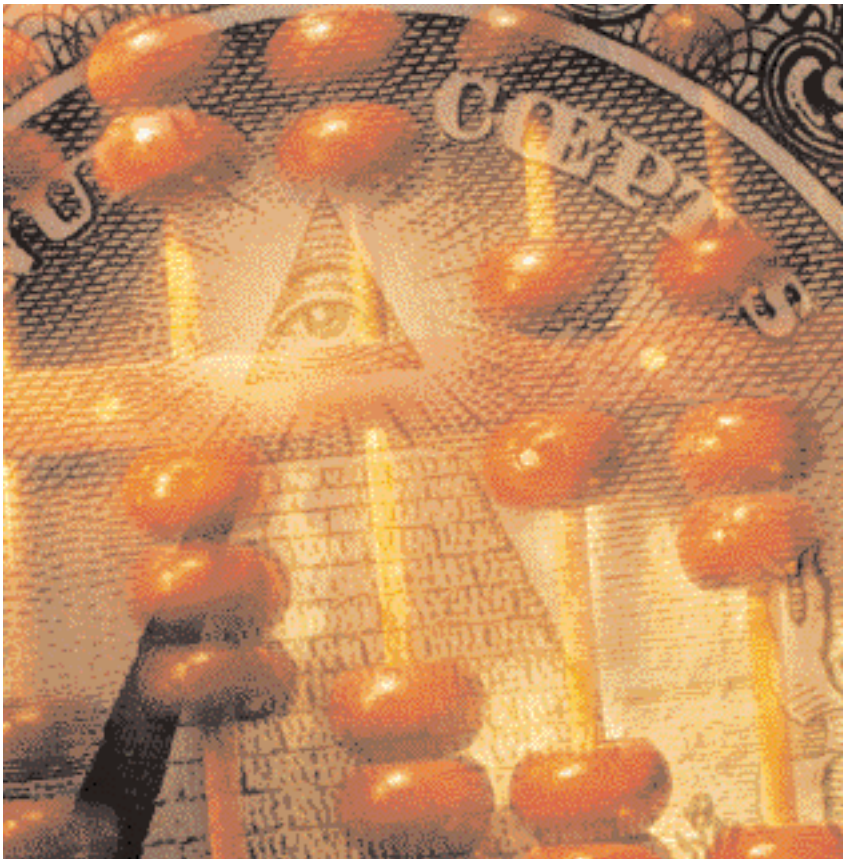

History of the Digest

The *NCPA Digest* has provided a continuing financial perspective of independent retail pharmacy over an extended period of time. E.N. Gathercoal's 1933 *Prescription Ingredient Survey* collated information from a series of seven surveys that covered the period from 1885 through 1932, mostly for use in determining what items should be included in various editions of the *United States Pharmacopoeia*. The National Association of Retail Druggists and the Curtis Publishing Company, publishers of *The Saturday Evening Post*, conducted studies in 1945 and 1947 that examined the operations of retail pharmacies; however, the series was not continued.

The only long-standing examination of retail independent pharmacies has been the *Lilly Digest*. This service was initiated in 1932 as a service to analyze—without cost—the annual profit and loss statement of any retail pharmacy owner who would supply operations data to Eli Lilly and Company.

The owner received a complete financial analysis of his operation, including how his financial results and operations compared to national averages of independent pharmacies that were similar in location and sales volume. When appropriate, constructive suggestions were made to help the pharmacy owner improve profitability.

In 1992, Lilly discontinued the report, but resumed it in partnership with NARD in 1995. Subsequently NARD (renamed the National Community Pharmacists Association in 1996) partnered with Searle, then Pharmacia, and now Pfizer to continue the *Digest* service to independent community pharmacists. (The *NCPA-Pfizer 2003 Digest* will be shipped with the November issue of *America's Pharmacist*.) Our study is the first attempt to gather information on independent retail pharmacy operations represented in a longitudinal study that continued basically uninterrupted for 60 years.

Information in the annual *Digest* was published as averages, stratified by many financial and operational variables. This allowed the pharmacy owner to compare his operations to the appropriate averages. We have identified more than 65 variables that have been reported at one time or the other. Our report compares the most important parts of the financial records:

- sales volume,
- profitability, and
- the prescription department.

Also, our analysis is limited primarily to 1941–2001. The information collected and published prior to 1941 was stratified very differently from later years, making meaningful comparisons difficult. For clarity we have reported our analysis in five year intervals. This

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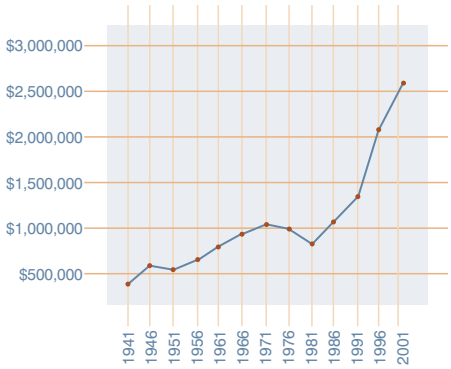

Figure 1. Annual Sales (2003 $)

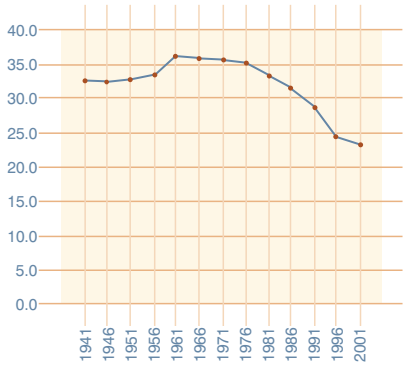

Figure 2. Gross Margin (Profit) as a Percentage of Sales

project is a work in progress; the data presented herein are preliminary.

Annual Sales

Over the 60-year comparison period, average annual sales per pharmacy have increased substantially, from $36,005 in 1941 to almost $2.5 million in 2001. However, a more useful interpretation of the sales increase can be made by converting historical sales dollars to 2003 dollars. Using 2003 dollars, annual sales begin at just over $450,000 and grow to almost $2.5 million—a sales increase of a little more than fivefold over the 60 years. The passage of amendments to the Social Security Act creating Medicaid in 1965 may have contributed to the growth of sales shown in the five-year period ending in 1971. Independent pharmacies showed significant increases in the growth and rate of growth for the next several decades, with the exception of 1981. This consistent increase may be attributed to the decrease in the number of independent pharmacies as well as a "survival of the fittest" phenomenon in that those pharmacies that survived were among the best and most efficiently managed. (See Figure 1.)

Gross Margin (Profit)

Gross profit or gross margin is the difference between the selling price of a good and the cost of the good to the business. This is the profit before expenses are subtracted leaving net profit. Gross margin is affected by several things, not the least of which is the mark-up or retail price of the goods. Independent pharmacies' gross profit as a percentage of sales slowly increased from the World War II years to the late 1950s and remained stable through the 1960s. It was in the early 1970s that a precipitous decline began and it has not stopped. Gross margins today decreased from more than 35 percent to less than 25 percent. This has been brought about largely by the proliferation of third-party prescription programs and increased price competition from chain pharmacies, grocery stores, and mass merchandisers. (See Figure 2.)

Net Profit

The proverbial "bottom line" is net profit, referring to the dollars remaining after the cost of goods sold and expenses have been subtracted from retail sales. This represents part of the total income of the owner, the other part being the salary that the owner pays himself. Obviously, if the selling price of goods and services is reduced through increased competition or restricted by third-party providers or insurers, net profits will fall unless the cost of goods or other operating costs also decline. Over the past six decades, average net profits have increased markedly. In today's dollars, a hearty increase is revealed for the past 20 years after a relatively constant level for several decades. (See Figure 3.)

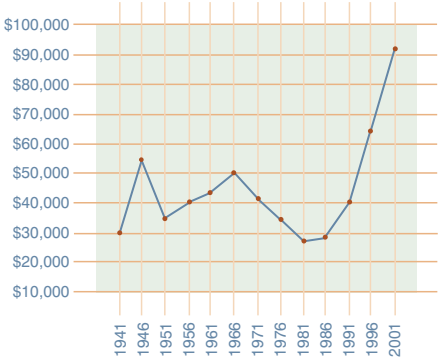

Figure 3. Net Profit (2003 $)

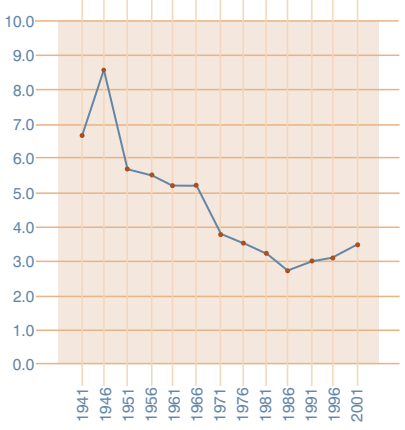

Figure 4. Net Profit as a Percentage of Sales

In terms of total income of the owner, independent owners are far better off today than they ever have been.

A more meaningful indication of the trend over time in net profit may be seen by expressing it as a percentage of sales. The period when net profits were highest for independent retail pharmacy was during World War II, a period that has been identified as the worst of times for the country but the best of times for independent pharmacy. In 1946 the average net profits as a percentage of sales was 8.6 percent. Since the post-war years, the "bottom line" of independent community pharmacy has been shrinking to the current level of 3.5 percent.

Possible causal factors include the increase in third-party programs and increased price competition from chains and other mass marketers. Increased product cost coupled with unchanging third-party fees has exacerbated this. Note the relative small trend upward in the past 10–15 years. During this period, many independents closed. (See Figure 4.)

Owner's Income

The financial well being of any business is reflected in the salary that the owner is able to pay himself. In spite of declining gross and net profit margins as a percentage of sales over the study period, owner's annual salaries have increased from less than $2,500 in 1940 to more than $109,000 in 2001. A better indication of owner's salary may be seen by examining the trend in current dollars. Growing from approximately $30,000 in 1941, salaries increased tremendously until the early '70s when they reached levels comparable to today. Paralleling the increased competition from other

retail operations and managed care, salaries decreased for a decade before beginning a resurgence to today's highest levels in 60 years. (See Figure 5.) In terms of total income of the owner (net profit of the business plus owner's salary), independent owners are far better off today than they ever have been.

The Prescription Department

Prescriptions and the prescription department have represented the focal point of independent pharmacy during the study period. In the compounding period of 1941, the average pharmacy filled about 5,000 prescriptions a year, approximately 15 a day. Prescription volume continued to climb until the late 1970s where it leveled off. Today, the average is some 51,000 a year or about 160 daily. (See Figure 6.)

Many factors are driving this growth; most significantly, the increase of modern pharmaceuticals, the growth of third-party prescription programs, and the increased life-span resulting from advances in health care. Beginning in 1965 with the creation of Medicaid and coupled with the growth of managed care in the 1990s, the proportion of third-party prescriptions has grown from less than 20 percent in 1971 to greater than 75 percent, almost doubling in the past decade. The implications of this include a parallel decrease in gross margins, the closing of independent pharmacies, and the need for pharmacy owners to become more astute business managers. (See Figure 7.)

Perhaps no other characteristic of independent pharmacy has changed more than the reliance of the pharmacy on the prescription department and prescription sales for financial survival. In fact, the situation regarding the relationship of prescription sales to front-end sales has completely reversed in the past 60 years. In 1941, approximately 13 percent of an independent pharmacy's sales were generated by the prescription department. In 2001, about 15 percent of the independent's sales were generated by front-end sales with 85 percent coming from prescriptions. (See Figure 8.)

Summary

With preliminary data spanning more than 60 years, it is difficult to identify the absolute impact of factors internal and external to the profession of pharmacy on the financial variables of independent pharmacy. In this preliminary analysis, some important factors that have affected the financial accounting of independent pharmacy include:

- The Great Depression
- World War II
- The Durham-Humphrey Amendments of 1951, which set out criteria for distinguishing between prescription and non-prescription drugs
- The Kefauver-Harris Amendments of 1962, which, sparked by the thalidomide-caused birth defects, strengthened the federal role in drug testing
- Competition from chain, grocery, and mass merchandisers pharmacies
- Proliferation of managed care and third-party prescription plans
- Aging of population
- Development of new pharmaceutical modalities

The financial strength of the average independent community pharmacy has changed dramatically over the past 60 years of operation:

- Sales in present day dollars have increased more than five-fold.

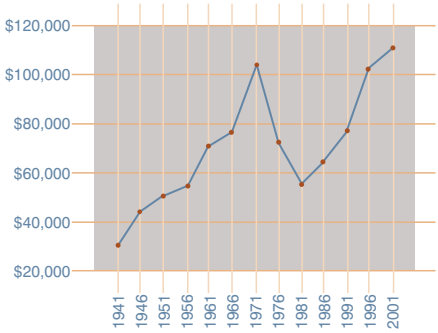

Figure 5. Owner's Salary (2003 $)

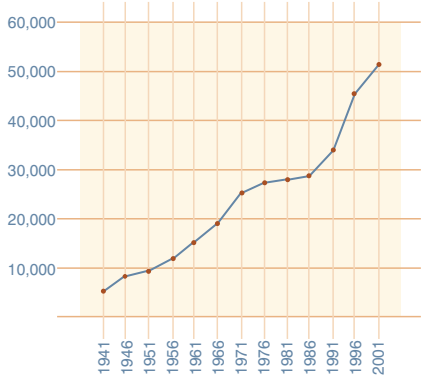

Figure 6. Number of Prescriptions Dispensed Annually

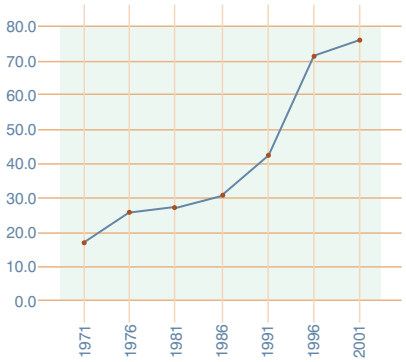

Figure 7. Third Party Prescriptions as a Percentage of Total Prescriptions

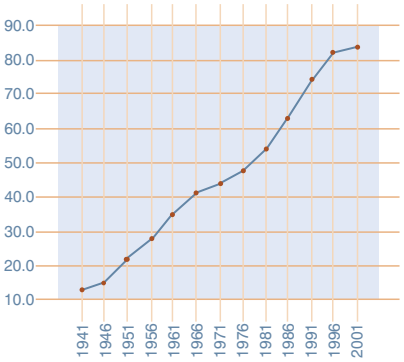

Figure 8. Prescription Sales as a Percentage of Total Sales

- Gross margins have decreased from 35 percent plus to less than 25 percent.
- Net profit has decreased to about 3 percent from a high of more than 8 percent.
- Prescription volume has increased 10-fold from 15 per day to some 160.
- Third-party prescriptions have increased to more than 75 percent from less than 20 percent in 1971.
- Prescription sales increased from 15 percent to 85 percent of total sales.
- Owners' total income in present day dollars is higher than ever. ■

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