There is no substitute for substitution

When choosing a generics partner, don't just look at price.

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Substitution and the role of a generics supplier in a pharmacy business are now being brought sharply into focus as the next component of the PBS reforms – the F2A (two per cent) and F2T (25 per cent) price cuts – is about to be implemented. Now more than ever, a commitment to substitution and developing a maximally supportive partnership with your generics supplier is essential to the ongoing success of your pharmacy.

Over the past five years, expiry of patents combined with increased competition from generics suppliers have allowed the average Australian pharmacy to offset its rising expenses with many owners unaware of their growing financial dependency on generic drugs.

"Deciding now on a long-term generics partner will minimise future customer disruption."

Chances are, if your pharmacy stopped dispensing generic medicines, you would lose more than half of your net profit, and if you have reasonable debt levels you simply could not survive.

PBS reforms and ongoing patent expiries will continue to increase the sensitivity of your business and your customers to generics suppliers and their products. Hence the concern of many of my clients when it comes to considering the impact of the reforms on their business and the decision of committing to a specific generics 'partner'.

Selecting a partner

Following are some of the issues I consider important when evaluating the role a generics partner should play in your business. My commentary and overview is not intended to promote any particular manufacturer, nor is it intended to discount the importance of originator brands to both the consumer and your business. The examples do however illustrate the financial importance of a resolute commitment to substitution.

When selecting a generics partner for your business you should consider (just as your customers do) that while price is a key determinant in the value equation, it is not the only determinant. There are other factors that need to be understood and given due consideration prior to committing to a generics partner and these include:

1. Consumer awareness and reliance on generics will only increase as patents expire;
2. Changing generics suppliers in future years will disrupt continuity and increase medication confusion for your customer. Many customers do not like being switched once they are familiar with a product;
3. As such, the capacity to continuously supply a broad range of products at competitive prices over the long term is just as important as being able to do it in the short term;
4. Minimising the number of generics suppliers will help streamline administration procedures including ease of drug selection by dispensary staff and reduction in the number or generic alternatives maintained;
5. The value of any qualitative business assistance such as training and education programs; and
6. A commitment to in-store activities to increase substitution rates.

Deciding now on a long-term generics partner will minimise future customer disruption. In addition, it will allow time to focus on broader strategic healthcare initiatives that will strengthen the business and replace the erosion of generics trading terms that is core to the ongoing PBS reform process.

Australian Generic Company	Company Acquired	Australian Manufacturer	International Parent	International Base	Product Range
Alphapharm	N/A	Yes	Mylan	US	Largest
Apotex	GenRx	No	Apotex	Canadian	Significant
Genepharm	Douglas	Some	Strides	India	Significant
Ranbaxy	N/A	No	Ranbaxy	India	Small
Sandoz	Hexal	No	Novartis	Switzerland	Significant
Sigma	Arrow	Some	N/A	Australia	Significant

A case study

To illustrate the power of substitution, the total impact of the changes to your pharmacy can be understood through a Pharmacy Guild ScriptMap report. For the purposes of this discussion though, I have attached a table to consider the financial impact of these changes through two products that include a Brand Price Premium (BPP) (Pravachol 40mg and Normison) and their Alphapharm generic equivalents.

My assumptions include:

1. Generic Net into Store (NIS) prices will remain constant post-August 1. However this only holds true where the current level of generic trading terms is greater than 25 per cent for an F2T product.

2. BPPs will be reduced in line with price reductions from August 1, and will remain constant until at least December 1.

3. I have also ignored the 18 cent increase to the Dispensing fee as of August 1.

The key points arising from the table are:

1. The more expensive the drug the greater the price cut;
2. Every pharmacy's financial outcome will be enhanced by increasing substitution rates;
3. Not all drugs will suffer a profit reduction after the price cut (refer Normison/Temaze calculations) due to both mark-up changes and $1.50 incentive for non-BPP drugs;
4. However, drugs falling under $31.30 Dispensed Price post-August 1, will suffer increased price competition from discount operators which may in fact erode any expected profit offset arising from the $1.50 incentive on other products. However, pharmacy may now be able to charge an 'allowable additional patient charge';
5. Cheaper drugs carrying BPPs which historically may have been considered not worth switching may require reconsideration (refer Normison/Temaze example) due to the $1.50 incentive;
6. Profit from many generics (see Pravachol example) post-price cuts will still produce a higher profit than the originator did prior to the price reduction;
7. Each pharmacy's outcome from the price cuts is different and is dependent on both drug mix and associated substitution rate; and
8. Any proposed pharmacy purchaser should obtain a Guild ScriptMap report from the vendor.

It is important to note that August 1 signals the start of the price reduction component of the reform process and not the end. Over the next five years, the ongoing international extinguishment of patents will see many changes to the manufacturing landscape. We have already gained some insight into what the future may hold given the local activity within this sector, the worldwide staff reductions to originator manufacturer workforces and various alliances/arrangements beginning to emerge (eg. Pfizer/Ranbaxy on Lipitor).

At APP the Government's representative, Mr Stephen Dellar, noted that they are aware of international price differences when it comes to generic medicines. The PBS reforms' weighted average disclosed price mechanism has been designed to reduce these differences over time and let the Government (and in turn the Australian consumer) benefit accordingly.

In summary, maximising your dispensary's financial performance following the advent of the next phase of PBS reforms is dependent on:

• Developing customer-focused protocols that allow you to actively pursue each substitution opportunity in your pharmacy; and

• When choosing a generics partner, balance price considerations with appropriate focus on the breadth of the range of business support services on offer to help grow dispensary profits. R+

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	Pravachol 40mg	Cholstat 40mg	Normison	Temaze
Pre August 08 (Example F2T Pricing)				
Chemist List Price	$47.80	$43.71	$3.31	$1.70
Mark-up	$4.78	$4.37	$0.33	$0.17
Dispensing Fee	$5.81	$5.81	$5.81	$5.81
Dispensed Price	**$58.39**	**$53.89**	**$9.45**	**$7.68**
Brand Price Premium (BPP)	*$4.50*	*n/a*	*$1.77*	*n/a*
Net into Store Price	*$47.80*	*$30.60*	*$3.31*	*$1.19*
Gross Profit pre Generic Trading Terms	$10.59	$10.18	$6.14	$5.98
Estimated Generic Trading Terms	n/a	$13.11	n/a	$0.51
GP$	**$10.59**	**$23.29**	**$6.14**	**$6.49**
GP%	18.1%	43.2%	65.0%	84.5%
Post August 08 (25% F2T Price Reduction)				
Chemist List Price	$35.85	$32.78	$2.48	$1.28
Mark-up	$4.50	$4.50	$0.37	$0.19
Dispensing Fee	$5.81	$5.81	$5.81	$5.81
Dispensed Price	**$46.16**	**$43.09**	**$8.66**	**$7.28**
Brand Price Premium (BPP) - refer below note	*$3.07*	*n/a*	*$1.38*	*n/a*
Net into Store Price	*$35.85*	*$30.60*	*$2.48*	*$1.19*
Gross Profit pre Trading Terms	$10.31	$10.31	$6.18	$6.00
Generic Trading Terms	n/a	$2.18	n/a	$0.09
Benchmark Price Incentive	n/a	$1.50	n/a	$1.50
GP$	**$10.31**	**$13.99**	**$6.18**	**$7.59**
GP%	22.3%	32.5%	71.4%	104.3%
GP$ Decrease / (Increase) from Pre August 08	*$0.28*	*$9.30*	*-$0.04*	*-$1.10*
GP$ Increase/(Decreae) - Generic (Post August 08) vs Originator (Pre Aug 08)		*$3.40*		*$1.45*

Assumptions and Acknowledgements

1. Originator and benchmark prices are calculated from Schedule of Pharmaceutical Benefits
2. Estimated Generic Trading Terms are illustrative only
3. Generic Net into Store prices will not change post August 1, 2008. However this only holds true where the current level of generic trading terms is greater than 25 per cent for an F2T product
4. Brand Price Premiums will be reduced in line with price reductions from 1 August 2008
5. PBS online fee and the August 1 increase in dispensing fee have not been considered in above calculations
6. The above examples are illustrative only and should not be interpreted as an endorsement of the originator or generic manufacturer.