail, especially millennials! Here are some interesting findings from a USPS survey:

- Eighty-one percent take the time to look through mail each day.
- Sixty-seven percent prefer reviewing physical mail to receiving emails.
- Sixty-four percent look forward to receiving mail each day.

Results from a neuroscience study revealed that “physical ads leave a longer lasting impact for easy recall when making a purchase decision [vs. digital]. Most importantly, physical ads triggered activity in the area of the brain (ventral striatum) that is responsible for value and desirability for featured products, which can signal a greater intent to purchase.” To sum it up, science is now proving that direct mail delivers better recall over longer periods, stronger brand associations and deeper emotional connections. Considering the information above, your marketing strategy needs to combine email campaigns along with direct mail to be the most impactful at reaching your audience

MARKETING & ADVERTISING CONTINUED

Social Media

While traditional advertisements and media placement are costly, maintaining a social media presence is relatively low cost and worthwhile for many independent businesses. Data from 2019 shows that 71 percent of consumers are more likely to make purchases based on social media referrals. Post pictures of your merchandise to help drive that increased foot traffic

Sponsorships & Community Donations

Be strategic about more costly advertising options. It is nearly impossible to compete with the advertising budgets of grocery stores, chain pharmacies, and online retailers. Consider sponsorships or donations as other ways to promote your business while giving back to the community. Surveys have shown that nearly 90 percent of consumers would purchase a product because a company supported an issue they care about.

Tracking

Whatever you choose to do, it is important to track each marketing activity and their respective results so you know what succeeds and offers a return on your investment of money and time. Document changes and adjustments to campaigns and track those changes over time. Most social media platforms and websites have some sort of analytics component to show the level of engagement people have with your online presence.

CHAPTER 3

COMPETITION

It becomes easy to focus your attention on traditional competitors like pharmacy chains and big-box stores because for most of you, the prescription department represents the bulk of your business. While these businesses are direct competitors, they too are up against businesses that are less traditional and maybe even overlooked, especially when analyzing your front-end business.

Grocery Stores:

Remember the good old days when pharmacies carried over-the-counter and health and beauty aids, and grocery stores carried groceries? That changed in the 1970s and 1980s; today grocery stores carry a full line of OTC and HBA products and many other items that used to only be found in traditional pharmacies. As a result, grocery stores are a major and often overlooked competitor to the front-end business of independent pharmacies.

In 2019, the average household in the U.S. visited grocery stores 1.6 times each week. While data on the average household visits to pharmacies is limited, Medicare reports an average of 13 visits per year for its patients. Additionally, the Centers for Disease Control and Prevention reports that between 2015-2018, 48.6 percent of the U.S. population took at least one prescription medication in the past 30 days.

COMPETITION CONTINUED

Grocery continued...

Since most grocery stores carry a wide variety of OTC and HBA products, if a consumer is not taking prescriptions, they can conveniently shop for traditional pharmacy products while they visit their local grocery. This means that more than half of the U.S. population has no reason to enter your store without some other compelling reason to do so. You need to find that compelling reason in your community. These statistics get worse with the younger, healthier population. Only 35.7 percent of adults 18-44 are taking one or more prescription medications. That means 64 percent of this important demographic has no compelling reason to shop with you unless you focus on giving them one.

Amazon:

Unless you have not been paying any attention, you know that Amazon has entered the pharmacy market with PillPack. It is not too late to compete to keep or expand your share of both the prescription and front-end market, but you are going to need to make changes. Let us look at some staggering numbers.

COMPETITION CONTINUED

Amazon continued...

Amazon is already capable of offering same-day or one-day delivery from its distribution centers to 72 percent of the U.S. population, according to RBC Capital Markets.

- In a recent survey with 4,185 respondents between 18-64, 86 percent said they purchased something from Amazon in the past 12 months. The next closest retailer was Walmart with 46 percent.
- The number of digital (online) buyers in the United States in 2020 was almost 256 million, representing 77.3 percent of Americans.
- The healthier age demographic of 18-44, of which only 35.7 percent are taking one or more prescriptions, also makes 50.4 percent of all online purchases in the U.S. If you add the 14-17 age demographic, the total jumps to 55.6 percent of all online purchases.

You cannot control reimbursement rates and the unfair practices of PBMs, but you can control your business model and the products and services you offer. Once you recognize who you are up against, you can turn that into an opportunity to compete.

COMPETITION CONTINUED

Amazon continued...

Let us untangle the important statistics from above to see what they mean to your business.

- First, if you do not have any sort of online presence, you are automatically walking away from an immense opportunity and a market in which 86 percent of the population participates! Keep in mind that you already struggle to attract the healthier age demographic of 18-44, and they make more than 50 percent of all online purchases – another opportunity lost.
- Second, if you are not offering same-day or nextday delivery, figure out a way to start. Looking at the numbers, Amazon can already offer this to 72 percent of the U.S., but the good news is so can you! Within the next few years, this simply won't be an option and every day you wait, Amazon is teaching young healthy Americans there is no need for your brick-and-mortar business.

COMPETITION CONTINUED

|Amazon continued...

So, where do I start? What are my options? While the list of ideas below is by no means all inclusive, here are a few important ideas.

- While e-commerce represents most purchases in the U.S. for things like books, music, and video, it only represents 13 percent of the market in health, personal care, and beauty. Of course, Amazon wants to change this, but it is not too late for you to participate as well. The key word being participate. If you have unique products, create an e-commerce site and add those products to it. Check with your POS vendor to see what options they provide. If you do not feel an e-commerce site is warranted, consider signing up for Pointy as discussed in the marketing and advertising section. Web presence is a new minimum.
- Delivery is becoming more of a requirement and less of an option. Since margins on prescriptions are already squeezed, look at ways to make your deliveries profitable:
 - Consider a delivery fee for same-day or next-day delivery but free for two-day delivery.
 - Make sure to set delivery patients up on medication synchronization, so you are only delivering once per month.
 - Add companion items to your deliveries. Recommend vitamins and supplements based on drug-induced nutrient depletion. This boosts your bottom line, helps pay for the delivery, and improves patient outcomes. A win for everyone.

CONCLUSION

Evaluate your pharmacy based on the items in this article. Be honest and plan for incremental improvements. You cannot do everything at once, but you have to start! Sometimes we get so buried in the weeds we do not take time to look around. The next time you drive up to your pharmacy, look around and pay attention to everything you see, all the way to the back. Then ask yourself, is this the image I really want to portray? Hopefully, the answer will be yes, but you will likely find room for improvement.

About The Author

Brad's lifelong passion for pharmacy began in his parents' drug store in Westport, WA, where he grew up and worked until departing to attend the United States Air Force Academy. He went on to become a C-141 pilot and eventually a T-37 instructor pilot.



Eventually, the world of pharmacy called again and Brad soon recognized a need in the pharmacy industry. In 1998, Brad founded Retail Management Solutions and embarked on a journey to help pharmacies become more profitable and customer-centric, leveraging technology-based tools and expert training to help pharmacy businesses succeed. RMS pioneered the pharmacy system integrations, creating a standard that remains in use to this day. RMS customers were also the first pharmacies in the country to be able to capture signatures electronically.

Today, Brad continues to lead RMS in our mission to make every pharmacy more profitable and customer-centric.