Deloitte Access Economics

Summary of Ian Harper's Presentation to APP 2013

'Good Health; Good Economics; Good Policy – The CSO in Practice'

Since its introduction in 2006 as part of the Fourth Community Pharmacy Agreement, the Community Service Obligation (CSO) has become an essential foundation of the Australian Government's Pharmaceutical Benefits Scheme (PBS). The CSO underpins National Medicines Policy goals for timely access to medicines and the quality use of medicines, with guaranteed access secured at a cost of only two cents for every dollar spent on the PBS.

With negotiations towards the Sixth Community Pharmacy Agreement soon to commence, it is worth recalling the public policy rationale for introducing the CSO, noting the value it delivers to PBS stakeholders and anticipating key challenges facing the CSO into the future. To secure continuing equity of access to PBS medicines and high quality of care, we must guard against complacency and ensure that the vital role played by the CSO continues to be recognised, and that it continues to be adequately resourced in future Community Pharmacy Agreements.

The Pre-CSO Era: emerging risks to the National Medicines Policy

Before the CSO, short-line wholesalers threatened timely delivery of the full range of PBS medicines, especially in rural and regional areas outside the major cities. Short-line wholesalers 'cherry picked' medicines that were highly profitable to range and deliver, leaving full-line wholesalers to range and deliver the less profitable medicines. With more than 90 per cent of the PBS costing more than the regulated wholesale margin to deliver, the business model of the full-line wholesalers was effectively undermined. As a consequence, full-line wholesalers (who were not obliged to supply all PBS medicines to all pharmacies) began to 'de-range' some medicines.

Generally, a government should allow the market to evolve without intervention, with competition being a more effective mechanism for determining the most efficient solution for meeting a customer's needs. But medicines are a special case: if patients cannot access the medicines they need in a timely manner, they risk avoidable hospitalisation. The cost of hospitalisation is borne by the government not by the wholesaler, so some form of intervention to protect the government's interest – not to mention the patient's – is warranted. The CSO was designed to address this market failure. CSO payments are made to wholesalers who commit to make all PBS medicines[1] available within 24 hours of receiving an order from a pharmacist located anywhere in Australia, and to do so at or below an 'approved price to pharmacy'.

The CSO today: delivering significant value to stakeholders

Today, the CSO guarantees timely delivery of PBS medicines to all 5,240 pharmacies across Australia, including rural and remote communities. Together CSO wholesalers:

- operate a network of more than 43 warehouses, covering more than 190,000m^2 and employing more than 3,000 staff;

[1] Some PBS medicines are not available to CSO wholesalers since they are distributed exclusively by the manufacturer directly to pharmacy. Deliveries of such medicines are not held to the same standard as those made available under the CSO since they are not funded by government through the CSO.

- conduct commercial arrangements with more than 150 manufacturers and more than 5,000 pharmacies;

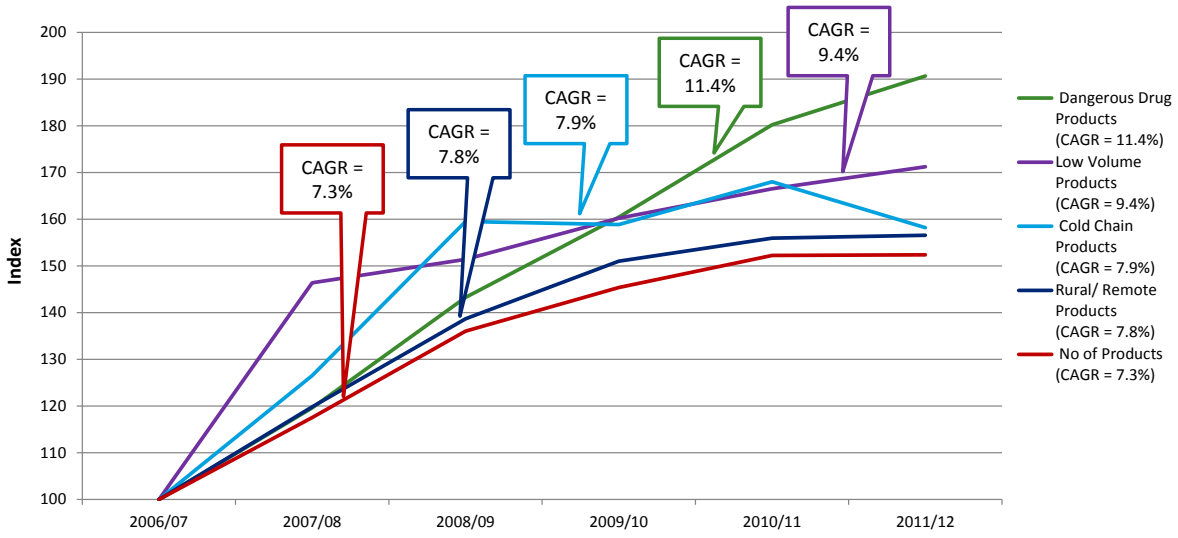
- deliver around 1 million orders or 6,000 medicines every day, including cold chain and dangerous drug products, and single unit deliveries where needed;

- supply the 90% of PBS medicines ordered by patients less than once per week per pharmacy; and

- keep detailed records to fulfil audit requirements imposed by the CSO Agency.

Since its introduction, the number of medicines to be delivered through the CSO has increased by more than 50% (due to the significant increase in generic medicines, equivalent to a compound annual growth rate (CAGR) of 7.3%), including a nearly 60% increase in medicines delivered to rural and remote areas (CAGR 7.8%), a more than 60% increase in cold chain products (CAGR 8.0%), a near doubling in the number of dangerous products delivered (CAGR 11.4%) and a 70% increase in low-volume products (CAGR 9.4%) (Figure 1). The higher growth rates recorded by these specialised deliveries demonstrate that the CSO is fulfilling its primary purpose. It also underscores that the importance of, and reliance on, the CSO is increasing. Specifically, those deliveries that the market alone would not deliver are in fact supported through the CSO.

Figure 1 – Growth in the number of medicines delivered through the CSO



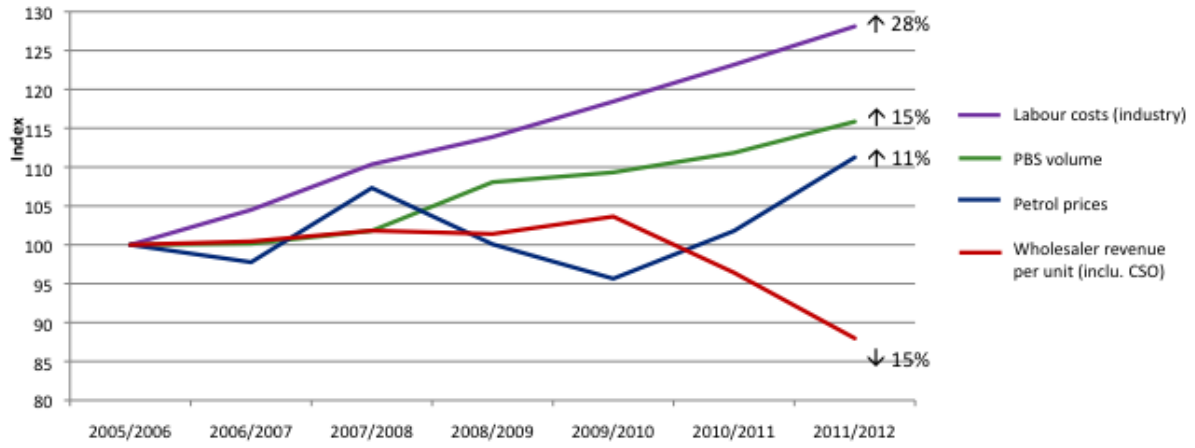
The CSO meets the needs of a range of PBS stakeholders, including patients, government, manufacturers and community pharmacy.

- **Patients** benefit from security of supply, especially in times of emergency like the recent bushfires and floods in different parts of Australia, but also every day as people get timely access to the medicines they need and the brands they trust.

- **Government** benefits from the efficient, comprehensive and guaranteed distribution of PBS medicines. PBS volumes have increased by more than 15 per cent since the introduction of the CSO while operating costs for wholesalers have also risen: labour costs by nearly 30% and petrol costs by 11% since 2006 (Figure 2). Yet the revenue to CSO wholesalers per unit delivered (that is, the per unit value of government outlays including the CSO) has fallen by

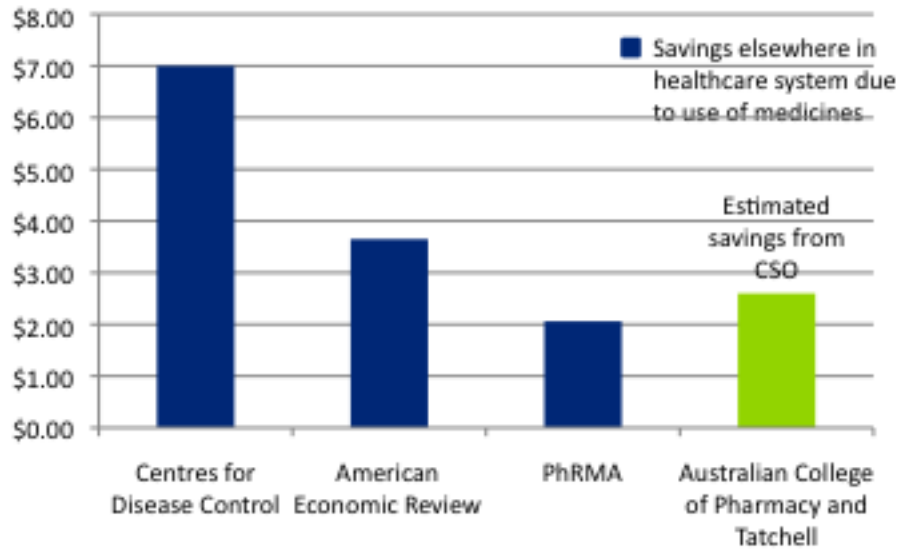
15% over the same period. CSO wholesalers are delivering more for less, with the efficiency gain accruing to government.

Figure 2 – Key distribution volume and cost statistics



The CSO ensures that all medicines are available, even slow-moving medicines. NPSA data show that 90 per cent of all medicines are ordered less frequently than one per week, with one fifth of these being ordered at intervals longer than 3 months. Moreover, properly used, medicines are highly cost-effective since they reduce expenditure elsewhere in the healthcare system. A recent study by Michael Tatchell for the NPSA found that, for every $1 spent on the CSO, $2.60 was saved elsewhere in the healthcare system, due to reduced risk of hospitalisation following delayed delivery of essential medicines (Figure 3).

Figure 3 – Value of medicines and the CSO



- **Manufacturers** benefit because the CSO guarantees access to pharmacy for their slower-moving medicines and enables them to avoid dealing separately with large numbers of

individual pharmacies. There is also built-in redundancy since more than one CSO wholesaler is available to distribute medicines on behalf of a manufacturer.

- **Community pharmacy** benefits primarily from the ability to avoid the expense of ranging up to 6,000 PBS medicines to meet licence obligations and patient needs, as well as the costs of dealing separately with up to 150 different manufacturers. These costs can be passed back to wholesalers where scale and scope efficiencies are realised through aggregation.

The future of the CSO?

Looking forward, the CSO has a continuing role to play in supporting primary care and the quality use of medicines. There is an increasing focus on primary care, in the context of the increasing burden of chronic disease, the ageing of the population and the broader strains on the healthcare system. An effective and efficient primary care sector is vital to meeting the fiscal and health challenges facing Australia to 2030 and beyond.

Community pharmacy already plays a vital role in the delivery of primary health care through screening, risk assessment and disease state management. However, the sector's role could become broader as governments look for more effective mechanisms for delivering community-based care for an ageing population, and with the advent of new technologies such as genomics, which will expand the range of medicines used and how they are provided.

At the same time, community pharmacies will likely come under continued pressure from Federal budget controls and their impacts on PBS outlays, as well as continued risks from competition and commoditisation within the retail sector. By supporting operational efficiencies and guaranteeing supply, the CSO can provide a firm basis for community pharmacy to meet these challenges and opportunities.

But the CSO itself must remain viable. While Figure 2 highlights the significant value for money that has been delivered by the CSO since its introduction, it also indicates that the policy may not be keeping pace with the cost of delivering the CSO services. Average wholesaler revenue per unit delivered has fallen substantially, given the significant increase in PBS volumes, and costs continue to rise. Since participation in the CSO is voluntary, wholesalers can simply exit the scheme should it become commercially imperative to do so. This would leave the PBS once again exposed to the risk of 'cherry-picking' and patients to the mercy of the market and its timetable for delivering the medicines they need.

The CSO is a defence against market failure in the delivery of essential medicines. It must be adequately resourced to ensure that it continues to *resolve* the market failure, to *deliver* on NMP objectives and to *support* the continuing evolution of community pharmacy.