

Ready to Partner with an Online Pharmacy?

Practices Can Save on Inventory Costs and More

by Lowell Ackerman, DVM, DACVD, MBA, MPA, CVA

The pharmacy has become an extremely competitive revenue center for veterinary hospitals, as the marketplace has become crowded with retailers offering similar or even identical products. There was a time when many products sold by veterinary practices were available almost exclusively through veterinary channels, but that may be just a fond memory for many veterinarians as they are faced with a new reality in dispensing. Is there a path forward for veterinarians, or should we just get used to the ongoing erosion of this important revenue stream?

In a typical primary care veterinary hospital, dispensing often represents 25%–30% of total revenue (including prescription and nonprescription items and diets), although that number has been dropping in recent years. Still, it is by far the largest revenue-generating category for most practices, so veterinarians need to consider strategies to maintain a meaningful share of this dispensing revenue . . . or change the veterinary business model so that it is not quite so dependent on this source of income. Both options deserve serious consideration.



Pet owners may not bother comparing costs on a one-time prescription (such as for treating an infection), but for medications used chronically and those used for parasite control, comparison shopping should be anticipated.

Why Is It so Difficult for Veterinarians to Generate Profit with Their Pharmacies?

As little as 20 years ago, veterinarians enjoyed a relative monopoly for dispensed products and the benefits of product sales for which they had little competition. Even the introduction of competing internet pharmacies didn't adversely affect veterinary market share much, although veterinarians did not welcome this intrusion into their business domain.

The main changes that have occurred that have had the most impact on veterinary practices are the more mainstream sale of products through retailers and the increased "share of voice" these retailers have with pet owners. It is now very easy for consumers to find their products of interest from various retailers, online and otherwise, and to shop for the best prices and delivery options as well.

The other aspect of dispensing that cannot be ignored if veterinarians want to dispense profitably is that inventory is not typically managed efficiently and effectively given its critical contribution to hospital income. You would think that something that reflects more than one-quarter of hospital revenue would be prioritized in hospital operations, but such is not the case in many instances. Thus, many practices carry too much inventory given their small retail footprint, and so the typical ordering and carrying costs are often excessive given the turnover associated with those products. Because of this, even if such inventory generates revenue for the practice, it may not generate sufficient profit given the costs involved.



The best ways for veterinarians to profitably provide dispensing include limiting the number of products stocked to those absolutely needed.

Pricing is another area of contention for many practices. When veterinarians had a relative monopoly on product sales, it was possible to use markups of 100% or more (150% or 2.5 times product cost was typical) and still maintain market share. However, that is very difficult in today's retail environment, where there are easy cost comparisons for consumers. Pet owners may not bother comparing costs on a one-time prescription (such as for treating an infection), but for medications used chronically and those used for parasite control, comparison shopping should be anticipated. This loss of business can be insidious, but it can also be devastating to the long-term success of the veterinary pharmacy. For instance, veterinarians may not be aware that parasite-control products typically represent the majority of their prescription-dispensing revenue. We have now reached a critical point at which more than half of pet owners are buying their

flea- and tick-control products through nonveterinary channels.

Other than marketplace competition and deficiencies in appropriate inventory management, there are two other features common in the veterinary business model that are not shared by our retail rivals: "production" and dispensing fees. In some practices, dispensing is not strictly a retail activity, and a commission (production) may be paid to veterinarians based on the products they recommend and dispense. There's nothing wrong with this in principle, but since retailers don't do this, it serves as one more impediment to competitive pricing. Since the veterinary price to consumers must reflect both fair pricing for the product itself and the commission to be paid to the veterinarian, the veterinary price is often significantly higher than that of the retailer. Similarly, adding a dispensing fee is something that

veterinarians have historically done, but it also inflates final product costs to the consumer when our competition does not do the same.

Managing Inventory Costs

The best ways for veterinarians to profitably provide dispensing are to limit the number of products stocked to those absolutely needed, ensure that product recommendations are routinely made by the hospital team so that product turnover is optimized, promote compliance so clients give the medications as directed and for the correct intervals (including refills), and price fairly so that there are few or no obstacles to client acceptance and purchasing.

From a medical standpoint, the best way of limiting inventory is to create standards of care within the hospital and only stock products that satisfy those standards of care. For example, if you create a standard of care for integrated parasite control for cats and for dogs, you can then select your recommended products accordingly to match the specifications established in your standard of care. You may even elect to have a backup choice on the shelf, but there is no need to carry more products for this purpose than that. There are many guidelines available that can be the starting point for your hospital's standards of care. Many can be found on the AAHA website at aaha.org/guidelines.

Why Partner with an Online Pharmacy?

Veterinarians do not need to stock everything in their own pharmacies in order to provide more complete retail options to their clients. If hospitals concentrate on stocking products

for which they have good turnover, profitability, and compliance, then it makes sense to let someone else shoulder the inventory costs for other products that might be used infrequently, for which there is not an adequate profit margin, or that didn't make the cut for the hospital's standards of care. The only other products to stock that don't meet those criteria are emergency drugs (which are not "shopped" and thus do not require competitive pricing), and "starter" packs to commence treatment and for which longer-term therapy may eventually be outsourced (e.g., diets, parasite-control products, NSAIDs, etc.).

Online pharmacies that work with veterinarians (such as Vetsource, Vets First Choice, and others) allow veterinarians access to a wide range of products that can be provided for home delivery, but the inventory itself is held and managed by the online pharmacy. The online pharmacy has its base price for the veterinary hospital to cover the product's direct and indirect costs and a profit margin for the online pharmacy. The veterinary hospital can then establish the retail price for its clients, and the difference between the base price and the retail price is paid back to the practice as the margin. In this way, practices can make a profit on inventory that they never have to stock.

Veterinarians can sometimes fool themselves into believing that they make more money selling the products from their in-house pharmacy because it is cheaper to buy the products directly from the manufacturer or distributor, but that often neglects the fact that there are very real ordering and carrying costs for inventory (often 20%–45% of the direct product costs), and for many products, it is actually more profitable to dispense them from an online pharmacy than to stock them in the hospital. This also minimizes "shrinkage," which reflects the fact that a percentage of stocked products never manage to find their way onto an invoice that gets paid.

Online pharmacies not only allow veterinary hospitals to limit their in-house inventory expenses, but in many ways, they may actually improve the profitability of dispensing in general. As mentioned above, they virtually eliminate shrinkage, since



those products aren't available in the hospital to be diverted. Products only get shipped if they are fully prepaid, and so (at least related to online sales) there is never a discrepancy between invoicing and inventory. Without having to contend with inventory costs, every online product sale can be profitable. The same cannot be said for in-hospital pharmacy sales.

Another benefit of online pharmacies is that compliance is often much improved, especially for chronic medications and parasite-control products.

When it comes to online pharmacies, pricing can be competitive by design. There may be a smaller profit margin for some products than others based on retail competition, but since there are no direct or indirect inventory costs, it is possible to compete even with slim margins.

Another benefit of online pharmacies is that compliance is often much improved, especially for chronic medications and parasite-control products. Once the medication has been prescribed and the number of refills documented, it is the online pharmacy that follows up with clients to ensure they are getting their refills in a timely manner. Not surprisingly, this feature alone has been responsible for increased pharmacy profitability and customer satisfaction in many instances.

What About the Hospital Team?

For hospitals that compensate their doctors based on production, online pharmacies can cause some trepidation, as veterinarians wonder

if they are going to make less money when fewer products are being dispensed directly and for which they would otherwise receive a commission. It's certainly a concern, but there are ways of structuring things to minimize that angst.

Paying production (commission) on products tends to inflate the costs of those products to the consumer

and so is likely not sustainable in the long run, as practices attempt to keep the price of products competitive for clients. Clients who purchase products outside of the veterinary channel, such as buying from a retailer or an unaffiliated internet pharmacy, do little to support veterinary hospitals directly or indirectly. That represents lost opportunities for everyone concerned.

There are ways to ensure that veterinarians are fairly compensated even when using online pharmacies. Veterinarians working for hospitals that compensate based on salary aren't affected at all, but even those working for hospitals that pay on production may not be as adversely affected as one might first assume. In fact, it is interesting to note that in many hospitals that have made the switch to online pharmacies, in-hospital client spending may change little, if at all. So, even though the client may pay the online pharmacy for products and characterize that spending as separate from the veterinary hospital, many clients still spend comparably at the hospital

because that is their expectation. Thus, if clients are used to spending a certain amount of money during a veterinary visit, many will still spend close to that amount (perhaps opting for additional diagnostics, dental care, etc. if offered), and consider the bill from the online pharmacy as a separate expenditure. If that doesn't happen, some hospitals have altered the percentage compensation on professional services or even switched from revenue sharing (production) to profit sharing based on the margins that the online pharmacy pays to the hospital. It is worthwhile to everyone to make this a win-win situation, since it lowers costs for the hospital, which in turn allows the hospital to lower costs to clients, which itself leads to greater compliance and client satisfaction.

Final Thoughts

The thought of partnering with online pharmacies may at first appear scary, and perhaps even a bit intimidating, but it makes a lot of sense from a business perspective. Veterinarians aren't retailers, and most hospitals do not adequately track their inventory and its profitability, so incorporating an online presence can greatly improve the sustainability of this service.

There are a number of good reasons to consider partnering with an online pharmacy. Convenience of home delivery is often cited as a reason for first making the switch, especially for pet foods and products not often dispensed, but practices that have embraced the change have experienced many other benefits associated with outsourcing inventory.

From a business point of view, online pharmacies add a degree of economic rigor to the process that

is often missing from in-hospital pharmacy management. With online pharmacies, profitability is immediately apparent because there is a direct accounting of products sold and margins paid to the practice as well as a variety of reports generated that allow better evaluation of the service, compliance, opportunities available, and profitability. As mentioned earlier, compliance is typically significantly improved as online pharmacies contact clients for prescription renewals rather than relying on clients to call in or hospital staff to reach out. Affiliated online pharmacies may also integrate directly with practice management software, provide email marketing opportunities to increase passive product sales, reinforce the need for diagnostic testing, and allow clients to establish their own reminder systems. Some also have associated compounding services.

Regardless of whether affiliating with an online pharmacy is right for you at this moment in time, if you haven't done so yet, it's worth learning about the pros and cons so you know your options. It may take some adjustments, and you may want to talk with some of your colleagues who have already made the transition, but you may have happier clients, fewer inventory headaches, and more profit from partnering with an online pharmacy. It's worth some consideration. ✨



Lowell Ackerman, DVM, DACVD, MBA, MPA, CVA, is an independent consultant, author, lecturer, and the editor in chief of *Five-Minute Veterinary Practice Management Consult*. Find him online at lowellackerman.com.



There are ways to ensure that veterinarians are fairly compensated even when using online pharmacies.