



Removing Tobacco from the Product-Mix: Evaluating Opportunities for Pharmacy Retailers

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Introduction

Impact of Tobacco and Role of Health Care Regulation

Controlling tobacco has been a focal point of health care policy and regulation over the past several decades. Tobacco use is the single most preventable cause of disease, disability, and death in the United States. Each year, an estimated 443,000 people die prematurely from smoking or exposure to secondhand smoke, and another 8.6 million live with a serious illness caused by smoking. Despite these risks, approximately 46.6 million U.S. adults smoke cigarettes. Beyond the direct effects of smoking on the smoker, tobacco smoke also causes harm for those around them. An estimated 88 million nonsmoking Americans, including 54% of children aged 3–11 years, are exposed to secondhand smoke. Secondhand smoke exposure causes serious disease and death, including heart disease and lung cancer in nonsmoking adults and sudden infant death syndrome, acute respiratory infections, ear problems, and more frequent and severe asthma attacks in children. Each year, primarily because of exposure to secondhand smoke, an estimated 3,000 nonsmoking Americans die of lung cancer, more than 46,000 die of heart disease, and about 150,000–300,000 children younger than 18 months have lower respiratory tract infections. As the nation continues to grapple with an evolving health care system with mounting costs, the issue of smoking cessation and enacting strategies to stymie growth – particularly amongst youth – is of critical importance to the health care debate as the burden of tobacco use results in more than \$96 billion a year in medical costs and another \$97 billion a year from lost productivity.

With the detrimental impact that tobacco has on public health and labor productivity, encouraging smoking cessation is a top priority for the healthcare system. Part of the strategy has been to limit venues where users can smoke, which in turn has been found to drive down smoking rates. A series of laws and regulations have been passed forbidding smoking in public parks and beaches, in the workplace, inside restaurants and bars. Raising the prices on cigarettes through higher taxes has been another tactic used. Evidenced by recent mergers including Altria's acquisition of UST Inc. in 2009, the tobacco industry has been consolidating, resulting in a domestic cigarette market that is dominated by three companies: Philip Morris USA (50%), Reynolds American (28%), and Lorillard (14%) have over 90% market share. As a result, these companies have tremendous pricing power, allowing them to raise prices to more than offset tax increases by redirecting the cost burden directly to the consumer. As the demand of tobacco is relatively elastic, price increases have resulted in a lower quantity of product sold. As a result of excise tax, net sales decreased over 40% between 2009 and 2010.

Nationwide, volume has been steadily declining as a result of tax increase, smoking bans, health concerns and social stigma, decreasing from 315.7 billion cigarettes in 2009 to 303.7 billion in 2010, or 3.8% in one year. This could be related directly to legislative efforts in some states, such as California, which has combined high taxation with several limitations of where users can smoke, leading to over a 40% decline in smoking rates over the past 25 years. These legislative actions has saved millions of lives and alleviated a substantial burden from the health care industry.

Legislative Action to Prohibit Sale of Tobacco Products in Retail Pharmacies

Pharmacies and retail drug stores are marketed as part of the health care community, helping customers treat, manage and combat chronic disease. Over 65% of the revenue generated by these pharmacy retailers is from the sale of drugs and other pharmaceutical products, and this amount is projected to increase. To this end, the pharmacy retailers have been positioning themselves as comprehensive providers of health care, strategically acquiring retail-based health clinics, launching wellness programs and campaigns, and offering initiative programs that can change how patients manage their prescriptions for chronic diseases. Even more frequently than patients may visit their doctors, customers shop at these pharmacy retailers, located nationwide and in close proximity to over 75% of Americans. As such, these pharmacy retailers are uniquely positioned to meet the country's health and daily living needs.

However, over 50% of pharmacy retailers nationally actively sell and market the number one cause of preventable death. This seeming contradiction has been an active debate since at least the 1980s, when the first pharmacies began to voluntarily cease the sale of cigarettes. However, due to the large market – 17.4 billion packs were sold in 2007 – pharmacies, in particular retail chains, feel the economic pressure to provide a profitable product in high demand to consumers. Although the American Pharmacists Association has taken an active role to encourage its members to cease the sale of tobacco, there has failed to be a large enough movement to voluntarily halt sales. Recognizing this incongruence, legislators have begun to increase restrictions on tobacco sales by retailers that operate in the health care space. In San Francisco, Boston and many other jurisdictions throughout the country, pharmacies have been the target of this regulation.

In 2008, the city of San Francisco passed a law that prohibited the sale of tobacco products at pharmacies in the city, the first ban of its kind in the United States. Following the example set by San Francisco, the city of Boston passed a law that banned the sale of tobacco products from any retailer that operated a pharmacy. Encouraged by the ban implemented by these cities, representatives from many state and local governments throughout the United States introduced similar legislation. In 2009, New York State Assemblyman Sam Hoyt (Dem - Buffalo) introduced Bill A05890, a bill that would have placed a statewide ban on the sale of tobacco products in pharmacies. Considered premature by critics, the bill failed to move beyond committee. In November 2010, Nassau County Health Commissioner Dr. Maria Torroella Carney called on pharmacies to stop selling tobacco products. While laws have unsuccessfully been brought to the legislative floors in Tennessee; Illinois; New York State and Rhode Island, at the local level San Francisco, Boston and eight other cities in Massachusetts have successfully passed laws banning the sale of tobacco in pharmacies.

While proponents of these laws have rightfully used tobacco's effect on public health and the ethics of selling what amounts to part of the health care problem in venues dedicated to health care solutions, many thus far have not adequately addressed the economic question: how would the cessation of tobacco affect these retailers' revenue? With a slow

economy and a highly competitive industry, pharmacy retailers have strongly resisted change due to the perception that it would have a substantial impact on their revenues, already dragged down by slower demand and heightened competition both from within their industry and others such as grocery stores and convenience stores. However, our analysis suggest that the perceived outsized effect on revenues is largely unfounded and that pharmacy retailers can minimize loss with a strong strategy around expanding their pharmacy benefit management and health clinic programs to include smoking cessation, actively promoting smoking cessation through generic drug and private label brand treatment and benefiting from a boost in brand equity through emerging as a first adopter and leader in a major epidemic within health care.

National Pharmacy Chains Must Develop a New Strategy

The responses of pharmacy retailers to legislation passed by the city of San Francisco and various cities throughout Massachusetts have been inconsistent and vary by chain and geography. Regarding a pharmacy tobacco ban, CVS CEO Thomas Ryan has said “We have a vision in our company to strive to improve human life, and it is a challenge around cigarettes . . . I wouldn't rule it [the ban] out at some point down the road.” However, in response to the San Francisco ban, Walgreens attorney Daniel Kolkey said “Walgreens doesn't understand why it should lose all these sales in pursuit of an ordinance that doesn't reduce any tobacco sales at all but shifts them to Walgreens' competitors.”

Presently, revenue generated from tobacco products account for less than 1% of pharmacy retailers' total sales. Increasing costs and scrutiny, in addition to compressed margins, will only make selling tobacco products less worthwhile for pharmacy retailers. As tobacco regulations are being passed throughout the country – especially in key markets like San Francisco, Boston and now possibly Manhattan – a window of opportunity exists for national pharmacy chains to become early (or voluntary) adopters to remove tobacco from their product mix. Analysis done for the Manhattan Smoke Free Partnership suggests that complying with a ban of tobacco products, or voluntarily initiating a ban of these products ahead of potential legislation, may actually present pharmacy retailers with revenue generating and cost cutting opportunities as they reposition themselves as comprehensive providers of health care. Pharmacy retailers can minimize loss from this ban with a strong strategy around smoking cessation product development and campaigns and a marketing initiative to boost brand equity for emerging as a first adopter and leader in a major epidemic within health care.

Most major retailers are adopting means to position themselves as centers of wellness in the wake of health care reform and the looming healthcare crisis in the country. With 65% of profits coming from prescription and non-prescription drugs, these retailers can strategically capitalize on current legislative momentum by removing tobacco and strengthening their brand as a partner for health and health care in their local communities. By implementing such a strategy, national pharmacy chains can brace themselves for a volatile legislative landscape. Strategically branding themselves as smoke-free would strengthen their brand as a true proponent for health and health care. The retailers should also begin investigating how to increase drug and over-the-counter

sales (many which fall under high margin private label brands), counseling and workshops, similar to other programs in hypertension, diabetes and influenza.

Such repositioning will not only require effective marketing and branding to communicate such a shift (which will be discussed in the last section) but also strategic implementation of new business processes and practices. For example, before removing tobacco from the product mix, national pharmacies will need to conduct economic analysis to evaluate the profitability of alternative revenue streams and use those findings to identify a new sales and marketing strategy to mitigate losses. Another important aspect in repositioning pharmacies as wellness centers will be partnering with the local community. This repositioning and turn the risk of losing a key product and profitability in the future into a communications and branding reward right now.

Business Opportunity for Pharmacy Retailers

Pharmacies Have an Opportunity to Proactively Respond to Regulation

With the precedent set by the cities of San Francisco and Boston, the ban of tobacco products in pharmacies is gaining national recognition and New York City could be the next jurisdiction to enact this groundbreaking law. The Manhattan Smoke-Free Partnership (MSFP), a health advocacy group that increases awareness of tobacco control issues among community members and policy makers in the Manhattan borough, advocates for legislation that increases restrictions on the sale and marketing of tobacco products in retail outlets. The organization is currently beginning to create a strategy to pursue a point-of-sale retail reduction of tobacco through a law banning its sale in pharmacies after a successful initiative to ban smoking in parks and beaches was passed in February 2011. Should this law pass, three of the country's top ten metropolitan areas would have laws prohibiting the sale of tobacco in pharmacies – a substantial portion of major retailers' market share. The emerging regulatory change will force pharmacies to either continue to fight the issue in court or use the occasion to re-visit their sales strategy and identify means to increase revenues and profitability despite the loss of a major product.

A voluntary removal of tobacco from a pharmacy chain would be a multifaceted process as it would result in direct loss from tobacco revenues, product cannibalization, a loss in marketing dollars provided by tobacco companies, square footage loss from the absence of tobacco and a change in message explaining the shift away from a long held practice. However, preliminary analysis suggests that despite these losses, retail pharmacies could mitigate and even grow revenues through certain strategic decisions:

- Retail pharmacies could gain a considerable advantage in their brand value by anticipating the ban and proactively responding with a voluntary elimination of tobacco products. This strategic product mix decision is an investment in brand equity that may increase customer loyalty and attract additional health conscious patrons. Both Target and Wegmans have adopted this strategy.
- In shifting the focus of their mission statements to health and wellness, a great opportunity arises in integrating smoking cessation products and clinic and chronic illness management programs with the phasing out of tobacco sales. CVS/Caremark, Walgreens and Rite Aid have made the expansion of their

pharmacy benefit management and health clinic networks a key part of their growth strategy and actively promoting wellness against the number one cause of preventable death in the country would add tremendous legitimacy and scope to these programs.

- Pharmacies are pushing to increase sales of private label brands due to their high margin - low cost structure. Specifically, CVS is seeking to raise private label brand revenue from 17% to 25% of total front end sales. With a fundamental objection to the tobacco ban being lost revenue, retailers can replace the low margin-high tax tobacco products in the valuable square footage behind the counter with new high margin private label products. This coincides with the pharmacies' pre-existing strategy to re-visit floor plans and explore means to increase revenue per square footage, evidenced in Walgreens recent initiative whereby they spent an average of \$25,000 per store on new layouts to boost sales in high margin product lines.

Change Management Must Be the First Step in Implementation

Change management focuses on the behaviors, motivations and attitudes of the chain's workforce. The change management and implementation mission is divided into three major tasks:

- Prepare for change
- Manage change
- Reinforce change

Preparing for change involves readiness assessment, obstacle identification, development of mitigation strategies and outreach/communications. Managing change involves planning, training, communications, implementation support and outreach. Reinforcing change involves coaching, performance evaluation, and outreach.

The change management process for a pharmacy chain removing tobacco from its product mix may include such tasks as:

- Establishing a top down sense of urgency to motivate the initiation of changes required
- Creating and maintaining a program vision which depicts and reinforces the objectives of the changes and the ultimate objectives of the program
- Changing the attitudes, behaviors, and habits of the chain's workforce to eliminate obstacles to change, and encourage the workforce to take risks, bring forth new ideas, and implement the changes needed
- Creating an environment that encourages near-term successes and provides the incentives and rewards for making these changes
- Institutionalizing the process so that further changes are possible and so that employees begin to promote the vision embodied in changes already made
- Demonstrating the successes of the new environment and process changes to propogate the new approach to others in the workforce who may not have seen the light

Retailers Can Showcase Their Commitment to Public Health

Many consumers are not cognizant of the branding dissonance between a given pharmacy's contribution to public health and its simultaneous detriment due to the sale of tobacco products. Although this branding incongruence does not seem to deter consumers from making purchases, it does pose a significant branding opportunity. While a pharmacy City may not incur a direct result to this brand-inconsistency, the opportunity to gain brand strength, improve community visibility, grow overall market share and avoid the risk of forced compliance to tobacco control regulation without a sufficient strategy will pay dividends.

This opportunity lies in the potential to use removal of tobacco products as a publicized step towards contributing to better public health in the community. This message could be delivered both as a stand against tobacco addiction, as well as to make a broader claim about what lies at the heart of pharmacy service: being a beacon of hope for better health in their local community. With the removal of a profitable product, pharmacies may lose a source of revenue, but they will also gain an opportunity to build a major communications campaign founded on the principles of commitment to public and community health. In a media environment saturated with health care discussions, this message would break through the clutter and resonate with potential consumers.

The branding and strategic communications opportunity is thus two-fold: First, with major brands like Wegman's and Target voluntarily halting tobacco sales, it will only be a matter of time before a national firm capitalizes on the opportunity to market this practice as a contribution to public health and a stand against tobacco addiction. Pharmacies have the least risk in doing so because they are already in such close proximity to health care; for consumers, the association would be logical. The branding potential would also be significant; in addition to using the tobacco issue as a vehicle for the pharmacy's brand, it could also be a vehicle to increase sales for tobacco cessation products.

Second, with managers at each location across the country becoming an advocate for this change, a strategy to engage with local community partners to promote better health, and now a tobacco counter-marketing campaign to begin carrying the message that tobacco products are no longer being sold, a national chain pharmacy can hedge against profit loss and begin the final step of leveraging these competitive advantages to develop brand equity as a true community wellness center.

The elements of such a campaign could possibly include tasks such as:

- Formative research (qualitative, quantitative), consumer-based, segmented audiences
- The development of an overarching campaign strategy for a wide range of audience sizes and types (general/targeted, including multi-cultural and non-English-speaking audiences)
- Testing campaign messages for targeted audiences
- Concept, development, design and production of health and program related materials (print collateral, broadcast, web-based, new media)

Removing Tobacco from the Product Mix: A Strategy for National Pharmacy Chains

- Coordination and communication with internal and external stakeholders
- Evaluation of campaign effectiveness (application of research to track campaign effectiveness and adjust tactics where necessary)
- New media channels and tactics, including interactive, mobile, e-partnerships, user-centered websites
- Strategic partnership development and maintenance (non-profit, media, entertainment, web)

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