Introduction to Financial Management in Community Pharmacy Practice

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at

Community Pharmacists Practice Association CPD training

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Introduction

• It is no secret that community pharmacy practitioners are challenged in their quest to deliver the highest standards of pharmaceutical care to their clients and making reasonable income.

• A number of Pharmacies owe heavily, are in distress and are struggling:
  – to sustain their businesses,
  – to take care of themselves, their dependents and
  – their employees

• As a result, it is not uncommon to find Community Pharmacists leaving their pharmacies in the care of others to engage in other business venture to supplement their income.
Learning Objectives...

• To help participants to begin developing an understanding of how finance enables one to evaluate how close the firm’s **investments, financing, and dividend decisions** come to an objective of maximizing shareholders wealth.

• To introduce participants to:
  – The environment in which Community Pharmacy business & financial decisions are made.
  – Basics of financial statements – Cash flow, Profit & loss (Income) & Balance sheet
  – The use of financial ratio to evaluate the financial condition and performance of a company.
Financial management

- Financial management involves the solution of three major decisions – Investments, Funding & Dividend.

- Together they determine the value of a pharmaceutical company or an individual.

- All of these decisions demand a Pharmacist with a broad outlook and creativity that will influence all facets of the enterprise in order to create value for owners/stakeholders.
Investments decision

The Investment of funds in assets determines:

– the size of the Pharmaceutical company,
– its profits from operations,
– its business risk, and
– its liquidity

Because the future benefits are not known with certainty, investment proposal involve risk.
The goal here is to determine the best financing mix or capital structure:

- Short-and medium term financing - e.g. over drafts, loans, etc
- Long-term financing - e.g. Shares and Equity

Obtaining the **best mix of financing** determines the Pharmaceutical firms **financial charges** and its financial **risk**.
The dividend decision

• This includes the percentage of earnings paid to owner(s) or shareholders in cash dividend.

• The dividend payment ratio determines the amount of earnings retained in the Pharmacy and must be evaluated in the light of the objective of maximizing owners/shareholder wealth.

• The dividend decision must be analyzed in relation to the financing decision-
Difficult business environment:

• Poor economic conditions driving turnover and profits down

• Retailers complained of:
  — High overhead cost,
  — Pilfering,
  — Excessive Tariffs & Taxes (GRA, MMDAs, PSGH, Pharm Council)

• Delayed National Health Insurance reimbursements, and

• No professional/dispensing fee charges to cover overheads
Increasing Competition

- Number of retail pharmacies have increased so competition is rife, but this is mainly on pricing
- The number of OTCMS have also increased
- Emergence of Alternative Sales Channels
  - 24/7 Public Hospital dispensing pharmacies
  - Retailing/Dispensing Physicians, Private Clinics/Hospitals
  - Health & Beauty /Natural Health Shops
  - Some Supermarkets
  - etc
Most retail pharmacies' methods of **Pricing** aims to sell products for “a bit more” than the purchase price. *(Policy: Cost Price \( \times 1.33 \))*

**Overtrading**: Some business owners buy so many goods at a time that they do not have enough money to pay for other things.

**Lack of records or information on the business**: Some business owners do not keep adequate records on their business. They are therefore unable to take **good decisions** about their business.

Some also
- Mistake cash for profit
- Free credit to customers
- Free supply of goods to family members and friends
- Lack of planning
Community Pharmacies: Start ups..

- Under-estimating start-up time
- Limited access to retail pharmacy market intelligence
  - Weak business/market information systems
  - Limited access to quality market intelligence
  - Nobody knows the size of the market, although rough estimates are possible
- Unrealistic expectations
- Lack of cash to run the business
- Most retail pharmacies use unsophisticated methods to finance their business.
- Retail Pharmacies largely depend on wholesalers to finance their businesses.
- Poorly designed and/or maintained retail pharmacy facilities
Management of Community Pharmacy

Community Pharmacy Practice today needs:

– A **business focus** to ensure effective uses of the Pharmacy’s
  • monetary,
  • human, and
  • material resources;

– And, the **management processes** to do this will involve:
  • planning,
  • organizing,
  • staffing,
  • directing and
  • controlling
Management of Community Pharmacy

• Planning:
  – The most critical element of the management process is planning.
  – **Without a business plan** the pharmacy’s operation will have no purpose and no direction. #s, Assumptions etc

• Organizing:
  – Once you established the objectives of the business and resources of the pharmacy is delineated, you identify all the tasks to be performed within the pharmacy and then group them in some logical way.

• Staffing:
  – This involves determining the human resource need of the pharmacy

• Directing:
  – No pharmacy will be successful if the resources are not directed properly on daily basis

• Controlling:
  – It involves periodic assessment of the status of the pharmacy eg Review of financial statements, stocks taking etc
Functions of Community Pharmacy Business

While the functions of business can be categorized in many ways, the most important for pharmacy can be grouped as:

- human resource management,
- operations management
- marketing
- **Accounting**
  - focuses on the pharmacies cash position
- **Finance**
  - Seeks to get the maximum benefit from those that are or could be converted to monetary units.
  - included in the financial function are activities such as obtaining needed capital for the pharmacy, managing cash, managing receivables, and investing in receivables
# Functions of Community Pharmacy Business

## Human Resources
- Prepare job descriptions
- Hire personnel
- Manage personnel
- Evaluate personnel
- Determine compensation levels
- Motivate/Terminate employment (e.g., retirement, dismiss)

## Operations Management
- Determining Pharmacy layout
- Define job to be performed
- Define work flow
- Purchase inventory and equipment
## Functions of Community Pharmacy Business

<table>
<thead>
<tr>
<th>Marketing Management</th>
<th>Assess internal strengths and weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Identify competitors and their respective strengths and weaknesses</td>
</tr>
<tr>
<td></td>
<td>Identify possible target markets</td>
</tr>
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<td></td>
<td>Evaluate and select target market(s)</td>
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<td></td>
<td>Product strategy development</td>
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<td>Sales and Distribution strategy development</td>
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<td>Price Strategy development</td>
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<td></td>
<td>Promotion strategy development</td>
</tr>
</tbody>
</table>
Functions of Community Pharmacy Business

Accounting:
- Develops sets of “books”
- Records business transactions
- Prepare financial statement for internal & external use
- Computes taxes and statutory deductions

Finance:
- Determine financial needs
- Identify sources of borrowed funds
- Identify sources of equity capital
- Develops operating budget
- Invest excess funds
- Evaluate financial position
- Manage current assets (cash, account receivable)
- Manage fixed assets (eg. Computers, dispensing equipments)
Financial Statement

- It is important that the records kept on a business are organised in such a way that the business owner as well as outsiders, such as bank officials, can easily see the performance of the business.

Some of these statements are:
- Cash flow Statement
- Profit and Loss Statements
- Balance Sheet

- The three statements work together to give you and others a clear picture of the business at a given time.

- Clearly, these cannot be done accurately if data/records are not kept
Cash Flows

• A Cash flow statement can be used to assess the Timing, Amount and Predictability of future cash flows and it can be the basis for budgeting.

• A cash flow statement can answer the questions
  – “Where did the money come from” and “Where did the money go?”

• Cash flow statement is important to financial management

• It can be prepared Monthly, Quarterly or Annually basis
Ways by which Cash comes into the Business

How Does Cash Come Into a Business?

Cash comes into a business through the following ways:

– From selling your products and services (sales)

– From your bank, credit union (loans)

– From other sources. (e.g., Family, friends)

– Investment income
Ways by which Cash Go Out of a Pharmacy Business

Cash goes out of a business through:

• Purchases of products- medicines and sundries
• Packaging materials
• Travel & Transportation
• Wages and salaries
• Drawings
• Utilities- water, electricity, phone call
• Rent
• Equipment & furniture
• Repayments of loans & Interests
• Accounting and Auditing fees
• Pharmacy Council initial and annual registration fees
• Metropolitan/Municipal/District Assemblies registration & Permits
• Taxes- PAYE, Withholding Tax, Income Tax
• Please add more....
# Cash Flow

## LION SHARE PHARMACY

### Money in this month

<table>
<thead>
<tr>
<th>Description</th>
<th>Jan</th>
<th>Feb</th>
<th>Marc</th>
<th>Apr</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Money present at start of month</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Cash sales</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Cash from credit sales</td>
<td></td>
<td></td>
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<tr>
<td>4. Other money in</td>
<td></td>
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</tbody>
</table>

**Total Money in this month**

### Money out this month

<table>
<thead>
<tr>
<th>Description</th>
<th>Jan</th>
<th>Feb</th>
<th>Marc</th>
<th>Apr</th>
</tr>
</thead>
<tbody>
<tr>
<td>5. Cash purchases</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Cash paid for credit purchases</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Wages/Salaries</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Drawings</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. Loan repayment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. Interest</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11. Pharmacy Council Registration</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12 Taxes</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13 AMA registration</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14 Others: Rent, PSGH dues, packaging materials etc</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12 Planned investments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Total Money out this month**

### Money present at end of month

<table>
<thead>
<tr>
<th>Description</th>
<th>Jan</th>
<th>Feb</th>
<th>Marc</th>
<th>Apr</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

22
Exercise 1
Cash Flow Planning/Analysis
A Profit and Loss Statement helps determine whether a business is operating at a profit or a loss for a given time period.

The more frequently you calculate your profit and loss, the sooner you will know the financial position of the business.

There are five specific steps to determine the profit and loss in a business:

- **Sales**: including sales for cash and credit.
- **Cost of Goods Sold**: is the price paid by the business for the items sold.
- **Gross Profit**: calculated by subtracting the Cost of Goods Sold from Sales.
- **Expenses**: includes labour costs and other costs of operating the business.
- **Net Profit**: amount remaining when the Expenses are deducted from the Gross Profit. This figure will indicate whether you are operating at a profit or a loss.
Lion Share Pharmacy Ltd.
Profit and Loss Statement for the year ended December 2016

Sales...........................................  GH₵ 46,800
Cost of goods sold....................  GH₵ 35,600
Gross profit.............  GH₵ 11,200

Operating expenses  GH₵ 6,000

Net profit  GH₵ 5,200
The Balance Sheet

The Balance Sheet is a financial statement that shows what you own and what you owe at any day in the life of the business.

- What a business owns is called **ASSETS**
- What it owes is called **LIABILITIES**

The Balance Sheet is prepared in such a way that, if you subtract the value of the **LIABILITIES** from the value of the **ASSETS**, the difference in value amounts to the amount of money that the owner/shareholders put in the business. That is **Equity/Shares**
Glossary... Asset

• **Current Assets**: These are the things that your business uses in providing goods and services and also for running the business. Specifically, these are
  – The goods (medicines & other products) that have not been sold.
  – The amount of money you have as working capital.
  – The amount of money owed to your business by customers and other people/businesses (debtors).

• **Fixed Assets**: These are land, buildings, vehicles, machines, equipment, tools, etc. that the business uses to provide the services.
• **Liabilities**: Liabilities are the things that the business owes to other people or businesses. It could be money borrowed from bank, friends, lenders or goods credited (i.e., Medicines bought and not yet paid for).

• Types of liabilities are:
  
  – **Short-term liabilities**: These are debts that your business has to pay within a period of one year or less. It could be a creditor or bank overdraft (i.e., an amount of money that your bank lends to you but which you have to pay for within a year).

  – **Long-term liabilities**: These are debts that the business has contracted and has to pay back in a period of one year and above. An example of such debt is a loan for which the pay-back period could stretch over several years.
The Balance Sheet...Example

Lion Share Pharmacy
The Balance Sheet
As at 31st December 2016

<table>
<thead>
<tr>
<th>ASSETS</th>
<th></th>
<th></th>
<th>GHC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>6,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Account Receivables</td>
<td>200</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory (stocks)</td>
<td>5,400</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Current Asset</strong></td>
<td><strong>11,600</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Furniture (shelves, Tables, Chairs etc)</td>
<td>3,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equipment (A/Cs, Computers etc)</td>
<td>400</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Fixed Assets</strong></td>
<td><strong>3,400</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td><strong>15,000</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>LIABELITIES</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts Payable (Medicines, Sundries)</td>
<td>1,500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Utilities (Rent, water, telephone etc)</td>
<td>150</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td><strong>1,650</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Owner's Equity</td>
<td><strong>13,350</strong></td>
<td><strong>15,000</strong></td>
<td></td>
</tr>
</tbody>
</table>
Exercise 2
Preparing & Analysing a Balance Sheet
<table>
<thead>
<tr>
<th><strong>FUTURE BEHAVIOUR PHARMACY</strong></th>
<th><strong>The Balance Sheet</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>As at 31st December 2016</strong></td>
<td><strong>GHC</strong></td>
</tr>
<tr>
<td>Cash at Bank</td>
<td>200</td>
</tr>
<tr>
<td>Cash on hand</td>
<td>50</td>
</tr>
<tr>
<td>Account Receivables</td>
<td>-</td>
</tr>
<tr>
<td>Inventory (stocks)</td>
<td>25</td>
</tr>
<tr>
<td>Furniture (shelves, Tables, Chairs etc)</td>
<td>35</td>
</tr>
<tr>
<td>Equipment (A/Cs, Computers etc)</td>
<td>50</td>
</tr>
<tr>
<td>Rent advance paid</td>
<td>40</td>
</tr>
<tr>
<td>Accounts Payable (Medicines, Sundries)</td>
<td>100</td>
</tr>
<tr>
<td>Utilities payable (Water, telephone etc)</td>
<td>50</td>
</tr>
</tbody>
</table>

**What is Owner's Equity in the Business?**
Analyzing Financial performance

The financial statements or data can be used to analyze the Pharmacy’s overall performance and assess its financial standings.

The type of analysis varies with according to the specific interest party involved.

– Trade creditors (Wholesalers, Banks etc.)
– Bondholders
– Investors in common shares
– Financial Manager
Analyzing Financial performance

- **Trade creditors** - are interested in the **liquidity of the firm**. Their claims are short term and the ability of a firm to pay these claims is best judged by means of a thorough analysis of its liquidity. (Liquidity ratio)

- **Bondholders** - claims are long term and so interested **cash flow ability** of the firm to service debt over a long term.

- **Investors in common shares** - interested in **present and expected future returns** and the stability of these earnings as a result they will concentrate their analysis to the firm’s profitability as well as its ability to pay dividends.

- **Financial Manager** - should be interested in **all aspects** of financial analysis that **outside suppliers of capital** use in evaluating the firm.
  - It is also for **its own internal control**. In particular it is concerned with profitability on investment in the various assets of the company and in the efficiency of asset management.
Use of Financial ratios

Financial ratio or index is used to evaluate the financial condition and performance of a company.

**Trend analysis**-
- comparing present ratio with past and expected future ratios of the same company
- study the composition of change and determine whether there has been an improvement or deterioration in the financial condition and performance over time

**Comparison with others**-
- Comparing the ratios of one firm with those of similar firms or with industry averages at the same point in time.

- **Caveat**: Avoid using rule thumb indiscriminately.
Type of Ratios

• Liquidity
• Profitability,
• Debt,
• Coverage and
• Market value ratios
Liquidity Ratios

They are used to judge a firm’s ability to meet short-term obligations. Essentially, this is to shorter obligations with short term resources available to meet these obligations.

- Current ratio
- Quick Ratio
- Liquidity of receivables
- Duration of payables
- Liquidity of inventories
Current ratio

Current ratio = \frac{\text{Current Assets}}{\text{Current Liabilities}}

- The higher the ratio the greater the ability of the company to pay its bills.

- This is a crude measure of liquidity; a firm having assets composed principally of cash and current receivables is generally regarded as more liquid than a firm whose current asset consist of primarily of inventories.
Quick Ratio

A somewhat more accurate guide to liquidity as it provides more penetrating measure of liquidity than current ratio.

Quick ratio = \[
\frac{\text{Current Assets} - \text{Inventories}}{\text{Current Liabilities}}
\]
Why is it Important to Manage MONEY Properly in a Business?.. 1

Many businesses fail not because the businesses do not make profits, but because money is not managed properly.

The following are some of the reasons why a business can face financial difficulties:

• **Inadequate amount of money to start a venture**
  Very often, small business owners do not make enough effort to calculate how much money they need to start the business and survive in the next few months. They start with very little money and cannot meet obligations.

• **Overtrading**
  Some business owners buy so many goods at a time that they do not have enough money to pay for other things.
Why is it Important to Manage MONEY Properly in a Business?.. 2

• **Too much credit**
It is not bad to give credit to attract and retain customers. However, if a shop owner’s money would be tied up for too long, the owner will not be able to settle his/her expenses.

• **Lack of information on the business**
Some business owners do not keep adequate records on their business. They are therefore unable to take good decisions about their businesses.

• **Negative cash flows**
Whenever the total amount of money that goes out of the business in payments is more than what comes in as sales, the business will face cash shortages.

• **Drawing too much**
When you draw too much money from the business for yourself, instead of putting enough back into the business, it will be difficult for the business to grow.
How To Reduce Cost In The Business

• **Reduce Losses Caused by Purchasing Practices**
  – Buy from sources that have a reputation for good quality.
  – Provide good storage facilities to avoid damage to the stock of drugs.

• **Reduce Labour Costs**
  – Labour costs are in the form of wages and salaries. Make sure workers or assistants are paid for actual work done.
  – Do not tolerate assistants who come to work late, or assistants who talk too much during work hours.
  – Avoid poor physical working environment, it will reduce worker productivity.
  – Avoid high worker turnover because you will spend a lot of time training new assistants.
  – Use the correct equipment and develop your skills as well as those of your assistants in order to reduce the time for providing service to a customer.
• **Reduce Indirect Costs**
  – Use water, electricity (power), and telephone only when necessary.
  – Use the most economic means of transportation.

• **Reduce the Amount of Working Capital You Need**
  – Do not stock drugs beyond the quantity that is required.
Controlling the Money in your business

Being an entrepreneur means that you are interested in planning for the future and changing from what is happening now to what you hope will happen in the future.

Entrepreneurs rely on information to be able to plan and control their businesses successfully.

A number of important rules must be followed if you are going to keep control of your business and be able to plan for the future.

• Keep your business money separate from your personal and family money. Keep separate bank accounts – one for yourself and your family and another for your business.

• Pay yourself and each other member of your family working in your business a regular wage, which is charged as an expense to the business in the same way as wages for other staff.
Controlling the Money in your business

• Decide how much you can take out of the business each Month or Week as salary and whether you can take out more than your salary (drawings) or whether you have to re-invest some of the profits into your business.

• All receipts should come into the business in cash if possible. If credit is necessary, come to a suitable agreement and get your cash from customers quickly.
Controlling the Money in your business

• All cash received every day should be banked every day and a record kept of those receipts, i.e., retail businesses should use a cash register. Your business will need a cash receipt book.

• All payments of expenses and other amounts on behalf of the business should be by cheque, with a record kept of what payments are made and the reason for the payments—Payment Voucher

• If you or your family take any goods or equipment from the business for your own personal (permanent) use, then a record of this should be made in the business. You should be charged in the same way as any other customer or client should be charged.
Controlling the Money in your business

• Keep a regular check on your bank account to see that money deposited is recorded and cheques sent are presented for payment and that balances in the bank agree with your records in your office - **Reconciliation**

• Cash available in the bank must be sufficient to meet daily and weekly cash requirements.

• Plan ahead if you need additional cash by way of an overdraft or loan from your bank - **Cash flow statements**
Thank you
Referencing materials include:

- *The Economist, October to December 1999 editions*
- *Essential Pharmacy Management (online), Second edition* Tootelian, Dennis H; Wertheimer, Albert I; Mikhailitchenko, Andrey

THANK YOU