Changes at the French pharmacy

Government action to stem a deepening funding crisis is being felt throughout the French distribution chain. Jean-Michel Peny outlines how original brand, generics and OTC companies might adapt their strategies in response to pharmacists' efforts to maintain profit levels

The French Sickness Funds are in crisis. The deficit is estimated to reach €10.9 billion this year and, with almost 30% of all reimbursed drug costs being spent in the distribution chain, it cannot be entirely surprising that the margins to wholesalers and pharmacists are being cut.

The first of what is widely expected to be a series of such cuts was announced in February and is prompting pharmacists to reconsider the management of their business (reimbursed drugs account for 79% of turnover and 77% of the profits in retail pharmacies) and their relationships with all their suppliers. To help pharma companies anticipate the strategic impact of such changes, it is important to understand how such moves are likely to affect pharmacy profits. This was the subject of a Smart Pharma Consulting study that involved interviews with 206 pharmacists as well as people representing the health authorities, pharma companies, pharmacy unions and pharmacy purchasing groups. What it showed is that change is on the cards and that pharma companies – both branded and generic – should not wait for the competitive environment to be shaped around them.

Retail pharmacy evolution

Few countries are as regulated as France. Prices, margins and discounts are all controlled, giving the authorities much scope to change the business dynamics. To encourage pharmacists to increase their use of generics, for example, the margins were equalised with those of original brands in absolute terms to compensate for the fact that generics are on average 30-40% cheaper. The discounts pharmacists can accept on original brands have also been capped at 2.5% of the wholesaler price and raised to 10.74% for generics.

In practice, the situation is even more favourable to generics companies because the authorities turn a blind eye to the illicit discounts they offer. These can average 40% and reach 70-75% on certain high-volume products. It is not surprising, therefore, that generics grew by 42% in 2002 compared with only 3% for original brands, and account, on average, for 11% of pharmacy profits but only 6% of sales. The only reason these illegal discounts have not been stopped is because the authorities want to encourage sales of generics. Unlike the situation in either Germany or the UK, they cannot rely on physicians to prescribe these cheaper equivalents.

However, since the introduction in 2003 of a reference pricing system (TFR), the health authorities are less concerned by the extent of generic substitution. If it is not high enough for a given product, a reference price (the maximum level at which reimbursement from the Sickness Funds kicks in) can be introduced and patients reimbursed on the basis of the generic price. For the first wave, introduced last October, the target for generic penetration was set at 45%, while for the second wave – planned for the end of 2004 – the objective is 60%. This measure reflects an important political change. For the first time since 1999, the authorities have introduced measures that directly affect pharmacy profits.

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The first wave of TFR is estimated to reduce pharmacists' margins by 0.6 percentage points on an annual basis and the lower margins instigated in February will reduce this by a further 0.3 points. If the government is tempted to clamp down on the illegal discounts from generics companies, profits will be cut even more.

More than 70% of the pharmacists interviewed believe new measures will be introduced in 2004 to realise even greater savings to the Sickness Funds. These may include:
- The introduction of the kind of clawback system that operates in the Netherlands and the UK, along with changes to the discount caps.
- The application of the TFR irrespective of the level of generic penetration, as happens in Germany, Portugal and Spain.
- The lowering of the maximum prices of generics, which are currently set at 40% below those of the respective original brands, to 50% or even 60% below these products.

Of these options, the easiest and most efficient would be to reduce generics prices. A price decrease of 20 percentage points will save €150 million a year for the Sickness Funds, but cut pharmacists' overall margins by another 0.6 points. The government may also consider withdrawing the discount caps, which do not generate savings and are almost impossible to control.

Strategic options

Retail pharmacists have three complementary strategic levers they can activate to protect their income. The first would be to focus on products that are not subject to economic controls. In France, this includes prescription lifestyle drugs such as those for erectile dysfunction, baldness or obesity. Pharmacists may not be able to directly influence the initial sales of such drugs but they can provide advice to improve compliance and therefore patients' repurchasing rate. The prices of these drugs are not government-controlled and in practice pharmacists apply a mark-up of 70% to 90% on their net purchasing price (after deduction of discounts in the range of 10%).

Other products exempt from government controls include over-the-counter (OTC) drugs, where pharmacists apply the same mark-up as for lifestyle drugs but can obtain higher discounts ranging from 15% when bought through wholesalers to 40-50% when supplied by manufacturers. Again, pharmacists have a role to play in recommending products but the market has been disappointing and sales fell by 7% in 2002. However, it should improve in 2004 and 2005 because several hundred semi-ethical products are being de-reimbursed making them *de facto* OTC goods.

Then there are health products repre-

Photograph by Stefano Bianchetti/Corbis

French pharmacists may be more open to proposals from pharma companies to help expand markets by educating and advising their customers about certain conditions.

senting 15% of pharmacy sales and 16% of their profits. Within this category, medical devices, skin-care products and dietary supplements are the most important and are still under-developed; while the demand is potentially high. Pharmacists should seize this opportunity to boost sales by adopting a more commercial approach, one that includes various merchandising initiatives.

In addition to developing sales, pharmacists might also consider reducing their purchasing costs. One option would be to negotiate higher legal discounts for reimbursed drugs. This will be easier where generics are concerned, especially if their maximum authorised prices are brought down. But it is unlikely the government will free the discount level, at least in the short term, for original brands. If generics discounts are liberalised, pharmacists will have more room to manoeuvre but if lower prices are also mandated, it may mean the generics companies cannot afford to offer the same discounts in absolute terms.

Purchasing groups

A second option would be to reinforce the power of ‘purchasing groups’, of which some 60% of France’s 22,700 retail pharmacies are members. A major problem with these groups is that members do not feel obliged to buy the products for which a price has been negotiated. Around 23% of pharmacists in the survey said they were not satisfied with their ‘purchasing group’, saying the lower prices do not outweigh the constraints in terms of the limited number of drugs involved, minimum volumes, and so on. Purchasing groups could perform better by imposing a more stringent purchasing policy, as some groups already do. Or they could create an inter-group structure to lead negotiations for even lower prices on a limited list of high volume products.

A third way of improving pharmacy performance would be to merge into larger structures where sales opportunities are higher and there is greater negotiating power vis-à-vis suppliers. When compared with the other major European countries, France is well served by pharmacies, having 2,600 inhabitants per retail outlet versus 3,800 in Germany and 4,700 in the UK. Only Greece and Spain have a higher concentration. Health authorities are already convinced of the benefits of fewer pharmacies, but they also know that the larger the pharmacy the lower the margins on reimbursed products they can support.

It is clear that retail pharmacists must evolve. In so doing, they create threats and opportunities for pharma companies that will be different depending on whether they are generics, OTC or original brand players.

With the patent expiry of several megabrands this year, generics companies are expected to intensify their discount ‘war’. But heavy discounts are already eating into their operating profits that run, on average, at an estimated 3% loss. Since sales levels are a key success factor, the smaller companies do not hesitate to offer discounts of up to 75% on fast-selling molecules, even though this strategy is suicidal because each of the four leading generics companies – Merck Génériques, Biogaran, GNR Pharma and Teva Classics – protect their positions aggressively. Together they account for 65% of the generics market.

The patent expiry of omeprazole this month (April) is already creating a stir. The drug achieved sales of €380 million in 2003 and is expected to extend the market for actual and potential generic drugs by 17%. Some generics companies have even signed orders with pharmacists before patent expiry to be in a position to supply it at the first opportunity.

Generics companies may have gone too far, however, by sending out a signal that they can afford to offer extremely high discounts. But even if the government imposes price reductions as a result, the induced loss of profit may well be compensated for by generic omeprazole and other major earners that come off patent this year, such as zolpidem (Ambien/Stilnox) for insomnia, citalopram (Celexa/Seropram) for depression, cetirizine (Zirtek/Zyrtec) for allergies, the antibiotic ciprofloxacin (Cipro/Ciflox), and ACE-inhibitor lisinopril (Zestril). Meanwhile, 61% of the pharmacists interviewed expect illegal discounts to be stopped as well because even if the authorities do favour generics, they are not willing to support them at any cost.

Generics companies should not therefore keep all their eggs in one basket. Indeed, 78% of the pharmacists interviewed said they would try to sell more OTC drugs and other non-reimbursable products and services. Generic player G Gam has already responded by launching a range of generic OTC products and will soon be followed by other players, all of which have several semi-ethical generics on the list the government plans to de-reimburse this year.

In another move, Biogaran starting selling two ‘essentially similar’ molecules recently, one for hormone-dependent acne (Minerva) and the other an oral contraceptive. These drugs are not substitutable since they are not reimbursable. Casting the net even further, Ivax, the third largest generics company in the world, acquired a range of anti-asthmatic products from 3M Health Care last year that are reimbursable but not strictly speaking generics, since they do not have proven bioequivalence and cannot be substituted by pharmacists. Ivax promotes these products as original brands with its own sales force and without the need, in principle, to offer discounts beyond the legal 2.5%. Other opportunities for generics companies to extend their business include selling health products, such as dietary supplements or home tests, that are free of pricing controls, thus limiting their dependence on health authority mandates.

Apathetic OTC market

Pharma companies with OTC portfolios should not expect too much from what is a particularly apathetic market. Its revival requires a fundamental change in the thinking of pharmacists, who must become more entrepreneurial; patients, who must accept more responsibility for the cost of drugs to treat minor ailments; and the government, in terms of taking a more positive attitude by launching information campaigns, as it did for generic substitution. Any change will be progressive and will take four to five years before significant results are observed. If patients do not find semi-ethical drugs equivalent to those that will soon be de-reimbursed, a timid increase in the OTC market might be expected. Past experience of authoritative switches from semi-ethical to OTC status has shown a rapid drop in sales that free pricing cannot compensate for. On the other hand, OTC companies should fear greater competition from generics companies that may launch low-priced branded generics for non-prescription products. More than ever, companies will have to fight to reinforce the value of their OTC brands and to sign deals with pharmacists and the most disciplined purchasing groups to secure their loyalty.

Original brands strategy

In this troubled environment, original brand pharma companies must play their hand well. So far, collaborations with pharmacists have been limited mainly to special discounts of 5-20% granted in an attempt to limit sales erosion induced by generics. Illegal discounts are not the exclusive province of generics companies. However, this strategy has not been particularly convincing because the offers have not been as attractive as those for the corresponding generics. If the health authorities do reduce generic prices, this practice will become more limited and may even disappear altogether.

Original brand companies might instead try to instigate innovative 'win-win' partnerships with pharmacists. In so doing, they first need to ask if pharmacists can:

- Influence prescription levels.
- Persuade patients to better comply with their prescription drugs.
- Play an active role in disease or risk-factor screening.

It may be that pharmacists, having close links with certain physicians, ask them to favour the prescription of certain brands for which they have obtained attractive discounts. This practice is illegal, however. The alternative is for pharmacists to suggest that people ask for a prescription for Cialis, say, rather than Viagra. But a better strategy might be for original brand companies to collaborate with pharmacists on the grounds that this can lead to better compliance. Pharmacists have a role to play in educating patients so they better comply with their treatment, particularly in asymptomatic conditions such as hypertension, diabetes and high cholesterol, or where the treatment is complex such as in the use of anti-asthmatic devices. When products generate unwanted effects such as drowsiness with antihistamines or diarrhoea with the anti-obesity drug Xenical, pharmacists can provide valuable support that results in better compliance. Besides, with an increasing number of hospital products such as anti-cancers and HIV treatments becoming available on the open-care market, pharmacists have no choice but to deliver advice and information. If companies are unhappy with the results from initiatives already undertaken in this respect, it may be that a lack of incentives and/or inappropriate commercial agreements, along with poorly prepared pharmacy teams, has stalled progress.

Building partnerships

A third way for original brand companies to build partnerships with pharmacists is through initiatives that help them to develop markets in which they occupy a leading position. It could be beneficial, for instance, for a leading oral antidiabetic manufacturer to collaborate with pharmacists to encourage people to control their blood glucose levels with devices they provide and which might earn a nominal sum for the pharmacists. If the results are abnormal, patients would be advised to visit their physician. Such initiatives could even be launched jointly by two or three pharma companies in areas that include high cholesterol, nicotine addiction, obesity, and hypertension.

To bring significant results these operations must be carried out on a large scale, be well planned and properly implemented, and with a measurement system in place to monitor the impact on drugs consumption. Fees paid to pharmacists for their collaboration should be based on tangible and reliable parameters. In such scenarios, pharmacists and pharma companies have more to share than just discounts. They can jointly create value for their respective enterprises, for patients and even for health authorities, if their initiatives lead to better management of public health.

The ongoing evolution in the French drug distribution chain shows how all players must take stock. Generics companies need to diminish the risks associated with their reimbursed products by widening their scope to embrace non-reimbursed ones. OTC companies threatened by their generics counterparts will have to defend their brands more than ever and orchestrate the promotion of OTCs to patients in close collaboration with health authorities and pharmacists. Original brand companies have an opportunity to co-operate with retail pharmacists on disease screening and patient compliance initiatives. It is now time for generics, OTCs and original brand companies to adapt their strategies to these changes and to get started on implementation before their competitors beat them to it.

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Generics companies	OTC companies	Original brand companies
Opportunities: •Patent expiry of several megabrands.	**Opportunities:** •Growth of the OTC market through the de-reimbursement of semi-ethical products.	**Opportunities:** •Willingness of pharmacists to increase income through deals with original brand companies.
Threats: •Risk of price cuts imposed by authorities. •Intensification of discount war. •New wave of reference pricing. •De-reimbursement of generic molecules planned by the health authorities.	**Threats:** •Fewer brands switched from semi-ethical to OTC status. Higher prices do not compensate. •Ambiguous message from the authorities stating that de-reimbursed products have not been proved to be efficacious and that minor ailments should be treated with them.	**Threats:** •Patent expiry of several mega-brands. •Faster penetration of generics after patent expiry because: a) they are now accepted more readily and b) the discounts offered by generics firms. •De-reimbursement of 426 products planned by the health authorities.
Strategic recommendations: •Development of a range of 'essentially similar' (non-substitutable) drugs. •Extension of the product offer with non-reimbursed products such as OTCs, dietary supplements and lifestyle drugs. •Positioning as low-price suppliers of health products for pharmacies.	**Strategic recommendations:** •Mobilisation of patients, pharmacists and health authorities to boost OTC markets. •Reinforcement of OTC brand equity to meet the challenge from the generics players. •Signing of agreements with pharmacy purchasing groups to push the OTC brands. •Extensive communication about the OTC brands to pharmacists.	**Strategic recommendations:** •Collaboration with pharmacists and/or purchasing groups to introduce progammes to: a) Enhance patient compliance with treatment. b) Screen for diseases and other risk factors. c) Support the transfer of certain drugs from the hospital sector to retail phamacies. Such drugs include those against HIV, cancer and arthritis.

Figure 1: A different environment requires a different response. Source: Smart Pharma Consulting.