

The Pharmaceutical Retail Market Battle

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In the Spring of 2010, the Ontario government proposed major changes in the way which pharmacies in Ontario can operate. The Ontario Government controls the distribution of prescription brand-name and generic drugs offered by pharmacies in Ontario. Similar controls exist in other provinces. The prices of brand-name and generic drugs are also set by the Ontario government, after considering submitted documentation by the manufacturers and current world prices of brand-name drugs. In Ontario, the price of generic drugs is currently set at 50% of the brand-name equivalent. Brand-name prescription drugs are protected by patent for a period of 20 years. Prices paid by the government for brand-name prescription drugs are also negotiated, with the manufacturer often being required to offer a low enough price to be listed under the government drug plan that “buys” in large numbers. Rebates based on the list price are often used to meet the desired price. Other provinces have discovered that the price offered to the government in Ontario was lower than that being offered in other provinces.

There are two major proposals in the new legislation pertaining to the way pharmacies can operate in the province. Based on the proposed changes, revenue per pharmacy is expected to drop by \$300,000, or about 10% of store revenue. One of the new policies that the government proposes to implement is that drug manufacturers will no longer be allowed to provide cash incentives (i.e., “professional allowances”) to pharmacies to stock the generic brands of a specific company. The “professional allowances” amount to more than \$750 million a year in the country. The government indicates that pharmacy owners themselves have indicated that 70% of this money was used for rebates, not for patient care. Shoppers Drug Mart (<http://www.shoppersdrugmart.com>), the largest pharmacy operation in Canada, with more than 1,200 stores, about 600 of which are located in Ontario, has responded by indicating that the loss of the cash incentive will lead to the closing of stores, a reduction of staff, the reduction of services (e.g., reducing store and pharmacy hours), and the introduction of fees for certain pharmacy services (e.g., elimination of free home delivery of prescriptions). At the time of the announcement by the government, Shoppers Drug Mart actually cut the store hours and the hours of operation for the pharmacy counter of its stores in London, Ontario, the political riding of the Health Minister.

Another proposed policy is to reduce the price of generics to one-half of the current value (i.e., to 25% of the brand-name equivalent price). The aim of the latter policy is to reduce the cost the government faces with public drug plans (e.g., the Ontario Drug Benefit Program). While the public drug plan prices for generics will take effect immediately, once the legislation is passed, the equivalent reduced price for generics in private drug plans or covered directly by the individual will be phased in over a period of three years.

One of the underlying reasons for the proposed changes by the government appears to be the fact that the aging baby boomers are stimulating the demand for prescription drugs, particularly generics paid for by public health plans, which are leading to increasing costs to the taxpayers. The two proposed

changes represent ways for the government to reduce the cost of health care in the province. The removal of the professional allowances, now a cost of doing business, will reduce the markup manufacturers have to take for the drugs that they sell. The reduction in the price of generics will reduce the direct cost paid by the government.

The CEO of Shoppers Drug Mart has indicated that the professional allowances are just fees paid by the manufacturers of generic drugs for shelf space (i.e., a stocking fee). The CEO also wants the government to increase the allowed dispensing fees under public drug plans from \$7 to \$8, even though the actual cost of dispensing such drugs is \$14. Dispensing fees for private plans at Shoppers Drug Mart are close to \$12; at Costco, the fee is \$4.11. In the Province of Alberta, the government has set the dispensing fee at \$15. Shoppers Drug Mart also wants to be able to provide its own lower cost, private label generic brand of drugs (with more convenient-to-use packaging) to cut the cost to consumers, something that the government disallows. The store already has its own line of store brands in other product areas and it recognizes that branding in this fashion is one way to increase the level of customer loyalty to the store. The reason the government does not allow drugstores to offer their own private label generic drugs is concern with the possibility of a conflict of interest in dispensing this brand instead of offering other generics to consumers.

The CEO of Shoppers Drug Mart has stressed that what changes the company will actually carry out will depend on the nature of the new law that is set in place. There is also concern by members of the trade that changes similar to those proposed by the Government of Ontario, the largest province in the country in terms of population, will be proposed by other provinces across the country, particularly if the Ontario proposals are implemented. Shoppers Drug Mart operates across Canada.

Another concern of Shoppers Drug Mart is that, Loblaw (<http://www.loblaw.com>), the major grocery chain in the province and in the country, with about 1,000 stores under various banners, has indicated that it will improve the operating hours and service level at the pharmacies that operate in the various company grocery stores. Other retailers of this nature may also follow suit.

Another major player in the pharmacy market is Rexall (<http://www.rexall.ca>), which operates Rexall and Pharma Plus stores, among others. Rexall has also indicated that operating hours and services will have to be curtailed. The company also has instituted a delivery fee of up to \$8 for prescriptions and has cancelled programs for summer students and (pharmacy) interns, as well as put into place a hiring freeze at head office in Mississauga, Ontario.

Both Shoppers Drug Mart and the Rexall chain have provided sign-in petition books to enlist the support of customers who side with the concerns of the pharmacies; this information is to be passed on to the trade association (The Independent Pharmacists Association of Ontario [IPO]) and others. One side of a two-sided, 1-page, 3.5" x 8.5" brochure available at the Rexall (Pharma Plus) stores indicates that the changes will mean the cutting of "frontline healthcare," less service for customers, and the possible closure of pharmacies. The brochure asks customers to sign the petition available in the store, to call 1-866-880-6531, or to visit the <http://www.StopCuts.ca> web site. The listed telephone number is actually the contact number for the MPP's (i.e., the Members of the Provincial Parliament), but no such identification is provided in the brochure. The words "cutting," "less

service,” and “close” are underlined in the brochure. The identified website is a “trade community” representing the interests of those involved in the pharmacy area.

The other side of the brochure again asks for support to stop the cuts, but no specific cuts are listed, including the reduction in price for generic drugs. On this side of the brochure, there are a number of quotes from newspapers, a news agency, and a web site owned by a newspaper. Briefly, the quoted headlines indicate that patients will suffer because of the funding cuts; that there is a war going on between the Government of Ontario and the pharmacies; that the political party in power believes that there are too many drugstores for the market; that there will be less staff, fewer hours of operation, and store closings; that there could be additional fees for services now provided free (e.g., blood-glucose monitoring, blood pressure tests, and patient counselling on medications); and that higher dispensing fees for prescriptions or charges for calling doctors to approve a repeat.

As indicated, one of the proposed changes by the government is the elimination of the “professional allowances.” Customers are being asked to call the government to stop the cuts, but the specific cuts (e.g., professional allowances, lower generic drug prices) are not specifically mentioned in the brochure, in the newspaper ad, or in the petition, sign-in book. Interestingly, there has been some reference to the fact that the professional-allowances system was actually set up by the government. All that is stated in the sign-in book is that the cuts may lead to higher prices, lower services, and possible store closing.

The Independent Pharmacists Association of Ontario (<http://www.ipoassociation.com>) also has concerns with the government proposal and with the market-level proposals of other stores, since stores like Loblaw, can use the pharmacy as a loss leader. It is a difficult business model for smaller pharmacies to match. It has also been suggested that some of the small, family-owned pharmacies may have to close because of the impact of the proposed changes and because of the nature of the changing competitive market. The trade community for pharmacists has also run a one-page ad in newspapers stating the pharmacists’ position on the government proposal, with particular emphasis on how the proposed changes by the government will negatively impact consumers. There is no mention of the price reduction for generics or how consumers will benefit from the price reduction.

While there seems to be unified front in the pharmacy industry, other types of retailers seem to be ready to take advantage of the retrenchment activities of the traditional pharmacies. The President of Loblaw has indicated that the move by pharmacy chains, like Shoppers Drug Mart and Rexall, to reduce hours and services provides an opportunity for other retailers to take advantage of the change in the market by the dominant players by going after greater market share; recognizing that customers always want better service.

Others in the industry also recognize that by improving the nature of in-store pharmacies owned and operated by other retailers, such as Loblaw, Costco (<http://www.costco.ca>), Zellers (<http://www.zellers.com>), and Walmart (<http://www.walmart.ca>), there is the opportunity to encourage customers to switch from the traditional pharmacy, recognized as a difficult task, to use the pharmacy services at the supermarket or other retailer operations. Once in the store, hopefully, customers will purchase other goods during their visit, including the high margin health and beauty

aids (HBA).

Specifically, Loblaw plans to improve the hours and services at its currently existing 500 in-store pharmacies and to test a small-pharmacy format at other supermarkets under its control that do not have pharmacies. Other changes include expanding the number of in-store medical clinics from the current 84 to more than 200, hoping that customers drawn to the clinics will purchase their required prescription drugs at the in-store pharmacy, as well as purchase other goods and services while in the store. The company is also investing in high-tech pill counters and other related technology in order to further reduce costs. In order to increase its customer base, the company also will be looking to acquire the prescription lists of smaller pharmacies that fail to successfully adapt to the changing market.

Besides the major two proposed changes in the government bill, there are other proposed changes. The government plan also calls for an increase in dispensing fees of up to \$4 for prescriptions covered under the Ontario Drug Benefit Program (ODBP) in rural or underserved areas of the province. For all other areas of the province, the dispensing fees would increase by \$1 for prescriptions covered under ODBP. All such dispensing fees would increase annually in the following years. A budget of \$150 million, including a new \$100 million fund, will be set up by the government to pay pharmacists to carry out various services, with specific money being set aside for rural pharmacy services and long-term care pharmacy services. All savings under the reforms resulting in the reduction of the price of generic drugs will be channelled back into the Ontario health-care system. The funds will be used to add new prescription drugs to the ODBP formulary and to improve the quality of care at hospitals, to hire more nurses, to improve the quality and level of home care, and to reduce emergency-room waiting times.

Finally, the government has indicated that there is room for concessions. If pharmacists are willing to perform other services (e.g., administer vaccinations) normally performed by those in the medical profession, there could be additional remuneration. There has also been the suggestion that the government, itself, could get into the business of dispensing drugs. It should also be noted that Shoppers Drug Mart previously expanded into the packaged, frozen, and dairy grocery-market and the upscale cosmetics market, in the latter case, carrying products that were traditionally found in department stores. While Rexall also carries packaged grocery products and upscale cosmetics, it has yet to move as deeply and broadly into the grocery or cosmetics business as Shoppers Drug Mart.

Focus: The concepts that are relevant to this case are categorized by general topic area, as set out below.

General marketing concepts: external environment (CERTS: competition, economic, regulatory, technological, social [culture, political]); business goals.

Consumer concepts: consumer behaviour; behavioural approach to store classification: convenience store, shopping store, specialty store; price elasticity (elastic, inelastic, unitary elastic); derived demand; target market; demographic segmentation; geographic segmentation; attitude formation and attitude change; enduring vs. situational involvement of pharmacists; one-stop shopping; impulse buying; brand and store loyalty; adoption process ([non-awareness], awareness, interest, evaluation, trial, decision, confirmation); decision stages and intervening processes model (actual state, desired state, consumer problem, product level [product attribute cognizant stage, product evaluation stage, product decision stage], brand level [brand attribute cognizant stage, brand evaluation stage, brand decision], store level [store attribute cognizant stage, store evaluation, store decision], post-cognizant stage); Heider's balance theory (P-O-X model).

Product/service concepts: traditional and expanded consumer goods classification; behavioural consumer goods classification (see Bucklin, 1963 - Product-Patronage Matrix - convenience good, shopping good, specialty good); manufacturer brand; dealer brand; generic dealer brand; generic dealer brand of drugs; manufacturer generic brand of drugs; evaluation of packaging (VIEW); 1st generation packaging; 2nd generation packaging; generic demand; selective demand.

Place (distribution) concepts: supply chain management (physical supply, material's management, physical distribution, channel relations); retailer; manufacturer; channel facilitator; B2C, B2B, and B2G market for proprietary drugs; institutional approach to store classification (convenience store; shopping store; specialty store: single-line, limited-line, super-specialty store); power (reward, coercive, legitimate, expert, referent); stocking fees; retailing mix; retailing strategy; conflict; intra-type competition (conflict); inter-type competition (conflict); vertical conflict; vertical integration (forward, backward); horizontal integration; channel facilitator; scrambled merchandising; core-fringe channel structure model; theories of retail institutional change (theory of natural selection, general-specific-general [accordion theory] model, wheel of retailing, dialectic process).

Promotion concepts: advocacy advertising; one-sided vs. two-sided communication; dyadic interaction model as it pertains to the role of a change agent ([1] force, [2] patronage, [3] attractiveness (similarity: physical, ideological), (likability) [4] credibility (technical expertise, trustworthiness)); attitudinal vs. behavioural brand (store) loyalty; communication process (sender, encoding process, message channel, decoding process, receiver, noise, feedback, common frame/field of experience); push money; trade allowances;

Price concepts: cumulative vs. non-cumulative quantity discount.

Other concepts: none identified.

Questions:

1. Identify the different general types of channel members involved in the case. Of the channel members identified, what is the type of each? What types of channel members are not identified in the case?
2. Why is the Government of Ontario considered a channel facilitator? Explain.
3. What is the distinction between manufacturer brands, dealer (private) brands, and generic brands in the channel of distribution for canned goods? What is meant by a generic drug? How are generic drugs different from normal generic consumer goods? How is a generic dealer brand of drugs different from other types of dealer brands sold by the same store and different from a manufacturer's dealer brand of drugs?
4. What is the distinction among the B2C, B2B, and B2G market for (proprietary) prescription drugs as it applies to this case? Explain. (Note: B = Business; C = Consumer; G = Government)
5. Using the normal consumer goods classification (see Copeland, 1924 - convenience goods, shopping goods, specialty goods) for prescription drugs, how would prescription drugs be classified? Explain.
6. Using the expanded view of consumer goods (Convenience goods: staples, impulse, unsought, emergency; Shopping goods: homogeneous, heterogeneous; Specialty goods), how would prescription drugs be classified? Explain.
7. Using the behavioural approach to the classification of consumer goods (see Bucklin, 1963 - Product-Patronage Matrix), explain how prescription drugs be classified? Explain.
8. Using the institutional approach to store classification, how would pharmacies be classified? how would grocery stores (supermarkets) be classified? how would all of the stores mentioned in the case be classified?
9. Given the volume of prescription drugs "bought" by the Ontario government under the Ontario Drug Benefit Program (ODBP), what type of quantity discount applies? Explain.

10. The dimensions of the external environment can be represented by the acronym, CERTS - competition, economic, regulatory, social (e.g., culture, political). Explain which and how each of these areas are relevant to the case, if any.
11. In the context of channel relations, define the concept of power. How does this concept apply to the Government of Ontario and other provincial governments relative to the manufacturers and retailers of prescription drugs?
12. What are the different types of power? Identify and explain each type. Which ones are relevant to this case? Explain.
13. The “professional allowances” paid to pharmacies by the manufacturers of generic drugs to stock the generic products of the manufacturer can be considered to be push money or a trade allowance. Explain what these terms mean in this context. Is it ethical for pharmacies to accept such money and is it ethical for manufacturers to offer such incentive? Are stocking fees commonly used in other retail areas? Explain. Does the payment of such stocking fees result in higher prices being set by the manufacturers in order to cover these costs? Explain.
14. If pharmacies are receiving the “professional allowances,” what should they be doing with this money? What are they doing with this money? Why are such fees called “professional”? Why are they not just called “promotional” or “stocking” allowances? What are such fees called in other retail areas? Remember, the “professional allowances” relate to a B2B transaction, not to a B2C transaction.
15. If the proposed changes of the government are implemented, the pharmacies have indicated that a number of changes will occur in the way pharmacies are operated. In what way do such changes reflect certain aspects of the retailing mix of the stores? What are the major components of a retailing mix? How do the proposed changes by the pharmacies reflect changes in the retailing strategy of these stores?
16. What is the nature of the price elasticity of brand-name drugs? for generic drugs? for dispensing fees? Explain.
17. How does the concept of derived demand apply to the case?
18. Describe the nature of the target market(s) relevant to the case? How does the concept of demographic segmentation apply? geographic segmentation apply?
19. How do the concepts of generic and selective demand apply to the case?

20. Explain how the concept of product life cycle applies to the case. At the general product level, where in the PLC are prescription drugs as a product category? generic drugs? Explain.
21. What are the business goals of the government when it comes to running the Ontario Drug Benefit Program (ODBP) specifically and health care in general?
22. The acronym, VIEW (visibility, informative, emotionally appealing, workable), can be used to evaluate the 2nd generation packaging of a product. Only “visibility” is perceptual in nature; the remaining three characteristics are “attitudinal” in nature. 1st generation packaging is designed to protect the product as it moves through the entire channel and during use. 2nd generation packaging seeks to achieve the intent of the VIEW acronym. In the case of the line of dealer brand of generic drugs proposed by Shoppers Drug Mart, of what relevance is the VIEW acronym? Of what relevance is the VIEW acronym for brand-name prescription drugs and generic drugs, overall?
23. Define conflict. Explain how inter-type competition (conflict) applies to the case. Explain how intra-type competition (conflict) applies to the case. What is the conceptual nature of the conflict between the traditional pharmacies and the government?
24. Explain how backward vertical integration applies to the case. To what extent does forward vertical integration apply to the case?
25. Explain how vertical conflict applies to the case.
26. Explain how the concept of horizontal integration applies to the case.
27. How has Shoppers Drug Mart indicated that it will change its retailing strategy in order to deal with the proposed government changes in health care in Ontario affecting pharmacies?
28. How has Rexall indicated that it will change its retailing strategy in order to deal with the proposed government changes in health care in Ontario affecting pharmacies?
29. What type of advertising is the pharmacy industry in Ontario carrying out by placing a one-page newspaper ad promoting its position of the proposed government changes, by distributing a brochure reflecting its concerns, and by asking customers to sign a petition against the proposed changes? Explain.
30. Explain how the Independent Pharmacists Association of Ontario (IPO) is a facilitator rather than a channel member.

31. Explain how the small brochure distributed by pharmacists reflects a one-sided vs. a two-sided communication in a format opposite in approach to that which is normally used in advertising. Why do you think this approach used (i.e., one-sided of the given nature)? How would you have designed a two-sided communication on this matter? Why do you think the two-sided communication approach was not used? Which approach do you think would have been more affective if the intent was to gain the support of consumers? How effective do you think the one-sided approach used will be, if consumers become aware of the other details of the proposed changes that were left out in the ad and the brochure? How do you think consumers would react upon learning the other details of the proposal put forward by the government?
32. Explain the relevance of scrambled merchandising in this case.
33. Explain how the core-fringe channel structure model applies to this case.
34. Which theory (theories) of retail institutional change apply to this case? Explain.
35. Explain how enduring and/or situational involvement of pharmacists is relevant to this case.
36. Explain the relevance of the potential for impulse shopping is relevant to this case.
37. Explain why consumers are reluctant to change pharmacies? How does the dyadic interaction model in the context of a change agent apply to this case? Why is there store loyalty when it comes to pharmacies?
38. Explain the relevance of one-stop shopping to this case.
39. What is the distinction between attitudinal vs. behavioural brand and store loyalty? How are these concepts relevant to this case?
40. What are components of the communication process model? Explain how each component relates to this case?
41. Explain how the adoption process relates to this case.
42. Explain the nature of consumer problem identification and solving under the decision stages and intervening processes model as applied to the shopping behaviour of a consumer of prescription drugs.
43. Explain how the concept of horizontal integration applies to this case.

44. Explain how Heider's balance theory, using the P-O-X framework, applies to this case. Include in the discussion, positive unit relation (U), negative unit relation (notU), positive sentiment (L), and negative sentiment (DL), to the extent that each concept applies. For dyads, use P and X; for triads, use P, O, and X. Indicate whether the relationship is balanced or imbalanced.
45. After reviewing the actions taken by pharmacies (behavioural- and communication-wise), do you think they have lost some of their thunder and need to re-think their strategy, given the decision by supermarkets, like Loblaw, to become more aggressive in the prescription drug and healthcare market? Explain. Do you think that the traditional pharmacies thought that supermarkets would take advantage of the market opening provided by the traditional pharmacies in the manner described? Explain. If the pharmacies thought in this way, why did the traditional pharmacies respond to the government proposal in the way that they did? Explain.
46. Conceptually, what is the nature of the conflict between the traditional pharmacies and the government? How do you think the conflict between the government and the pharmacies should be resolved? Explain. What are the possible ways of resolving the conflict?

Note. The majority of the facts presented in this case were drawn from the following sources:

[1] Flavelle, D. (2010, May 5). More drugstores is Loblaw's prescription. *The Toronto Star*, pp. B1, B2. [2] Flavelle, D. (2010, May 7). Shoppers wants private label generics. *The Toronto Star*, p. B4. [3] Howlett, K., & Strauss, M. (2010, April 13). Pharmacy chain takes fight to minister's riding. *The Globe and Mail*, p. A6. [4] Howlett, K., & Strauss, M. (2010, April 14). Second pharmacy chain to cut Ontario services. *The Globe and Mail*, p. A11. [5] Ontario Ministry of Health and Long-Term Care. (2010, May 26). *Drug system reforms: Our plan*. Retrieved from http://www.health.gov.on.ca/en/public/programs/drugreforms/our_plan.aspx#1 [6] Picard, A. (2010, April 15). The province wouldn't use such tactics on MDs. *The Globe and Mail*, pp. L1, L6. [7] Radwanski, A. (2010, May 26). Pharmacy-feud mandarin leaving post. *The Globe and Mail*, p. A12. [8] Strauss, M. (2010, May 5). Drug market battle looms. *The Globe and Mail*, p. B3. [9] Strauss, M. (2010, May 7). Shoppers eases criticism of drug reforms. *The Globe and Mail*, p. B7. [10] Taylor, F. (2010, April 15). Shoppers picks a fight that it will not win. *The Globe and Mail*, p. B12.