

Cvs: the web strategy essay



Marketing Channels WRITTEN GROUP CASE ASSIGNMENT CVS: The Web

Strategy This case is about CVS, one of the biggest drugstore chains in the US.

The Harvard case study was made between 1999 and 2001, while CVS was facing the major challenge of acquiring Soma. com and relaunching it as CVS. com, in order to respond to the new trend of web-based drugstores like Drugstore. com and Planet Rx.

Our report will summarize the evaluation and analysis of the firm's existing distribution channel at the time (1999), identify the problems that CVS had to face, and propose solutions to those problems (these solutions will be compared with what CVS actually did between 1999 and 2007). Thus, this audit will be divided into two main parts: 1/ Current state of the channel (1999): -Structure -Members -Allocation of channel functions -Flows -Ability to meet target customer segments' demands for service outputs -Power and conflict characteristics / Recommendations and actual evolution of CVS since 1999: 1/ STATE OF THE CHANNEL IN 1999: Structure and Members:

Drugstores are very old retail institutions in the United States. It can be tracked to the mid-1700s. Pharmaceutical wholesalers were first integrated backward and forward.

In the nineteenth century, pharmacies that were independent of physicians arose. Wholesalers were no longer integrated backward or forward, they were local and there were lots of them. Independent drugstores gave way to chains during the 1980s and 90s. By 1999 chains controlled 69% of the \$115 billion in drugstore revenues (CVS was ranked second right after Walgreen).

At first the larger chains (CVS, Walgreen, Rite Aid and Eckerd) pursued strategies of regional dominance, which led progressively to a contest for national presence.

The market for drugstore products was four times the combined sales of books and CDs. In 1999, the typical chain drugstore was about 9000 square feet, serving homes in a radius of five minutes driving time. The average store had \$4. 6 million in annual sales, and prescription drugs made up 48% of its revenues. It sold, in addition, a wide range of health, beauty and household goods. The \$115 billion market was split evenly between drugs for chronic conditions and those for acute conditions.

The use of both chronic and acute prescription drugs was concentrated among older Americans. The functioning of the distribution channel for drugs is quite complicated due to the implication of several members. In the US, the marketing of drugs is regulated by federal and state agencies, with the effect that drugs must be prescribed by licensed physicians and dispensed by licensed retailers. Besides that, the costs of personal and family medical problems were borne mainly by employers as a benefit of employment or a retirement plan, or by trade unions as a benefit of membership. The management of these costs is outsourced by employers to one or more Managed Care Organizations (MCOs). Employers collected fixed monthly payments from employees, added contributions of their own, and used these funds to pay premiums to MCOs to cover the medical costs of families of employees and union members.

These MCOs competed for employers business, so they had to reduce aggregate health costs and therefore the premiums charged. To do so, they turned to Pharmacy Benefit Managers (PBMs) in the 90s, to manage drug prescribing and dispensing. By the end of 2000, PBMs would handle 89% of all prescriptions in the United States. MCOs judged the competing PBMs' performances by how well they controlled drug costs and improved the quality of patient care. PBMs and MCOs became active managers of medical problem-solving by publishing formularies, which were lists of approved drugs on which they had negotiated favorable prices with manufacturers. They often required patients to use lower cost generics instead of branded drugs, or buy chronic medications by direct mail rather than at pharmacies.

This rationalization of the prescription drug supply chain made the PBMs a powerful force in the pharmaceutical industry, which constituted a threat to manufacturers and retailers. Thus, several drug manufacturers acquired PBMs hoping to manage the rationalization to their own advantage. All four of the largest chains owned PBMs. But still, they had to negotiate with rival PBMs in order to serve most of the customers in a store's market.

And similarly, rival PBMs had to deal with the largest retail chains so that employees can fill prescriptions at stores convenient to their homes.

Allocation of channel functions: Prescribing: The decision lay with the physician and PBM. PBMs influenced choice by creating lists of drugs approved for particular applications. If a physician or a patient wanted to use a drug not listed on the formulary, the PBM would not reimburse its costs.

PBMs set their formularies after negotiating prices and volumes with

manufacturers, retail margins with pharmacies, and inclusion or exclusion of specific drugs with MCOs.

Dispensing: Depending on the condition (chronic or acute) and dosage requirements, a patient could take delivery of prescription drugs either at a pharmacy or by having them mailed to the home. Through pharmacies: the patient brings the written prescription to the drugstore or the physician could 'call it in'. The patient pick up the drugs in person and pays a small co-payment (\$5 or \$10), while the PBM reimbursed the pharmacy at the agreed manufacturer cost plus pharmacy margin. Through mail order: Patients with chronic conditions were usually given prescriptions of longer than 30 days' duration.

PBMs required that pharmacies not fill these chronic medication prescriptions, but rather turn them over to their mail order subsidiaries that most of them created in pursuit of supply chain efficiency. They invested in regional distribution centers and bought drugs in bulk. Co-payments of the customers were lower. Although PBMs bore mailing costs, mail order companies achieved higher per-script margins than pharmacies due to economies of scale. Online dispensing: Internet pharmacy all used the same procedure to fill a consumer's prescription. Customers had to register at the site, and report if they wanted reimbursement or not.

If they did, they were asked to give the name of the MCO and their membership number. Next, the customers could transfer an existing prescription, mail a new one to the site, instruct the prescribing physician to mail, phone or fax it, or instruct the site to phone the physician. The

reimbursement approval process adds 2 – 3 days to the time the delivery would take. Customers are not charged for shipping as long as the order included prescription drugs. Online drugstores needed the approval of the customer's PBM to offer reimbursement and initially PBMs applied the rule that all prescriptions over 30 days would be filled by themselves. It is written in their clients' contracts that they are the exclusive mail-service provider.

The decision to buy soma. com in 1999 was a very clever one. The site offered since 1997 prescription drug fulfillment and refills, and also sold over the counter medications, vitamins, and other health products. Soma.

com provided e-mail prescription refill reminders to registered users and 24-hour access to pharmacists via e-mail and telephone. They also had a fully equipped automated warehouse, and a fulfillment center in Cincinnati that was high tech in terms of its ability to fill scripts. This acquisition allowed CVS to gain time because it would have taken them 3 to 4 months to build what they bought for the same cost. The people working for soma. com were also very well trained.

Besides, CVS hoped to offer CVS. om the benefits of its buying power, advertising strength, brand name, strong and active ties with PBMs, and access to 280 million prescriptions, while retaining the entrepreneurial spirit of the soma. com team. Flows: Physical possession: manufacturer > wholesalers and retailers > customers Ownership: manufacturer > wholesalers and retailers > customers Promotion: manufacturer > wholesalers and retailers > customers Negotiation: manufacturer – PBMs – wholesalers and retailers Financing: manufacturer > wholesalers and

retailers > customers Employers and unions > MCOs and PBMs > retailers

Risking: wholesalers and retailers Ordering: customers > wholesalers,

retailers Payment: employees and union members > employers and unions

> MCOs and PBMs > wholesalers and retailers Information: manufacturer >

wholesalers and retailers > customers Ability to meet target customer

segments' demands for service outputs: In this section, we will be taking a

look at the various service output demands (SOD's) that are present in the

market and how CVS conducts its operations to meet the customers'

demands. We will be looking at the bulk breaking capacity that CVS has, as

well as the spatial convenience, variety and assortment, the waiting and

delivery time, and the information provision. For bulk breaking, CVS offers to

its customers the capacity to order as much as their physician prescribed.

The customer has a wide range of product to choose from. They sell

prescription and non prescription drugs for acute or chronic conditions. They

also provide a wide range of beauty and health goods, as well as greeting

cards, which are highly profitable, and which are important generators of

store traffic. CVS had 4000 locations located mainly in the northeast in 1999

but they kept acquiring independent stores nationwide till nowadays which

allowed them to cover a huge number of patient lives. In 80% of the markets

they operate in, they are number one or two in terms of market shares.

They filled 280 million scripts per year. Through this strategy, CVS has been

able to place its brand on the mind of all buyers for its proximity, and it

allowed CVS to gain negotiating power over PBMs, since their stores were the

most convenient for a large portion of their clients' employees. Besides, the

CVS. com site offered a range of delivery options. An order placed online

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could be mailed to the customer's home or picked up at the local CVS store. Pick up at local store was best for acute conditions.

For workers who have children and do not think about getting to a store till 11'o clock at night, it is very convenient to shop online and place an order and pick up that much needed prescription on the way home. This created an advantage over pure online competition. The waiting and delivery time is minimal if the customer picks the drug at the pharmacy. But for online orders it takes some days to approve the reimbursement by PBMs and to ship the products, which does not make sense for acute conditions.

For information provision, pharmacists are legally required to provide patient counseling. CVS. com (and previously soma. com) had ensured that pharmacists were available 24/7 to advice patients via e-mail and telephone on proper dosing, possible side effects and drug interactions. This allowed CVS to develop very strong ties with clients.

Power and conflict characteristics: Conflict: Conflicts occur primarily when one of the channel members prevents the others from achieving their goals. The main conflict aroused with PBMs, because they used to put pressure on retailers to decrease their margins in exchange of the inclusion of their products in the reimbursement lists. But the last set of mergers and acquisitions gave CVS more strength because of their wide coverage of patient lives. Besides that there was the major problem of the reimbursement of online dispensed drugs. Online drugstores needed the approval of the customer's PBM to offer reimbursement, and PBMs initially applied the rule that all prescriptions over 30 days should be filled by

themselves. All of the PBMs with which CVS dealt had agreed to reimburse patients filling 30-day prescriptions on the cvs.

com site, except Merck-Medco, the largest of them with 51 million covered lives. Merck-Medco wanted to be the exclusive mail-service providers and they tried to block online drugstores from competing with them on that market. Merck-Medco arguments were that their core competency was in filling prescriptions at very low cost. They had invested heavily in automating the process, and they needed large volumes to justify that investment.

They had no interest in letting others mail drugs to any of their customers. 2/

RECOMMANDATIONS AND ACTUAL EVOLUTION OF CVS SINCE 1999: In September 1999, CVS. com had been open for business for a month. Sales due to the site were quite modest. They barely exceeded those of a conventional drugstore. The lowest prices, free shipping and abundant product information were apparently not enough to draw customers to online drugstores.

One of the measures that could be taken is to invest heavily in advertising but still it would be hard to compete with pure-plays companies at that game, because the more pure plays spend on advertising, the higher their stock market valuation climb. The other possible measure could be to have a fully integrated channel, by acquiring PBMs. Caremark, one of the nation's leading pharmacy benefit management (PBM) companies, provides comprehensive prescription benefit management services to over 2, 000 health plans, including corporations, managed care organizations, insurance companies, unions and government entities. With net revenue of

approximately \$37 billion (including approximately \$5.8 billion of retail copayments) in 2006, they were also one of the largest PBMs. In 2007, CVS Corporation and Caremark Rx, Inc.

complete their transformative merger of equals, creating CVS/Caremark, the nation's premier integrated pharmacy services provider, combining one of the nation's leading pharmaceutical services companies with the country's largest pharmacy chain. The company fills or manages more than one billion prescriptions per year, more than any other pharmacy services provider. CVS Caremark drives value for pharmacy services customers by effectively managing pharmaceutical costs and improving healthcare outcomes through its 6,200 CVS/pharmacy stores; its pharmacy benefit management, mail order and specialty pharmacy division, Caremark Pharmacy Services; its retail-based health clinic subsidiary, MinuteClinic; and its online pharmacy, CVS.com.

Here are some key events of the CVS' evolution since 1999: 1999: Tom Ryan is named chairman of CVS Corporation, succeeding company co-founder Stanley Goldstein. The company announces its intentions to enter Florida, with stores initially planned for the Tampa market. CVS/pharmacy launches CVS.com, the first fully integrated online pharmacy in the U.

S. 2000: CVS announces plans to enter the Chicago market and continue expansion in Florida with stores slated for Fort Lauderdale and Orlando. 2001: CVS/pharmacy introduces the ExtraCare Card, becoming the first national pharmacy retailer to launch a loyalty card program. CVS records annual

sales exceeding \$22 billion, and continues to expand into diverse, high-growth markets in Central and South Florida.

2002: CVS continues to grow, announcing its plans to enter the Texas market with stores targeted for high-population-growth markets such as Dallas and Houston. Also in the plans — the company's first locations in Phoenix and Las Vegas. 003: CVS celebrates its 40th anniversary, and announces its planned entry into the Minneapolis / St. Paul, Minn. Market.

The company's Extra Care loyalty card program ends the year with more than 44 million cardholders. 2004: CVS completes its acquisition of 1, 268 Eckerd Stores and Eckerd Health Services, Eckerd's PBM/Mail-order pharmacy business, increasing its store count to more than 5, 000 locations and becoming America's leading pharmacy retailer. CVS/pharmacy announces entry into California. 005: CVS/pharmacy ends the year as the largest pharmacy retailer in America, with more than 5, 400 locations in 34 states and Washington D. C.

2006: CVS acquires 700 stand-alone Sav-On and Osco drugstores from Albertsons, making CVS/pharmacy #1 in fast-growing Southern California and enhancing its presence in key Midwest markets. CVS/pharmacy serves more than 400 million customers. 2007: CVS Corporation and Caremark Rx, Inc. complete their transformative merger of equals, creating CVS/Caremark, the nation's premier integrated pharmacy services provider. Conclusion: Overall, we, as a group, would like to say that this case study has been very beneficial to our understanding of the topics that we have covered throughout this semester. Through this analysis, we have been able to have

a closer view of the very complex channel system that exists in the pharmaceutical industry.

We have also tried to conduct a successful audit and come up with recommendations in order to further improve the whole distribution processes. However, recommending improvement changes to the leader drugstore chain in the US is a difficult task to accomplish.