



REVIEW OF PHARMACY REMUNERATION AND REGULATION A BRIEFING NOTE ON NPSA'S SUBMISSION

The current Review is a very timely consideration of the regulations and remuneration that enable achievement of National Medicines Policy (NMP) outcomes. NPSA makes the case for why medicines wholesaling in Australia has worked so well up to now; what is at risk if the status quo is maintained; and how wholesaling under the Pharmaceutical Benefits Scheme (PBS) can be improved.

In general, NPSA continues to support:

- The policy framework centred on the National Medicines Policy for healthcare support to all Australians regardless of where they live through a viable medicines industry;
- The network of over 5,500 community pharmacies, which provide dispensing and other medicines-related healthcare services; and
- A compact between Government, industry and consumers through the Australian Community Pharmacy Agreement (CPA) or comparable arrangements that provides stability and predictability to Government and Industry.

Our conclusion is that the current wholesale funding model (mark-up plus the CSO funding pool) works well, but it needs to be updated and adjusted to reflect current realities and anticipate future evolution in the Australian community pharmacy and medicines markets. The current wholesaler remuneration formula is not viable in the medium term. A change in the mark-up structure, coupled with a continued CSO Funding Pool, is justifiable to provide greater stability and sustainable levels of remuneration into the future.

1. Full line wholesalers play a vital role in the delivery of the National Medicines Policy

The Commonwealth Government as a monopsony buyer of medicines, effectively sets the prices for PBS-listed medicines and the terms on which they are dispensed and sold. This means from the outset this sector is a highly regulated and distorted market.

Full-line wholesalers are the linchpins of the whole PBS system, for if full-line wholesaling breaks down, there is a risk that the whole medical prescribing and pharmaceutical service delivery system breaks down with them. It is critical national infrastructure that needs to be sustained, while still promoting competition and efficiency in the market.

Wholesalers supply approximately 6,200 PBS items (or stock keeping units) to over 5,500 community pharmacies and through them to millions of consumers throughout Australia, generally within 24 hours. This vital service enables the dispensing of 295 million scripts annually by Australian community pharmacists. This model consolidates and brings efficiencies to what would otherwise be an extremely inefficient and fragmented supply chain between over 100 manufacturers and thousands of pharmacists. The effectiveness of the NMP depends on a clear and stable set of regulations and remuneration certainty throughout the PBS supply chain.



Wholesale and distributor remuneration for PBS products is currently provided through two key funding mechanisms:

- A regulated mark-up percentage of 7.52 per cent applied to the PBS price; and
- A share of a Community Service Obligation (CSO) Funding Pool that incorporates a wholesaler's share of the volume of medicines dispensed.

The CSO Funding Pool has worked well for both the Commonwealth Government and the Australian public. It compensates for a myriad of market failures that distort the market and how pharmaceutical goods and services are priced and paid for. It supports the partnership between Government and pharmaceutical manufacturers, wholesalers and dispensers. The CSO Funding Pool is open to all companies that meet the community service standards and compliance requirements. (Prior to its introduction, many activities had become unprofitable for wholesalers.) The CSO Pool has become an even more essential remuneration component over time particularly as successive PBS remuneration structures and savings measures have been implemented.

2. The changing regulatory environment has jeopardised the long-term sustainability of full-line pharmaceutical wholesaling.

Waves of PBS reforms whilst good for consumers have also hurt the viability of full-line wholesalers in two ways:

- Falling unit prices of PBS medicines have reduced the per unit margin available to wholesalers, who are remunerated based on a *fixed percentage mark-up* on the PBS price. Since 2011, the proportion of PBS products dispensed with an ex-manufacturing price under \$15 has increased from 55% to 77%. By 2020, it is forecast that over 84% of PBS medicines dispensed will be priced under \$15 due to price disclosure impacts; and
- At the same time, the wholesaling business has become more complex. Since 2011 the number of individual product items listed on the PBS and distributed by full-line wholesalers has increased by over 40%. This is largely the result of an increase in the number of competitors for off-patent medicines which has in turn delivered savings to government through price disclosure.

Without some incremental modification of the funding model, achieving NMP outcomes will increasingly be dependent on factors that are external to regulated wholesaler funding such as:

- Cross-subsidising distribution of PBS items via mark-up on non-PBS items; and
- Wholesalers charging service fees to pharmacies for the delivery of 'high volume' products in 24 hours and/or reducing terms of trade.

Responses that increase fees and costs to pharmacies would have a greater impact on the smaller independent pharmacists, many of which operate in rural and remote areas. This would jeopardise the financial viability of pharmacies and in turn, the consumers who rely on these pharmacies.

3. A sustainable funding model is required

Our independent economic analysis conducted by L.E.K. Consulting demonstrates that *there is adequate funding for wholesalers contained in the budget for 6th Community Pharmacy Agreement (6CPA)*. However,



the NPSA's forecasts of projected PBS expenditure and wholesaler remuneration fall below the government's budgeted numbers, resulting in a forecast funding gap of \$0.4bn to \$0.5bn over the life of the 6CPA. Without a change in the funding mechanism, this will result in a substantial shortfall to wholesalers, jeopardising long-term sustainability.

Prices are tightly regulated by policy and legislation throughout the pharmaceutical value chain. The recent trend in PBS prices has seen a bifurcation towards very low and very high prices, for example, very low wholesale prices for off patent cholesterol-lowering statins of \$3.69 for a four week supply compared to very high cost new treatments for Hepatitis C at a current wholesale price of \$66,000 for a 12 week course of treatment. As prices have quickly moved towards these two extremes, the fixed percentage mark-up structure has resulted in *an unsustainable drop in the average margin per unit* for full-line wholesalers, and as this decline in margin continues it will render the current PBS wholesaling model unsustainable. In short, mark-ups are failing to keep pace with cost and return-on-investment wholesaling realities.

The introduction of a *floor price* of \$8.00 - \$9.25 as proposed in our submission, similar to a structure now in place for pharmacists (the AHI), would enable more appropriate remuneration for the wholesaling of these medicines.

The current *mark-up ceiling price* of \$930.06 (which provides a \$69.94 per unit mark-up to wholesalers) is also no longer appropriate at the current level. An alternate structure for funding of high cost drugs that recognises the significant stock holding costs and cash flow risks though the supply chain is required.

CONCLUSION

NPSA is recommending that the \$2.775bn billion in government wholesale and CSO funding should be retained:

1. The wholesale margin of 7.52% be retained;
2. A product mark-up floor price of \$8.00 - \$9.25 be introduced (i.e. a wholesale mark-up of \$0.60 - \$0.70 per unit);
3. The CSO Funding Pool be retained at its current level; and
4. Indexation of the CSO reinstated.

NPSA members: API, National Pharmacies, Sigma and Symbion are all very keen to work with Government and our other partners to make the PBS and its supply chain, efficient, sustainable and affordable. This benefits all Australian consumers and ensures all objectives of the NMP are met.

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