Priceline

A NEW SCRIPT

AUSTRALIA'S FASTEST GROWING FRANCHISES

Priceline's whole-hearted embrace of franchising is changing the face of pharmaceutical retailing throughout Australia.

Report: Leo D'Angelo Fisher

New model: API chief executive Stephen Roche, left, and Priceline general manager Michael Langham

Photographs by James Davies

In the fast-changing pharmaceutical retailing market, staying one step ahead of consumer tastes and habits has become critical to survival. Wholesaler Australian Pharmaceutical Industries, which celebrates its centenary this year, has given itself a thoroughly modern makeover by becoming a franchisor to position itself as a health and beauty retailer through its Priceline chain.

Priceline joined the API stable in 2004, when the company acquired health, beauty and lifestyle retailer New Price Retail for $112.4 million. NPR was a stable of specialty retailers, including Priceline health and beauty stores and what was then the formative Priceline Pharmacy franchise, plus hair salon franchise Price Attack and homewares retailer House.

API chief executive Stephen Roche says this marked the beginning of "the new API" and a "retail-led, market-driven" strategy for growth, which already included a stable of retail pharmacy banner groups as channels for its manufacturing and wholesale business.

"API's reason for purchasing New Price was that it saw the long-term value of Priceline Pharmacy. Priceline was considered integral to API's future," Roche says. (API subsequently sold Price Attack and House.)

When API acquired Priceline, Jeff Sher was the chief executive of NPR and was instrumental in implementing the Priceline Pharmacy franchise strategy at API when he became the company's chief executive as part of the merger. At that stage there were just 16 Priceline pharmacies.

Priceline is one of Australia's fastest-growing franchise groups, with 205 stores in 2008-09, compared with 70 in 2005-06.

The plan is for 350 Priceline Pharmacy franchises by 2011, but Roche admits the high-growth strategy for Priceline got off to a rocky start. "We certainly stumbled ... in terms of the execution of that strategy."

One of the problems uncovered by early market research was that consumers generally didn't differentiate between banner groups, which made it difficult for Priceline to stand out. For Priceline to attract owner-pharmacists at the rate API wanted, the brand needed a more compelling presence in the marketplace.

"We knew the rewards would be there if we could successfully execute that strategy," Roche says.

Roche joined API in 2005 as Sher's head of strategic development. A pharmacy sector executive since 1997, he was previously group general manager of health services for Mayne Group, where he was responsible for pharmacy distribution, and chief operating officer of health-care services at FH Faulding & Co.

When Sher resigned in 2006 – he is a successful retail investor and chief executive of specialty retailer The Perfume Connection – Roche was appointed chief executive.

PRICELINE AND PRICELINE PHARMACY

Rank: 16
General manager: Michael Langham
Founded: 1982
Revenue 2008-09: $622.69 million
Growth: 63.40%*
Secret of success: Understand what the customer wants. The rest will follow.

* Average annual revenue growth in the three years to June 30, 2009

Roche was mindful that API, which listed in 1997, was not only answerable to its customers, but to the financial market as well. Also in Roche's considerations was the agitation by Woolworths and Coles, which were already making big inroads into health and cosmetics retailing, for deregulation to enable the supermarkets to open in-store pharmacies. (Under existing laws all pharmacies in Australia must be owned and operated by pharmacists.)

Priceline has a long pedigree, founded as a cosmetics discount chain by shopping centre magnate and long-time *BRW Rich 200* list member John Gandel in 1982 (see timeline). The brand was well known, but this was not without its sticking points, as Roche discovered when he commissioned a consumer perception survey.

Because not all Priceline stores contained dispensaries, most consumers thought of Priceline in its historical context as a retailer of beauty products and giftware.

The result, says the general manager of Priceline, Michael Langham, was a lack of brand clarity. "We were confusing the consumer," he says. "They didn't know what to expect when they walked through that door."

While sticking to the strategy of making the Priceline Pharmacy franchise central to the repositioning of API, in 2007 Langham led a rebranding program which ran over 18 months, underpinned by extensive surveys of consumers, pharmacists and suppliers.

Ultimately, however, it was Priceline's customers who were the biggest influence in the rebranding of Priceline.

"If you take as a starting point that the consumer or the patient is the fundamental nucleus of the business, then when we understand what they want, the rest will follow," Langham says.

In 2008 Priceline launched its new corporate livery, including a new colour – pink – reflecting research findings that the Priceline brand resonates most strongly with women. A new logo features the words "beauty, health, wellbeing" and images of a cradled heart and a green cross to reinforce the link between health, beauty and professional pharmacy services.

Priceline also relaunched its Clubcard loyalty program, which had signed up 3 million members by December last year, up from 2.5 million a year earlier. Clubcard members, 95 per cent of them women, accounted for more than 40 per cent of store sales in 2009.

"Clubcard is a key part of our marketing and a key part of our business. Its success is nothing short of phenomenal," Roche says.

An organisational restructure included the introduction of API's new supply chain system, Revitalise, which will integrate its national distribution network at a cost of $60 million by the time the program is completed in 2011.
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API currently has separate distribution chains for its pharmacy division (the Soul Pattinson Chemist and Pharmacist Advice banner groups) and its retail division (Priceline).

The integrated supply chain will provide annual savings of $18 million.

Roche says the relaunch has resulted in greater brand clarity among consumers and dispensary patients. This has been reinforced by a strategy to remove confusion between the pharmacy and non-pharmacy stores by divesting company-owned non-pharmacy stores and converting them to Priceline Pharmacy franchise stores.

Roche describes the transition from a predominantly corporate store portfolio to a majority of franchise stores, a process which has been under way since 2007, as "the central plank in our strategic development".

As well as removing consumer confusion about the two Priceline models, Roche says the move away from company-owned stores addressed concerns among franchisees – and prospective franchisees – that API was competing with them.

"We needed to make a serious strategic decision about the franchise model: were we going to continue with a mix of stores or focus on our franchisees? Our decision was that we were not going to compete with franchisees and that our ambition would be to become the best franchisor we could be."

Priceline added 30 new stores in 2009. At the time of writing, there were 331 Priceline stores: 216 franchises (180 of these pharmacies, 36 due to make the transition gradually), the rest corporate-owned. Roche says the plan is to expand the Priceline network to 400 stores in the first half of 2011, 50 of which will remain company-owned non-pharmacy outlets.

Roche says the rump of company-owned stores will be used as "laboratories" to test new products and Clubcard offers and to train retail managers and staff. Roche makes no bones about the difficulty of transforming API, led by the revitalisation of the Priceline franchise model.

"There's been a remarkable amount of work done to rebuild the business," he says. "Journey is one of the most overused words in the business vernacular, but we've had a hell of a ride the last three or four years."

For the 2009 financial year, API increased revenue by 9.6 per cent to $3.5 billion and net profit by 22.3 per cent to $18.6 million. The sale of stores to pharmacist franchisees contributed $6.1 million to earnings. (Store divestments raised $10.3 million in 2008.)

Roche says Priceline contributes 40 per cent to API's earnings (the rest comes from its wholesale and banner group activities). He expects this to grow to 60 per cent within the next three years.

The market is circumspect about the new API, with its share price at the time of writing languishing at 61¢, well down on its 2002 high of $4.50.

Investors' diffidence means API is regularly subject to market speculation. Having the acquisitive – and opportunistic – retail magnate Solomon Lew on the share register with a 12 per cent stake in the company also makes for some frayed nerves.

In February, Roche was forced to deny rumours of a management buy-out at Priceline. "There's no substance to that," he says. Of the constant rumour mill, including occasional speculation of acquisition by Woolworths, he observes: "It certainly adds to the complexity of my job." He adds that "nothing has been discussed or initiated" with Woolworths.

Steve Ogden-Barnes, a retail consultant at Deakin University's school of business, believes Priceline has played a critical role in helping to modernise pharmacy retailing in Australia.

"The traditional pharmacy approach to retailing has been underwhelming. Pharmacies historically have not done themselves any favours in the way they sell health and beauty products because it's not their area of expertise," he says.

"With Priceline, what you're seeing is the contemporary face of retail pharmacy, with a much more contemporary retail flavour."

Franchising doesn't suit all pharmacists, he says, which is why banner groups, buying groups tied to wholesalers, remain attractive to some pharmacists. "Banner groups give independent owners more latitude," Ogden-Barnes says. "With a franchise, you're either on the train or you're not."

Another retail consultant, Brian Walker, chief executive of the Retail Doctor Group, agrees that Priceline has successfully brought sophisticated retail disciplines to the pharmacy business.

But he believes challenges remain because of continued developments in the retail pharmacy market, including the emergence of discount barns such as Chemist Warehouse.

"Priceline is a fascinating case study of early market leadership, innovation and thinking that at some point finds itself challenged. I don't think they saw the enemy creep up on them," Walker says. "When Priceline started in the market it saw the opportunity to take pharmacists to a larger retail environment than they were previously used to, which includes putting themselves in some pretty expensive real estate.

"The next five years will be very interesting for the Priceline model. In my eyes, the jury is still out." BRW

Counter culture: API's Stephen Roche, left, and Priceline's Michael Langham

PRICELINE TIMELINE

1982 Priceline founded by shopping centre magnate John Gandel

1985 South African retailer Jack Goldin becomes joint owner of Priceline

1998 Listed South African retailer New Clicks Holdings acquires Priceline; New Clicks Australia set up to run Priceline

2002 Priceline Pharmacy franchise launched

2004 (February) Jeff Sher leads management buy-out of New Clicks Australia, including Priceline, from its South African parent. NCA renamed New Price Retail

2004 (September) Australian Pharmaceutical Industries acquires NPR (including Priceline); Sher becomes chief executive of API

2006 Stephen Roche appointed chief executive of API

2008 Priceline rebranding launched

2009 Clubcard loyalty program membership reaches 3 million