CHEMIST WAREHOUSE SUPPLEMENTARY SUBMISSION TO THE HARPER REVIEW

NOVEMBER 2014

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1. Introduction

Chemist Warehouse submits that the starting point for consideration of the appropriate form of regulation of the retail pharmacy industry must be that the status quo is not an option. This conclusion is apparent even from the comments made by the Pharmacy Guild of Australia (the Guild) in its submission and in public statements.

In its submission, the Guild says up to 40 per cent of all pharmacies will be unviable if they do not decrease operating costs. This is a consequence of government action to constrain the increasing demands on budgets – in particular, the Federal budget – of the health system, suggesting the prospect of pressure on revenues will not diminish. Chemist Warehouse submits that the most effective discipline on businesses to maintain a focus on controlling internal costs is competition.

Chemist Warehouse disagrees with the Guild's statement that retail pharmacy is, "a sector where competition is already effective, any possible gains from competition are likely to be extremely limited, and probably only temporary, while the impact of deregulation would ultimately be to permanently lose the substantial societal benefits of the current community pharmacy network".

Chemist Warehouse disagrees both with the proposition that the sector is effectively competitive and that there is little more to be gained from increasing pro-competition reform, or that there would be a permanent loss of societal benefits. We would contend that the primary societal benefit of the existing network is its relative ubiquity. If anything threatens this universality of access it is the existing rules that for the most part require the transplanting of existing approval numbers out of one location into another by prospective market entrants. Any legislative framework that removes the need to acquire an existing business to enable the opening of another in an alternate location, by its very nature removes any threat to this cherished and oft lauded ubiquity.

With regard to the first point, the business activities that Chemist Warehouse can identify it would wish to undertake, but is presently constrained from pursuing, provide compelling evidence of the latent value that just one competitor believes it can unlock if allowed to compete on a normal commercial basis.

With regard to the purported risk to societal benefits, Chemist Warehouse makes two points.

Firstly, Chemist Warehouse believes the Guild cannot both claim 40 percent of the sector is at risk of failure, and propose the status quo is protecting consumer interest.

Secondly, Chemist Warehouse believes the claim that social benefits provided by pharmacies would be lost if competition were increased does not bear scrutiny and is not consistent with the experience in other jurisdictions cited within its first submission. This evidence, along with the impact Chemist Warehouse has had on prices in markets it has entered, suggests there is more benefit available to communities in the form of improved access and lower prices from encouraging competition than there is from stifling it.

The primary societal benefit conferred to the Australian public is not coupled to the ownership structures behind a neighbourhood pharmacy. Society is for the most part ignorant and indifferent to the commercial structures that stand behind the pharmacy of their choosing. The public is not ultimately interested in where the final profits from their transaction reside. The societal engagement and relationship is with the dispensing and counselling pharmacist. The Australian public forges a bond of trust and respect with the chemist whom assists their pharmaceutical needs who in many cases (if not most) is not the store proprietor.

We estimate Guild membership today is around 2000 with about 5400 pharmacies in the country. There are about 28,000 pharmacists practising in the country, which suggests a very high proportion of customer interactions are with pharmacists working for someone else. In any deregulated structure that we would advocate, we see the need for all dispensing and primary pharmaceutical care to continue to be provided by appropriately qualified and trained pharmacists. That is, no change in care, simply in economic regulation.

2. The state of the industry and the implications

The Guild's submission contains discussion of numerous services that pharmacies provide that are "low-margin" or "loss making". It suggests that "it would be unlikely that they (pharmacy services) would be provided by an alternative, corporatised and profit-driven model".

This statement is deluded in its implication that a sustainable business model for pharmacies can exist that is not profit driven. Whilst specific services may be provided that themselves are only marginally profitable the provision of such services is for the most part to cement and entrench the loyalty of a profitable customer. A customer may be a profitable patient to provide pharmaceutical service to and if this is the case a service provider may provide some less profitable or even "loss making" services to keep that customer. Any business that understands the value of a customer, and we would contend that most businesses do, be they pharmacist owned or otherwise, would similarly provide whatever services were needed to keep profitable customers.

Further, Chemist Warehouse repeats its view that a deregulated industry is likely to evolve to support different models of pharmacy enterprises – from high volume, low margin retailers to high personal service models. In other words, the pharmacy industry should be no different from any other industry when the discipline of competition is applied. Individual businesses act to identify a market segment and customer profile they can attract and defend. If businesses are forced to find a competitive niche within a market segment that they can defend, pharmacies will become robust and resilient through business evolution, as opposed to reliant upon legislative protection.

The alternative to a market exposed to competition, if the Guild is correct in its assessment that 40 per cent of pharmacies are even today at risk, seems to be public intervention to prop up those businesses. This suggests a potential for higher costs to both the public purse and/or consumers.

3. The state of competition and opportunities

Chemist Warehouse is proud to have brought genuine competition to communities throughout Australia. However, there are dozens of locations into which Chemist Warehouse would like to invest from which it has been excluded for years by onerous regulations such as location rules and rules concerning the ownership of pharmacy businesses.

Since 2009 the same list of target locations where Chemist Warehouse believes the market is ripe for new entry has remained. The list when initially drafted contained (CiC) locations deemed desirable. In the intervening 5 years, only (CiC) have been successfully accessed. The failure to open the remaining (CiC) has nought to do with capital, labour or capacity and is wholly the result of the restrictive nature of the relocation laws.

The following list represents the (CiC) sites Chemist Warehouse has been endeavouring to secure for 5 years.

(CiC)

On this basis alone, Chemist Warehouse rejects the Guild's contention that there is little more to be gained from further competition facilitated by deregulation.

4. Further evidence from international experience

Implicit in the Guild's submission to this inquiry, and in subsequent public comments, is the proposition that pharmacies, particularly those in regional locations, are likely to be forced to close if regulation is relaxed to allow competitive entry of new pharmacies.

As discussed in our previous submission, evidence from European countries where similar reforms have been implemented does not support this assertion.

Further, a 2013 review of the experience in nine deregulated and regulated European markets concluded, "Access to pharmacies usually increases after deregulation but this is likely to favour urban populations with already good accessibility." There is no evidence that this came at the cost of a decrease in regional areas.

It also found, "In all deregulated countries and in Austria, the number of inhabitants per community pharmacy decreased since deregulation, whereas in all regulated countries (except Austria) this I indicator increased, in spite of newly opened pharmacies in Finland and Spain."[1]

[1] Vogler, Habimana, Arts; Does Deregulation in Community Pharmacy Impact Accessibility of Medicines, Quality of Pharmacy Services and Costs? P.319

S. Vogler et al. / Health Policy 117 (2014) 311–327 319

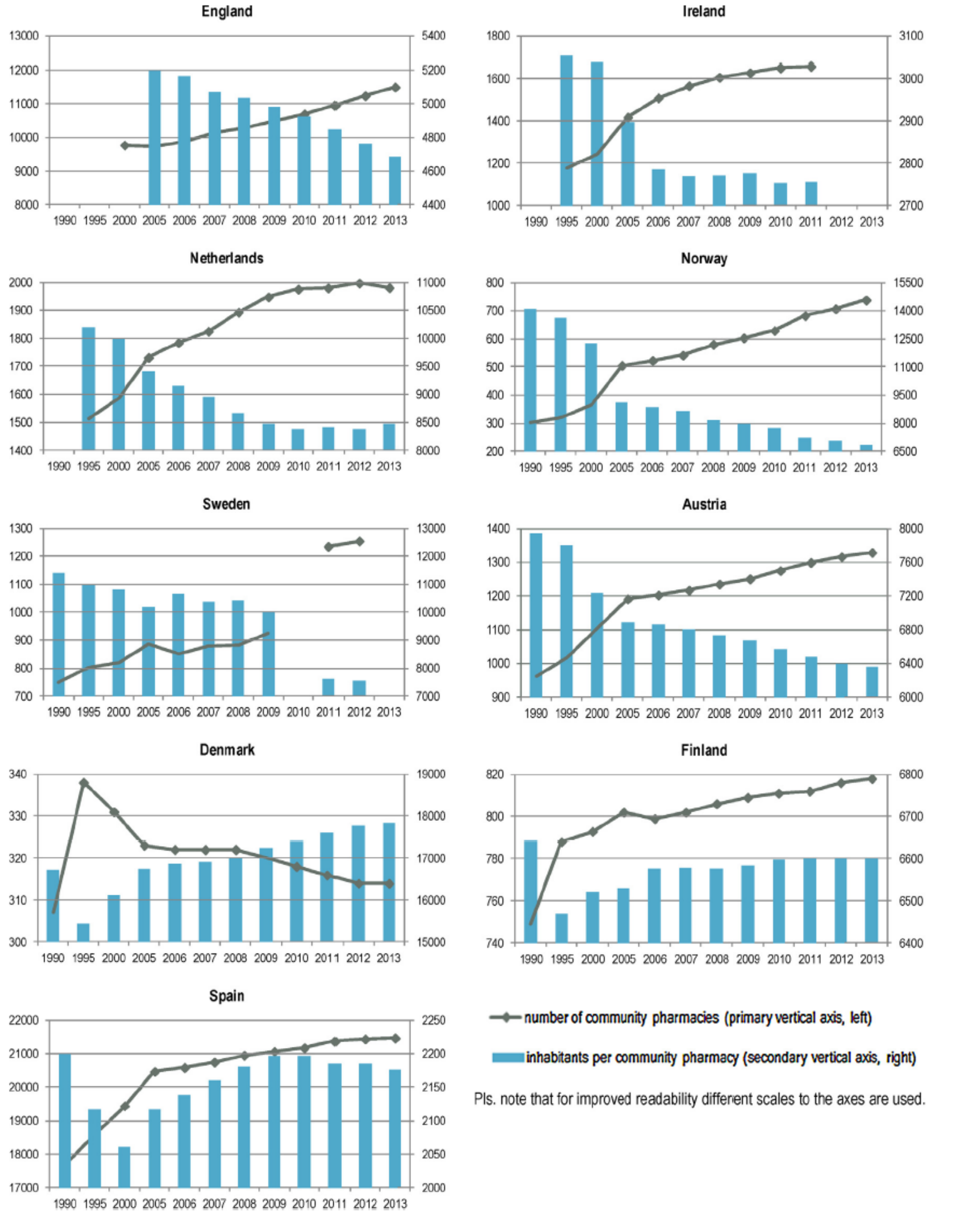


Fig. 1. Development in community pharmacies in nine European countries 1990–2013, in absolute number of pharmacies and in inhabitants supplied per pharmacy.

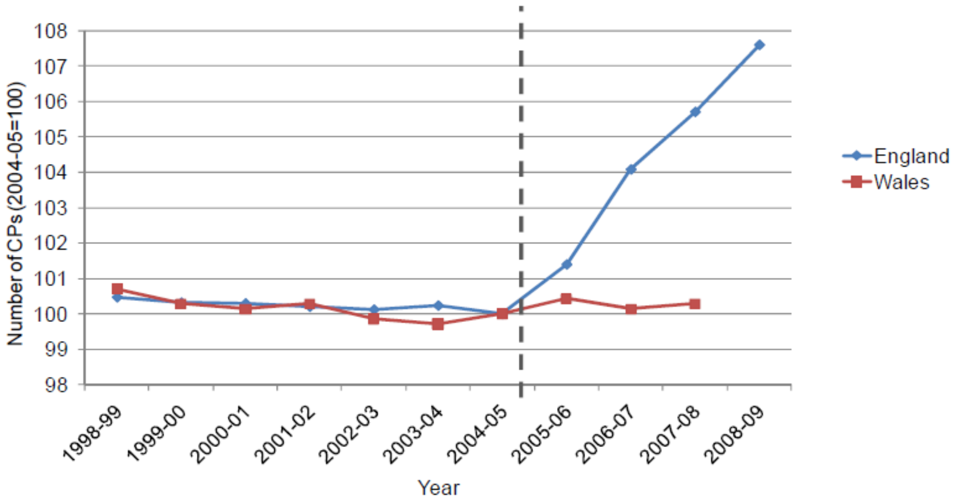
<u>Development in community pharmacies in nine European countries 1990-2013, in absolute number of pharmacies and in inhabitants per pharmacy.</u> [2]

In England, a study of the impact of the deregulation in that market by the Office of Fair Trading in 2010 compared the experience in England with that of Wales, where location restrictions were left

[2] Source: Does deregulation in community pharmacy impact accessibility of medicines, quality of pharmacy services and costs? *Evidence from nine European countries.* Sabine Vogler, Katharina Habimana, Danielle Arts, Journal Of Health Policy 2014 p.319

in place. In England there was an increase in the number of pharmacies immediately after deregulation, continuing to 2009, while the number in Wales remained flat.[3]

FIGURE 4.1 INDEX OF NUMBER OF COMMUNITY PHARMACIES IN ENGLAND AND WALES, 1998-2009



<u>Index of Number of Community Pharmacies in England and Wales, 1998-2009[4]</u>

In Norway, as a result of the changes in the pharmacy act, the general public has considerably better accessibility to pharmacies, as the number of pharmacies has increased from 399 in February 2001 to 622 as of June 2008.[5] In January of 2014 there were 767 pharmacies in Norway.[6]

5. A pathway forward

Chemist Warehouse recognises that the high degree of regulation presently in place means that it is necessary to consider carefully how to deregulate without causing unnecessary disruption to the pharmacy sector and, more importantly, the communities served by that sector.

Of particular concern to opponents of deregulation are the perceived risks of a decline in quality of service and of regional communities losing access to local pharmacies. Chemist Warehouse interprets comments by the Guild about the risk presented by a “profit driven” industry as being a concern that sharp practices, such as loss leading and deliberate commercial predation by well-funded entrants, will be used to disrupt and drive out of the market small, established pharmacists, and that competition law alone is inadequate to deal with this market-shaping conduct.

While the international evidence suggests this risk may be overstated, we believe those risks can be mitigated even further while enabling greater competition with all the attendant benefits.

[3] Evaluating the Impact of the 2003 OFT Study on the Control of Entry Regulations in the Retail Pharmacies Market. Office of Fair Trading. March 2010 p.32

[4] Evaluating the Impact of the 2003 OFT Study on the Control of Entry Regulations in the Retail Pharmacies Market. Office of Fair Trading. March 2010 p.32

[5] http://www.apotek.no/Files/Filer/NAF-bibliotek/PDF_Aktuelt_kolonne/FactsAndFigures2008.pdf

[6] http://www.apotek.no/Files/Filer_2013/ per centC3 per cent85pne per cent20sider/B per centC3 per centB8ker per cent20brosjyrer/key per cent20figures per cent202014.pdf

The ambition should be to change the regulatory regime such that the ONLY OUTCOME can be better coverage of more communities.

With regard to the ownership rules, Chemist Warehouse proposes that this should be restricted only through a “fit and proper person” test, rather than restricting ownership of pharmacies to pharmacists. This could include requirements to demonstrate appropriately upstanding financial, criminal, business and professional conduct histories.

Once the fit and proper person standard is established, a licence to open a new pharmacy should be priced at a level that reflects both the value to the Government of affording a business the right to distribute medicines under the PBS, but also provide some economic deterrent effect to those who might be motivated to “clear the market” of small, independent pharmacists. Chemist Warehouse suggests a figure in the order of $300,000 should satisfy those concerned about the risk of predatory market entry.

This would then be allied with changes to the location rules. While anyone licensed could buy an existing pharmacy, there could be continued restrictions on them moving that pharmacy more than 1-2kms. This would prevent rural and regional licences from being vacuumed up and moved to cities, and prevent “clustering” within cities – for example, around GP surgeries – to the detriment of other suburbs.

On the other hand, any fit and proper person convinced that a location could support a new pharmacy would be entitled to risk their capital establishing the business where ever they wanted.

Chemist Warehouse believes such a package of measures would resolve all the legitimate concerns expressed by those opposed to the deregulation of the pharmacy sector, while making the benefits of competition available to many more Australians.