2017

NCPA Community Pharmacy Start-up

BENCHMARKING REPORT

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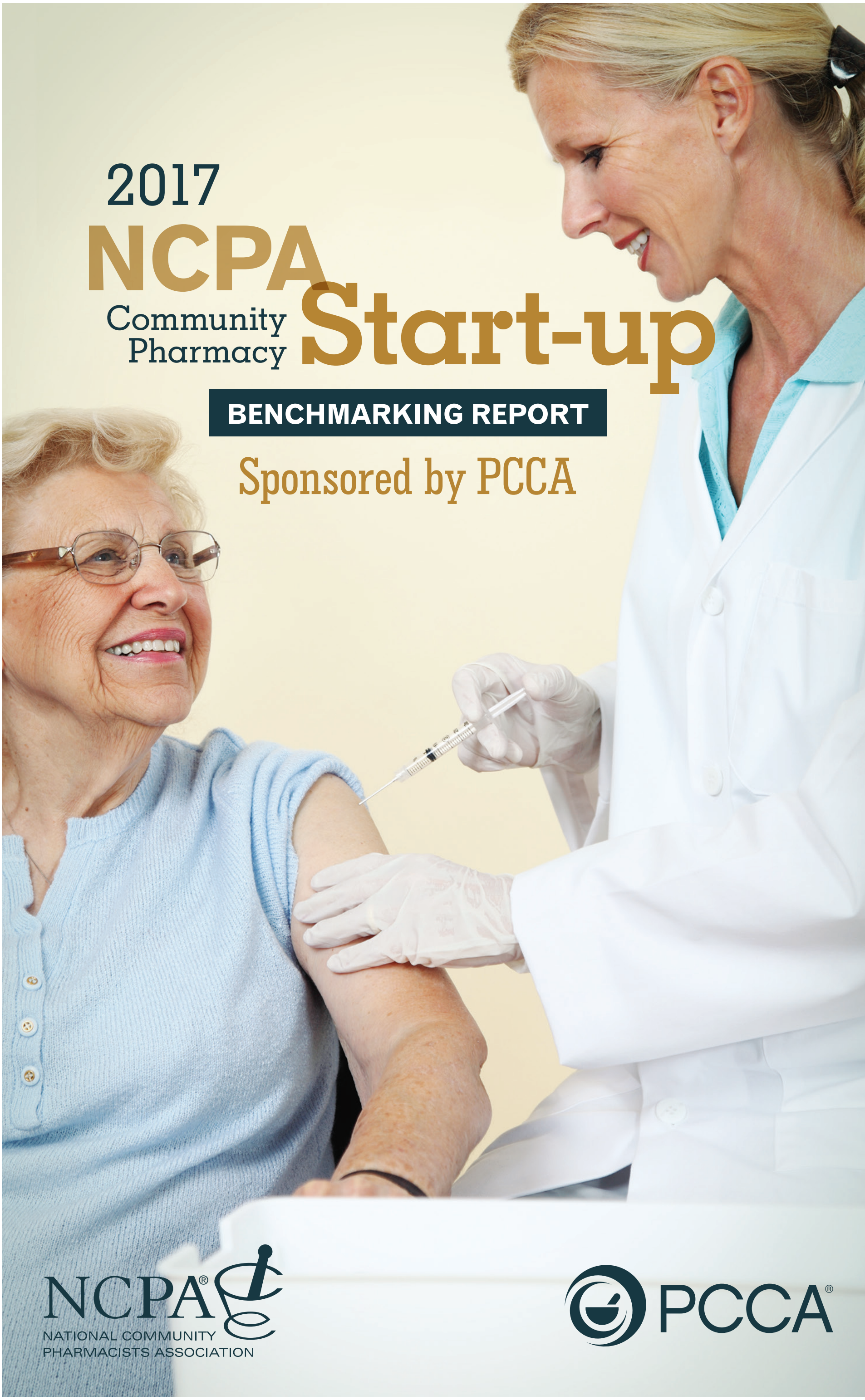

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NCPA Community Pharmacy Start-up Benchmarking Report, *Sponsored by PCCA*

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Introduction

This publication is the second edition of the benchmarking guide for pharmacy start-ups distributed by the National Community Pharmacists Association (NCPA), *the Voice of the Community Pharmacist*®.

Start-up pharmacies have traditionally had limited ability to evaluate their performance versus other new pharmacies in their first five years of business. For numerous reasons, well-established pharmacies perform at significantly different quantitative levels than new pharmacies and thus do not produce reasonable comparative tools. Measures such as sales volume and growth rate are significantly impacted by the longevity of the business. Depending on when a new pharmacy opens for business, market forces can also play a large role in their success rate. For instance, when Medicare Part D commenced in 2006, there was spike in the number of prescriptions filled in the overall marketplace. More recently, prescription drug coverage under new Affordable Care Act health plans has provided additional volume to the marketplace. Conversely, and at the same time, PBM mail order and specialty drug benefit designs are lowering the number of prescriptions available to fill at a community pharmacy. Thus, when evaluating a new pharmacy's performance, considering these kinds of factors against similarly situated new pharmacies is critical.

Government-funded prescription drug programs continue to comprise the majority of the retail prescription drug marketplace. Medicare, Medicaid and other government programs represent well over 50 percent of independent pharmacies' prescription business, and this number is rising as members of the Baby Boomers Generation become eligible for Medicare. Consequently, a pharmacy's performance within these programs can make or break a business, but particularly a new business.

It is also important that start-up pharmacies have strategies to compensate for low margins and DIR fees on traditional prescription dispensing. Such tactics include incorporating niche services such as compounding, immunizations, long-term care, adherence, and disease state management programs.

NCPA's longstanding series of Ownership Workshops continues to provide expert guidance to entrepreneurs desiring to open their first pharmacy, to chain pharmacists looking to be their own boss, and to current pharmacy owners interested in becoming a multi-store owner. Until this publication, there was limited data on those critical first years of business to incorporate with the techniques and business tools introduced to prospective and new pharmacy owners at the workshops.

For the second year, NCPA has surveyed start-up pharmacies from around the country that have been open five years or less to accumulate this vital benchmark information specific to new businesses. We are proud to provide you with this second edition of the *NCPA Community Pharmacy Start-up Benchmarking Report sponsored by PCCA.*

Methods: Survey participants consisted of pharmacy owners or their designees representing pharmacies that had been in business for more than one year but no more than five years. Participants were provided the option of filling out an online version of the survey or completing a hard copy version. The survey closed on Nov. 30, 2016. NCPA has exercised the utmost professional care in compiling the information received. While we have tested the data for clerical accuracy, the data supplied were not necessarily based on audited financial statements. NCPA does not make any assurances, representations, or warranties with respect to the data upon which the contents of this report are based. The first edition survey for this publication collected data from fiscal year 2010 through fiscal year 2014, while the second edition survey collected data from fiscal year 2011 through Nov. 30, 2016. Over 150 pharmacies participated in the first edition survey for this study with an additional 100 pharmacies participating in the second edition survey. Data from both studies were combined to generate results for this study.

Pharmacy Characteristics: Tables 1 through 3 show various characteristics of the sampled pharmacies. Forty-one percent of the sampled pharmacies operate as a stand-alone community pharmacy (Table 1). Thirty-eight percent and 14 percent operate within a shopping center or within a medical office building, respectively. An additional 7 percent operate within a grocery store or some other location setting.

Table 1: Pharmacy Practice Setting	
Stand-alone community pharmacy or in downtown block	41%
Within a shopping center or strip mall	38%
Within a medical office building	14%
Within a grocery store	5%
Other	2%

Table 2 below shows the average size of sampled pharmacies. The average sampled pharmacy is 1,733 square feet, of which 864 square feet and 869 square feet are dedicated to the prescription department and to the front end, respectively.

Table 2: Pharmacy Size (Sampled Pharmacies)	
Prescription department	864 sq. ft.
Front end	869 sq. ft.
Total	1,733 sq. ft.

The study shows that sampled pharmacies provide an array of niche services. Sixty-five percent of sampled pharmacies provide same-day home delivery. Sixty-eight percent and 63 percent provide MTM services and immunizations, respectively. Furthermore, 64 percent provide refill synchronization services. While the survey did not collect information concerning fees charged for niche services, they can be an important source of revenue for both start-ups and established independent community pharmacies. Providing these niche services also establishes the independent community pharmacist as a health care provider rather than just a dispenser of medication.

Long-term care is another niche with a few variables that need to be called out. Long-term care can be a niche in a full-service pharmacy, it can be a strategic focus, or it can be the exclusive focus. Most start-ups that service long-term care populations do so out of the same pharmacy from which they dispense prescriptions to patients in the community. For these combination community and long-term care pharmacies (sometimes referred to as a "combo shop" in long-term care jargon) the average number of beds serviced is 43.

If a start-up is classifying itself as a closed-door pharmacy and serving skilled nursing facilities exclusively, it is almost always because a combo shop has reached the threshold where this business can operate profitably on its own. Closed-door pharmacies may receive higher reimbursement for prescriptions and related services provided exclusively to skilled nursing facilities. Closed-door start-up LTC pharmacies represent 1.25 percent of survey respondents.

Table 3: Niche Services	
MTM	68%
Same-day home delivery	65%
Refill synchronization	64%
Immunization	63%
Long-term care	23%

Compounding Pharmacies

Introduction: Compounding pharmacies deserve a separate discussion. Overall, 59 percent of sampled pharmacies engage in some level of compounding, with 6 percent reporting that more than 50 percent of the total number of prescriptions dispensed were compounded. Preparing compounded medications can provide a start-up business with a clear way to differentiate its services from those of its chain competition. Compounding prescription medications is often a source of professional satisfaction for pharmacists. Start-up compounding-only pharmacies are opening at a fairly low, but steady, rate and are typically an offshoot from a full-service pharmacy that wants to establish a separate business identity for compounding services. Project costs for a start-up compounding-only pharmacy will differ because of specialized training, different equipment, inventory, supplier, and marketing expenses.

Compounding has come under increasing regulation, but still provides a promising avenue for pharmacies looking to diversify revenues and increase profits. The compounding common to the independent pharmacy ranges widely in complexity from non-sterile to sterile, non-hazardous to hazardous, and from full-line stores that compound to compounding-only pharmacies. Niches in compounding, such as veterinary compounding, are cash revenue niches that provide opportunities for reimbursements that are not dictated by third-party payer contracts.

Characteristics: Full-service pharmacies are almost always bound by third-party payer contract terms to have the ability to purchase and dispense the full complement of FDA-approved, finished pharmaceuticals and, if compounded medications are covered, to submit claims to the pharmacy benefit manager. Compounding-only pharmacies, on the other hand, continue to conduct a fair amount of cash business either because the pharmacy opts not to accept third-party reimbursement or compounds are excluded from coverage. Cash prescriptions, whether compounded medication or finished pharmaceuticals, give pharmacies control to set prices such that they cover the cost to dispense the prescription and provide a reasonable profit. Table 4 shows the average number of compounded prescriptions dispensed by year of operation. Compounded prescriptions steadily increase from 569 prescriptions dispensed after one year in business to 4,757 prescriptions dispensed after the fifth year in business.

Table 4: Average Number of Compounded Prescriptions Dispensed Per Pharmacy Location

	1st yr	2nd yr	3rd yr	4th yr	5th yr
Total Compounded Rxs	569	1,280	1,952	3,121	4,757

Pharmacies compound a variety of products. Twenty-seven percent of sampled pharmacies report compounding dermatology products and 25 percent report compounding hormone replacement products, while 20 percent report compounding veterinary products. Furthermore, 20 percent, 18 percent, and 7 percent of respondents report compounding products for pain, pediatrics, and ear, nose, and throat, respectively.

Conclusion: Compounding prescriptions as a market niche can prove an effective way to attract patients and provide differentiated services.

Financial Benchmarks

Pharmacy entrepreneurs are driven to find creative solutions to the medication and health care needs of their community. Pro forma financial statements are a critical element to assessing the viability of a pharmacy start-up project. Benchmarking reports such as this one help assess the success relative to similar businesses.

Tables 5 and 6 provide a brief overview of start-up pharmacy operations, by years in business. Sampled pharmacies in business for one year on average dispense 13,804 prescriptions per year. These pharmacies dispense 7,734 new prescriptions and 6,070 renewed prescriptions per year (Table 5). The number of dispensed prescriptions steadily increases with years in business. By the fifth year in business, the average pharmacy started from scratch dispenses 38,816 prescriptions, an increase of 181 percent relative to a pharmacy in business for one year.

Table 5: Average Prescriptions Dispensed Per Pharmacy Location (by Years in Business)

	1st yr	2nd yr	3rd yr	4th yr	5th yr
New Rxs	7,734	11,984	14,941	18,467	20,266
Renewed Rxs	6,070	10,268	13,314	16,906	18,550
Total Rxs	13,804	22,252	28,255	35,373	38,816

Table 6 below provides financial information by years in business. Average total sales increase from $910,894 after one year in business to $2,946,578 after five years in business. Furthermore, notice that over 90 percent of total revenue for each year in business comes from prescription sales. By the fifth year in business, a typical start-up pharmacy brings in $2,856,465 in prescription sales and $90,114 from other sales.

Table 6 also shows that gross profit increases with years in business. On average, sampled pharmacies in business for one year generated 16.6 percent in gross profit, but by year five the comparable figure increased to 22.2 percent, roughly 33 percent increase over time. Owner's Discretionary Income (owner's salary plus net profit) is not reported here but would be the gross profit minus expenses of running the pharmacy business such as wages, rent, utilities, office supplies, etc. The Break-even Commentary that follows addresses the point in time at which the start-up records positive net profits.

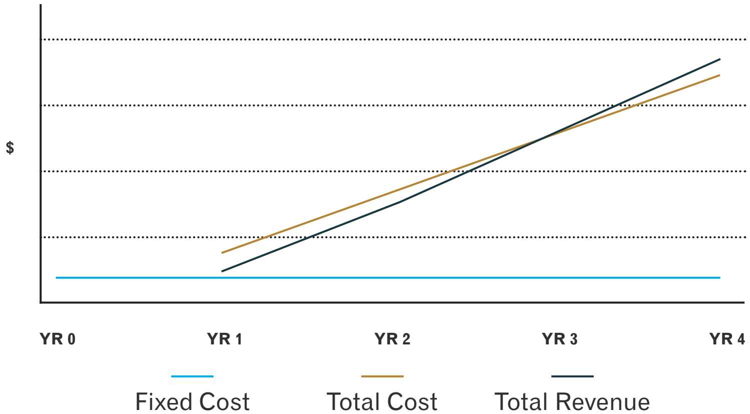
Table 6: Financial Averages of Pharmacy Operations (by Years in Business)

	1st yr	2nd yr	3rd yr	4th yr	5th yr
Rx Sales	$855,451	$1,295,643	$1,857,534	$2,397,255	$2,856,465
Other Sales	$55,443	$66,323	$60,521	$77,660	$90,114
Total Sales	$910,894	$1,361,966	$1,918,055	$2,474,915	$2,946,579
Rx Costs	$714,354	$1,135,972	$1,526,065	$1,918,788	$2,222,002
Other Costs	$45,806	$50,744	$46,757	$59,126	$72,495
Total Costs	$760,160	$1,186,716	$1,572,822	$1,977,914	$2,294,497
Gross Profit	$150,734	$175,249	$345,232	$497,001	$652,081
Gross Profit %	16.5	12.9	18.0	20.1	22.1

Break-Even Commentary

A number very important to pharmacy owners who have just started business is the break-even point, where a business starts to turn a profit. One way to analyze the break-even point is to focus on total prescriptions dispensed. Because prescriptions dispensed represent over 90 percent of total revenue, total revenue can roughly be estimated by multiplying prescriptions dispensed by the average price of a dispensed prescription. The weighted average price of a prescription dispensed by the pharmacies surveyed for this report is $62.20. Figure 1 (page 11) provides an illustration of break-even analysis utilizing prescriptions dispensed from Table 5. Figure 1 demonstrates that a typical pharmacy in business for one or two years records negative net profits because costs exceed revenues. But by approximately year three, revenues begin to exceed costs. For the average start-up, that occurs around 25,000 prescriptions. Most start-ups require financing to cover expenses in the first few years. Since most banks ask for three years of financial projections, it may be a useful exercise to estimate the fixed costs, variable costs, and total revenue over two, three, or four years to find the break-even point. It is difficult to predict what business will look like three or four years on, so revise these estimates every year with as much actual data as possible. Pharmacies that do not break even within five years should thoughtfully consider the future of the business. Bank financing usually has a five-year repayment schedule, making five years the latest reasonable point to break even.

Figure 1: Start-up Pharmacy Break-Even Point*



Pharmacy owners looking for ideas to shorten the time to break even need to consider ways to boost non-dispensing revenue. One way to do this is by offering services that don't require inventory or expensive equipment.

* Break-even point is where total costs, inclusive of all fixed and variable costs, are equal to total revenues. This occurs around year 3. A typical start up pharmacy can expect a yearly prescription volume of about 26,000 when they reach the break-even point.

Conclusion

The results from the start-up pharmacy survey largely agreed with anecdotal reports that NCPA members and Ownership Workshop graduates share. The first two things most pharmacists considering opening from scratch want to know is how much money is needed to start a pharmacy and how long until the pharmacy records a profit. Owning a pharmacy is still very much a viable career path. Success as an owner requires commitment to high-quality patient care while at the same time the ability to stay on top of trends in health care that will affect the business. Breaking even in the third year of operations is typical and financial projections should be cast with this in mind. Operating for two to three years before recording a profit affects the amount of capital to which the owner needs access. This report sheds light on the actual performance of the average start-up community pharmacy and serves as an important resource for benchmarking new pharmacies.

Notes

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