

## Business Focus

# 100 hour contracts: threat or opportunity

Are 100-hour contracts a business threat or an opportunity? **David Parker** sets the issue in context



The changes to the control of entry regulations in 2005 were precipitated by an Office of Fair Trading investigation that was highly critical of the lack of competition that resulted from the regulatory framework in place at that time. Indeed, the OFT was so critical that it proposed complete deregulation of entry to the pharmaceutical list. The Department of Health significantly watered down this advice by making a limited number of changes to the regulations with the aim of encouraging competition and thus improve services available to patients. These changes included four exemptions to the "necessary or desirable" test for entry to the list. The jury is currently out on whether these changes have in any way met their objective.

What is certainly clear is that the threat posed to existing pharmacy owners is significantly less than would have been experienced had the OFT had their way. In fact, apart from the odd, very rare, example the only exemption that has put real fear into pre-existing contractors is the 100-hour exemption.

It is easy to understand that an owner who has paid a good deal of money for the goodwill of a business, or has spent many years building a solid customer base, would be unhappy about the prospect of somebody joining the party for free. On the other hand, it is very hard to find a member of the public that considers a pharmacy that is open to serve them from 7am to 11pm to be a bad idea.

Whichever side of the fence you sit on, the plain facts of the matter are that the regulations are as they are, which for existing owners represents a threat and for aspiring owners an opportunity.

### Substantial applications

But just how much of an opportunity or threat does the 100-hour contract represent? The number of applications for 100-hour contracts has been substantial for obvious reasons. The exemption is very straightforward: you simply find premises, promise to open for 100 hours per week, buy some stock and, as if by magic, you are the proud owner of your very own pharmacy. (Although 100-hour applications can be rejected in exceptional circumstances)

The 100-hour opportunity has also coincided with two other market conditions that have increased the propensity for non-owners to chance their arm in business.

First, the locum market has changed quite significantly over recent years. Where the balance of power in the market was previously held by the locum, with a ready supply of work at healthy rates of pay, this balance has shifted somewhat recently.

Secondly, there is buoyancy currently in goodwill values for pharmacy contracts. The values at which pharmacies change hands simultaneously serves to both exclude many independent first-time buyers and emphasise the apparent opportunity of a "free business" offered by the 100-hour route.

However, existing and aspiring owners should take the threat or opportunity of the 100-hours contract with a significant pinch of salt. For, while there are certainly some opportunities to create a profitable business by trading for 100 hours per week, such opportunities are remarkably few and far between.

As any existing owner will be aware, by far the greatest cost line on his or her profit and loss account are staff-costs. In fact, good management of staff costs and opening hours can mean the difference between healthy profits and regular loss.

As most pharmacies only open for around 45 hours per week, it does not take too much imagination to recognise that staffing a pharmacy for 100 hours per week, many of them unsocial hours, can cost at least twice as much. The unavoidable fact that a pharmacist is required to be present for 100 hours per week means that a turnover of close to £500,000 is required to fund his or her salary alone. Add to this the other staff costs, rent, rates, heat, light, etc, and a turnover of close to £1m could be necessary just to break out of loss.

Of course, some operators of 100-hour pharmacies will work many of the hours themselves, and thus see some of the costs are absorbable. However, this will only be palatable in the short term if you are convinced that you are ultimately going to earn more money than you did as a locum or an employee.

The idea of a "free business" with nothing to pay and little risk is also somewhat inaccurate. Although the "barrier to entry" is lower than that for an existing contract, there are still some significant costs to bear and the commercial outcomes are somewhat less predictable.

The costs of entry into the 100-hour market will include at least the following:

- Purchase of a property or entry into a lease

— a typical nine year lease can amount to a tidy sum

- Fit out of a property — £50,000 is easily spent on a modest fit-out

- Stock — this is particularly tricky for a new-start pharmacy as it is impossible to know what stock to hold (Hold too little or the wrong products and you will either have a reputation for poor service or a lot of redundant stock on your hands)

- Accumulated losses — this is the biggest investment of all (Until the business reaches its break-even point it will be running at a loss. Under average operating conditions, break-even could mean around 6,000 prescription items per month or almost £1m turnover per year, no mean feat)

The losses to be made in the early stages of the business are substantial and only when the break-even point is passed will these even begin to be offset. As many existing 100-hour operators will recognise, break-even may be a long time coming or may never be reached. In fact, some are not even a quarter of the way to this target and face either a long time under water, or a tricky exit strategy.

Aspiring entrepreneurs should also recognise that the value of a 100-hour pharmacy is, like all other businesses, based on its ability to make a profit for a buyer. A 100-hour pharmacy that has a turnover of £500,000 will certainly be making a loss and can therefore be viewed as a liability rather than an asset. Only when a business starts to make profit will it have a value to anyone. Thus, the classical turnover ratios that are heard in the market do not apply in any way to 100-hour contracts. Based on its lower profitability, the additional headache and greater vulnerability, a 100-hour pharmacy with anything less than a £1m turnover will have little or no resale value. Above this the value will climb with turnover but less steeply than for a standard contract.

Wherever your opinions lie with regard to the value of a 100-hour pharmacy service, what is certain is that the threat or opportunity that 100-hours presents is of a limited nature and, whether exploiting or defending against the 100 hour exemption, the key considerations are the same:

- Can a 100-hour business in the particular location ever achieve the level of turnover required to make profit?

- Can the entrepreneur fund the cash-flow shortfall until then?

- If yes to the above then what level of profit might ultimately be made and will this offset the losses, and investments made?

- Can the aspiring business owner afford to take the risk?

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