CHEMIST WAREHOUSE SUBMISSION

TO THE INQUIRY INTO THE ESTABLISHMENT OF A PHARMACY COUNCIL AND PHARMACY OWNERSHIP IN QUEENSLAND

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1. Introduction

Chemist Warehouse is a franchise network made up of of like-minded pharmacists committed to providing Australian consumers with the best quality healthcare at the most affordable prices. Chemist Warehouse is Australia's Xth largest retailer by turnover, with sales of almost $X billion and more than XX,000 staff.

Chemist Warehouse has in excess of 380 stores, representing about 7 per cent of all retail pharmacies across Australia. However, Chemist Warehouse sales make up ~ XX% of total retail pharmacy sales, dispensing around XX% of medicines covered under the Pharmaceutical Benefits Scheme (PBS).

The pharmacy market is highly regulated. These regulations have the effect of artificially preventing business models within the pharmacy industry from evolving in the same way as has occurred in other similar, but unregulated, retail markets.

Nonetheless, it is clear that there are two business models that are growing in popularity as consumers' preferences change. The first is for large, high volume, lower margin pharmacies offering deep price discounts. Chemist Warehouse is the market leader of this approach, and has repeatedly been rated the number one pharmacy group for customer satisfaction (Roy Morgan Survey Data). The second model is for high service pharmacies offering detailed personal health advice and testing services, in addition to retail distribution of medicines and health products.

In addition, online health and pharmacy websites are rapidly growing in popularity. Chemist Warehouse itself operates chemistwarehouse.com and epharmacy.com.au, the number one and number two Australian pharmacy websites by traffic and transactions (Hitwise).

The development of the pharmacy industry into these models is consistent with the experience in many retail industries and suggests that consumer preferences, in the consumption of pharmaceutical goods and services, are no different from those for other retail goods and services.

Chemist Warehouse acknowledges that ensuring access to medicines at affordable prices, particularly for disadvantaged consumers, is an important matter of public policy. However, the present policy settings not only fail to serve this end, but are preventing competitive market conduct that would be more effective in delivering more medicines at lower prices to more consumers.

These restraints on ordinary trade should be removed in favour of a competitive approach to pharmacy in line with consumer demand and other retail industries. Overseas examples have demonstrated that once market limiting regulations are removed, outcomes are improved for industry participants but more importantly for consumers.

In response to the Health, Communities, Disability Services and Domestic and Family Violence Committee's (the committee's) inquiry into the establishment of a pharmacy council and pharmacy ownership in Queensland we submit the following in response to issues for consideration;

1. Are pharmacy ownership restrictions imposed by the Pharmacy Business

Ownership Act 2001 (QLD)(Act) necessary to protect consumers and deliver accessible and affordable medicines and services?

3. Would changing the pharmacy ownership restrictions under the Act improve community outcomes?
4. Should the Act be amended to allow any party to own a pharmacy, subject to requirements for dispensing only by a qualified pharmacist? Would the community be better off under such a scenario?
9. Do you think there should be restrictions on the number of pharmacies a pharmacist may own in Queensland?
10. Given there are no restrictions in the Australian Capital Territory or the Northern Territory, are community outcomes in the Australian territories different from the Australian states?

2. The true cost of regulation

Chemist Warehouse understands that the rationale for the extensive regulation of business models and conduct of Australian pharmacies is related to a desire to ensure equitable and universal access to medicines.

However, Chemist Warehouse submits that the effect of these regulations threatens the opposite. The impact of regulation has been to raise costs for consumers, to prevent innovation in the industry and to undermine the value of investments. Chemist Warehouse contends that this heavy-handed regulation of the industry could put at risk its long-term viability.

Chemist Warehouse believes that restrictions on who can own pharmacies is unnecessary and damaging regulation that should be reformed as a matter of urgency.

Restrictions on who can own pharmacies

The requirement that only pharmacists may own pharmacies, and that a pharmacist can own only five pharmacies in any one state, is unnecessary regulation that should be repealed. These constraints are creating financial instability that is more likely to threaten than secure the ability of the industry to continue to provide equitable and affordable access to medicine.

The ownership rules, coupled with changes in the supply chain relationships in the industry in recent years, have created a serious capital constraint for the pharmacy industry. In practice, a group of pharmacies cannot accurately demonstrate its financial success or ability to meet substantial repayments, because pharmacy businesses must be registered in the name of individuals, rather than as part of a group.

For individual pharmacists, ownership restrictions limit the market for those wishing to dispose of their business, suppressing prices and limiting credit worthiness.

For larger pharmacy enterprises, such as Chemist Warehouse, the ownership structure required by the current regulatory regime prevents capital raising to support innovation, expansion and modernisation. This constraint on Chemist Warehouse's ability to operate as any modern business should, is illustrated by the fact that the business has previously been unable to raise an $XX million bank loan against an annual turnover at the time of $X billion with a X% profit margin.

The complex ownership arrangements these regulations force on pharmacists who wish to be part of the Chemist Warehouse group of companies, means the banks cannot be confident that they will be able to secure collateral against their loans.

These capital constraints are having increasingly serious impacts on the operation of the pharmacy industry. In the past, the pharmaceutical wholesaling industry was able to offset the inability of retail pharmacies to raise capital from the usual sources by extending generous trading terms to the retail industry. Crucially, this has included extended credit terms for wholesale supply.

However, as PBS reforms have - in recent years – and continues to squeeze margins, the ability of the wholesale industry to provide this financial support has been eroded. Thus retail pharmacy nationally is under capitalized and this under capitalization of the industry continues to stymie innovation through under investment that inevitably leads to inefficiency and hence higher prices to consumers.

The constraint on pharmacists from owning more than five pharmacies in a state, and locational rules that prevent pharmacist entrepreneurs from opening wherever and whenever they believe they can profitably do so, has had the effect of denying consumers the benefit of competition.

Chemist Warehouse's experience demonstrates that the introduction of competition into the market for pharmaceutical products in a particular geography is not confined to pharmacies. Chemist Warehouse has observed a competitive response by all retailers of medical products, once it enters a market and introduces its price discounting strategy. For example, when Chemist Warehouse entered the Tasmanian market, the price for the popular hay fever medication *Telfast* was more than $75. Chemist Warehouse retailed the same product at $29. Within months the prices charged by other providers had fallen to similar levels.

It is an undeniable and inevitable direct consequence of the ownership rules coupled with the pharmacy relocation rules that they act to create local monopolies protecting the incumbent owners. These rules are to the detriment of both potential excluded competitors to the incumbent owners and those choice deprived local consumers. The pharmacy location rules act to insulate incumbents from the threat of new competition. When this protected status is dovetailed with the restrictive ownership laws, local monopolies naturally ensue.

Chemist Warehouse has observed over time when external interested parties review the retail pharmacy sector they will often inappropriately intermix and confuse professional pharmaceutical service provision and equitable ownership of a retail business. The two are entirely unrelated. Under any proposed model that Chemist Warehouse would support in relation to pharmacy ownership, qualified, registered pharmacists would always provide all the professional pharmacy services. Under the current model of pharmacist only pecuniary interest, profits from theses businesses

can only flow to a pharmacist, under a deregulated regime those same profits could flow to any proprietor entity. That is the sole difference, profit flows.

The primary societal benefit conferred to the Australian public through its engagement with retail pharmacy, is in no way coupled to the ownership structures behind a pharmacy. Society is for the most part ignorant and indifferent to the commercial structures that stand behind the pharmacy of their choosing. Where the final profits from their transaction reside, the public is not ultimately interested. The societal engagement and relationship is with the dispensing and counselling pharmacist. The Australian public forge 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.

In fact, we estimate Guild membership today is around 2000 proprietor pharmacists with about 5400 pharmacies in the country. The most recent report by the Pharmacy Board of Australia shows there to be 28,065 registered pharmacists practising in Australia, which suggests a very high proportion (>92%) of customer interactions is 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. We do not advocate for a change in the primary care regime simply in non-related economic regulation.

It is farcical to suggest that pharmacist only ownership results in a better caliber of owner. It is equally farcical to suggest that corporate or non-pharmacist individuals who may choose to own a pharmacy would be of a lesser moral character. Even the most cursory review of the disciplinary proceedings brought against pharmacist proprietors today by any one of the current regulatory authorities that govern the pharmacy profession, shows that the current ownership cohort is not without fault or failing. Many of the current pharmacist proprietors are upstanding people and fantastic business owners, yet some are not. The same would be able to be said of any potential cohort of owners. Many will be great, others not. The important thing is not whether you hold a Bachelor of Pharmacy, but rather that you are ethical, responsible and of high moral standing.

The hurdle to be cleared to enable proprietorship should not be one of prior education but rather a “fit and proper person” test. A “fit and proper person” test is neither novel nor new but a well-established principle in many other areas of the economy. The test could include requirements to demonstrate appropriately upstanding financial, criminal, business and professional conduct histories and I would suggest such a test is a superior test of appropriateness to control a pharmacy business then the attainment of a Bachelor degree.

The Australian Financial Review recently published an article on Pharmacy regulation in which they state, “… outdated ownership and location rules … are pointless. Provided operators are accountable for the quality and safety of medicines, pharmacies should be owned by anybody, and located anywhere. So what if Woolworths, Coles and Aldi, let alone allied businesses like hospital operator Ramsay, host medicine shops? So be it.” This clarion call from the mainstream media is simply one of many that demonstrates the public is ready for deregulation, we are all simply waiting for the legislation to catch up.

As the committee has identified in its issues paper, the Australian territories impose no limits upon the number of stores a proprietor pharmacist can own. Chemist Warehouse is unaware of this resulting in suboptimal health outcomes for Territorians, nor are we aware of any reports by anyone, anywhere, ever, that would indicate that this has resulted in a lesser quality of primary pharmaceutical care. Anecdotally from the review of Chemist Warehouse's internal records this anomalous ownership regime in the territories has not resulted in our territory based pharmacies having statistically different levels of customer complaints, dispensing errors, pharmacist misadventure, staff fraud, or any other negative outcome, which could be hypothesised to result from a differing ownership regime. In fact on many of these measures the pharmacies in the territories perform statistically better then the pharmacies in the states.

Chemist Warehouse contend that far from ensuring optimal patient outcomes, the regulated ownership of pharmacy is market distorting, may lead to localised monopolies, serves no clear purpose and act primarily to protect incumbent owners to the detriment of consumers. Further the ability of Chemist Warehouse to deliver the benefits of price competition is directly constrained by rules that prevent the expansion of our business model where the market would otherwise support the establishment of new outlets.

3. The overseas experience

Regulation of the location and ownership of pharmacies has been common in many countries, although the precise forms of regulation vary widely. Deregulation of the pharmacy sector has also occurred in some jurisdictions.

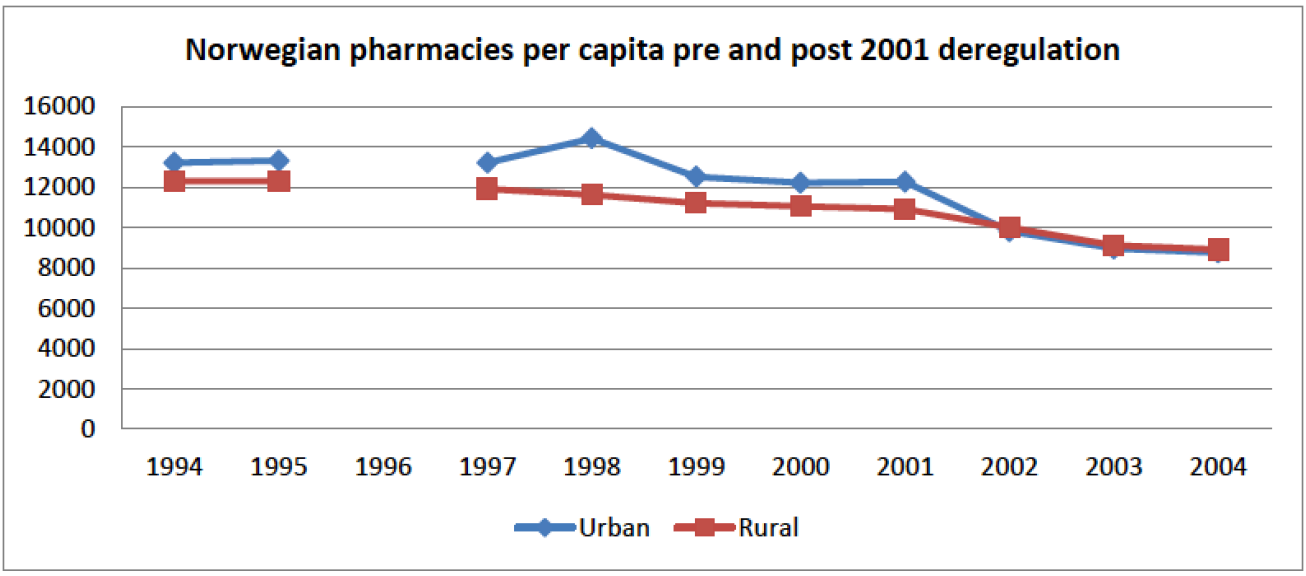
Pharmacies in the Nordic countries

The OECD has recently (2014) assessed the impacts on competition of the deregulation of the pharmacy sector in several European countries. The review found:

- Accessibility of medicines to consumers increased due to the establishment of new pharmacies and the extension of opening hours.
- Price decreases were observed in many countries – including a dramatic 42 per cent decrease in retail pharmacy prices in Denmark. No country reported increases.

Among the most striking findings were:

In Norway, where the pharmacy market was deregulated in March 2001, there were 128 new pharmacies established between January 2001 and March 2004 - a 32 per cent increase - compared to only 71 from 1991 to 2000.



Source: Deregulating the Norwegian Pharmaceuticals Market, 2007

A separate study of Nordic pharmaceutical markets found the number of pharmacies in Iceland, the first Nordic country to deregulate, increased by 41 per cent.

In Iceland, Norway and Sweden, opening hours increased on average from 42 hours per week to 53 hours per week after each introduced deregulation of their domestic pharmacy sectors.

Pharmacies in the United Kingdom

In the UK, regulation restricting new entry in the 1980s was followed by partial liberalisation as the negative impacts of this regulation became apparent. The UK therefore offers a unique and compelling case study in both the cost of regulation, and the gains from the relaxation of those rules.

A study (2003) of the UK pharmacy market by the Office of Fair Trading (OFT) examined the impact on consumers of the restrictions on market entry that were introduced in 1987 in that jurisdiction.
Among the findings were:

- The average number of new pharmacies opened per year fell from 130 per year before the restrictions, to five per year following the restrictions
- The regulations restricted competition between pharmacies, on both price and quality grounds
- The prices of over-the-counter medicines in national supermarkets (where those products could be sold competitively) were offered at about 30 per cent below the prices charged by pharmacies. The OFT concluded that this indicated that substantial price reductions should be expected from deregulation
- Opening hours of pharmacies were restricted, compared to other retailers such as supermarkets. The average pharmacy opened only 50 hours a week.
- The administrative cost to taxpayers directly attributable to the entry regulations was about £26 million annually.

As a result of these findings, and following recommendations from the OFT for full deregulation of control of entry restrictions, there was a partial deregulation of control of entry rules.

The OFT commissioned a subsequent evaluation of the partial deregulation in 2010. This report noted that the regulation of the prescription of pharmaceutical products meant:

"(P)harmacies compete largely for a fixed aggregate volume of prescription business, and do so primarily on location and convenience, and on service dimensions such as waiting times, opening hours and quality of advice and service".

The study found:

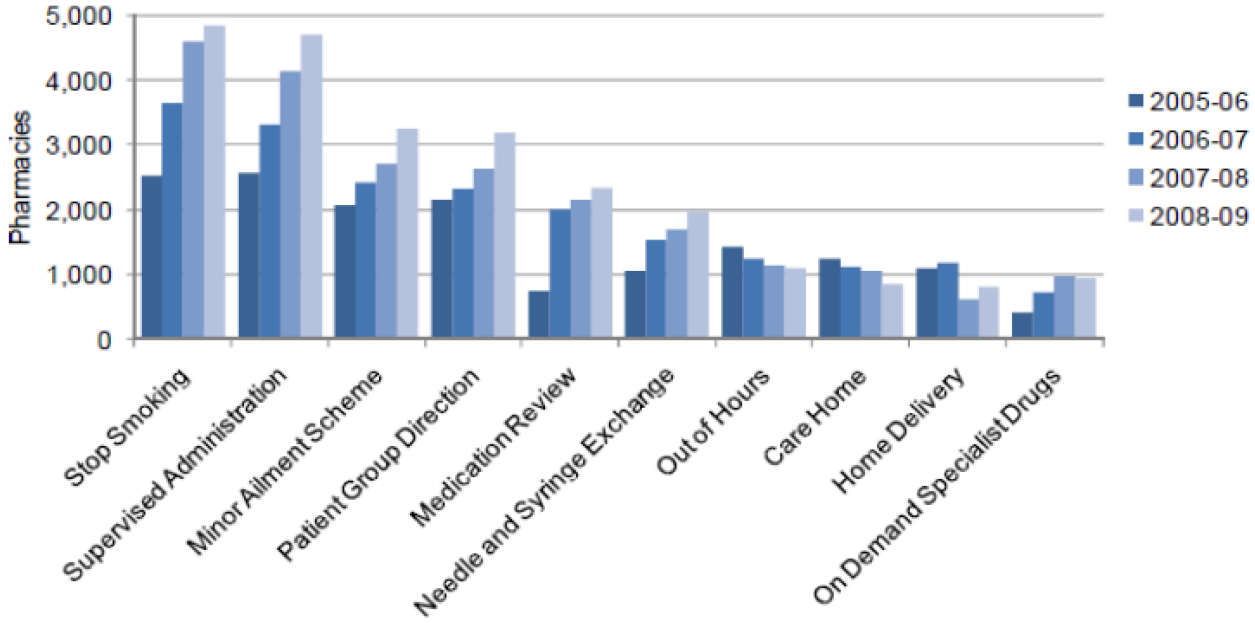
"Entry and competition in the pharmacies market as a result of the 2005 reforms have delivered benefits of choice and access to consumers and stimulated investments, and improvements in service that would otherwise not have been made. None of the feared ill-effects – net exit of pharmacies, disruption of services, or reduced investment overall – have materialised so far".

Among the specific outcomes observed were:

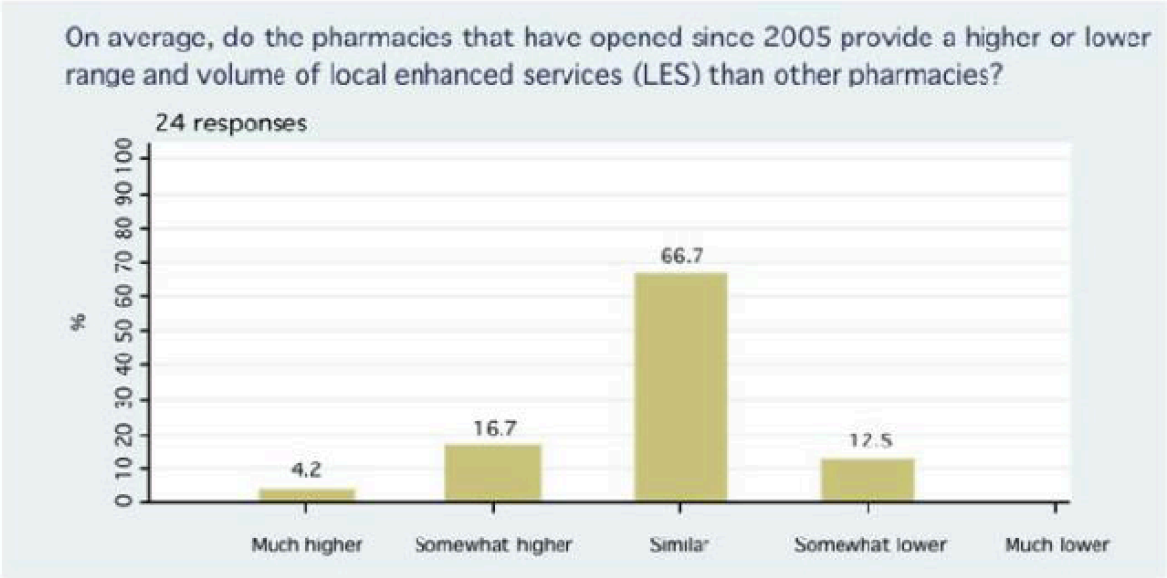
- An 8.8 per cent increase in the number of pharmacies in England
- A reduction in annual travel time for consumers of 2.6 to 3.9 million hours, valued at £16.4 to £24.5 million
- Estimated waiting time savings of £3.3 million
- A redistribution of 1.6 million visits from the hours 9am to 5.30pm due to extended opening hours, with most of the redistribution to the 5.30-7pm post working hours period.

In addition to longer opening hours, there was also strong evidence that pharmacies sought to compete with enhanced service levels to consumers. This move to service competition was led by new entrant pharmacies, including discount pharmacies.

Pharmacies in England offering local enhanced services



Entrant pharmacies in England and enhanced services



Source: DotEcon survey of English Primary Care Trusts, Nov 2009-Jan 2010

The study calculated the total consumer benefit from the reforms at between £21.1 million to £68.1 million per annum. It regarded these as conservative estimates.

6. Proposed way forward

Chemist Warehouse submits that there should be no restriction on who can own pharmacies.

There should be no restriction on who can risk their own capital to establish a business in a location where they believe they can make a profit. Existing pharmacies should not be protected from competition under the guise of ensuring services to all Australians. This policy approach does nothing more than penalise those consumers who might otherwise be in locations that would attract competitive investment. The present draconian restrictions on commercial behaviour have had such a distorting effect on Australia's pharmacy market that they represent a serious risk to the stability of the industry long term.

Chemist Warehouse notes that the proposals made in this submission are consistent with the recommendations of the Federal Government's National Commission of Audit Report 2014, The 2015 Harper Competition Policy Review and the 2017 King Review of Pharmacy Remuneration and Regulation, all of which have strongly advocated deregulation.

Chemist Warehouse would welcome the opportunity to discuss the matters raised in this submission with members of the committee or its secretariat.

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