

Office of Fair Trading Report on Community Pharmacy

Briefing Paper

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Overview

The attached paper summarises the main conclusions of the OFT report and the evidence supporting them. The main points are these:

- The OFT believes that ending restrictions to entry will bring benefits, in terms of lower prices, to consumers, save administrative costs and encourage innovation and quality improvements. The total quantified benefits amount to about £50-55 million.
- While recognising that access might be reduced by deregulation, it believes the risks of this occurring are low in part because new entry will improve access for some, loss of some pharmacies will not result in reduced access in most cases, because many are clustered in the same locations, and because many particularly those near GPs will retain a strong competitive position.
- If access for some groups does suffer it believes that measures bearing directly on those groups should be introduced on the lines of the Essential Small Pharmacies Scheme.
- It acknowledges that workforce constraints limit the speed at which change can take place.

The Control of entry regulations and retail pharmacy services in the UK: a report of an OFT market investigation

The OFT announced in October 2001 that it would be investigating the regime bearing on the dispensing of NHS prescriptions, which, from the OFT's viewpoint represent a restriction on the ways markets work. Its core aim is to assess 'how well the pharmacy market is working for its customers'.

When announcing the study on the 3 October 2001, the OFT stated [1] that:

It is important for consumers that a convenient service is available, because many want to purchase over the counter medicines with the benefit of a pharmacist's advice. Restrictions on where chemists can open potentially have an effect on competition and not only in dispensing prescriptions. The system will be reviewed to see how the present restrictions affect competition and consumers and whether there are alternative ways of achieving the public interest objectives behind the present arrangements.

Their report¹ was published in January 2003. Its central recommendation was that the existing restrictions on opening new pharmacies should be abolished. In the report's words:

We recommend that the control of entry regulations for community pharmacies should be ended. This would mean that all registered pharmacies with qualified staff may dispense NHS prescriptions.
(Summary para 1.25)

This recommendation is based on three related considerations:

- Entry control has impeded change: the introduction of regulation had the effect of almost eliminating the establishment of new pharmacies and the expansion of existing ones and hence made it harder for pharmacies offering 'lower prices, more convenient opening times, or valued and innovative services' (para 1.11) to enter the market. The report assumes that where supermarkets enter the market they will maintain longer opening hours than existing pharmacies. It estimates that supermarkets will open some 400-500 new pharmacies (it does not estimate entry from other sources). A statistical analysis carried out for the OFT suggests that adding to the

¹ The control of entry regulations and retail pharmacy services in the UK, available from www.offt.gov.uk

number of pharmacies will tend to promote service improvements such as home delivery and consultation areas.

- Entry control itself entails costs. The report estimates that the annual costs of operating the current arrangements to government and to business is around £26 million. The estimate is made as follows:

Administrative Cost Savings		£ million
Administrative costs to business		13
Appeal costs to business		2.5
Legal costs to business		0.2
Total business costs		15.7
Cost to taxpayer of Health Authorities	9	
Cost to taxpayer of Appeal Authority		1
Total NHS administration costs		10

(para 6.2, p 63)

- Consumers should benefit from lower prices for P medicines and GSL medicines of £20-25 million and £5 million respectively. This recommendation stems from the assumption that the entry of supermarkets will lead to lower prices for these products. The conclusion is supported by reference to the effect on prices of the elimination of resale price maintenance and a comparison of the current cost of a basket of pharmacy goods in supermarkets and other outlets.

The benefits identified above represent reflect the 'standard' view of the benefits of competition in any market: that entry restrictions allow firms to charge higher prices and reduce the incentive to improve quality of service. However, the research supporting their report did not find evidence of excess profits. Although premia are paid for NHS contracts, the report acknowledges that other factors are usually involved and hence they should not be regarded as a sign that excessive profits are being made. However the price differences observed between supermarkets and other outlets are clear evidence, the OFT considers, that there is scope for more widespread reductions, whether by existing outlets lowering prices or going out of business and their trade being transferred to lower priced outlets.

The report also accepts that the existing control arrangements have been

successful in ensuring that most people had easy access to a pharmacy either directly from home, or after visiting their GP. It concludes however that the abolition of control would improve access in other terms particularly opening times.

If access worsens as a result of competition then the OFT considers that other means should be found to ensure that good access is maintained. The report points to the existing Essential Small Pharmacies Scheme as an obvious possibility. In doing so the report reflects what was the view of the Department of Health when the scheme was reviewed by the Public Accounts Committee of the House on Commons in the early 1990s. It also points out that control of the location of new pharmacies is not universal: of other countries surveyed, Germany, the Netherlands, Canada and the US do not impose such controls.

In summary: the OFT makes a straightforward case *for* competition while recognising that competition may have undesirable side-effects. But it considers that if there were severe adverse consequences, then *ad hoc* measures should be taken to counter them. In what follows we consider how the report deals with some of the possible side-effects.

Access

We noted above that the OFT argues that access may be improved as a result of deregulation. Part of this argument rests on the definition of access which they extend to include opening hours and delivery services both of which they expect to improve if entry restrictions are lifted. As far as physical access is concerned, this conclusion rests on a number of different arguments:

1. Some (but not many) areas are not well served now: with deregulation, there would be no obstacles to newcomers trying to establish a business in them. The report points out that existing controls cannot guarantee the establishment of a pharmacy in particular areas and cite a report from the Social Exclusion Unit which suggests that access is poor in some poor neighbourhoods.
2. New entry by increasing the number of outlets will lead directly to better access. The OFT concludes there will be entry from:
 - Existing non-contract pharmacies (the majority of which are owned by Boots).

- Some independent pharmacists currently frustrated at the lack of opportunities to enter.
 - A substantial number of supermarkets, and
 - A few pharmacies entering (or moving) close to GP's surgeries.
- (para 5.52, p 60)

3. If supermarkets do open large numbers of new outlets and if this does lead to a reduction in the number of pharmacy outlets, this would not have much impact on access since existing outlets tend to cluster e.g. in high street locations. A thinning out of numbers in such areas would not reduce access in physical terms. This argument is underpinned by modelling the impact of entry: see notes below.

The OFT puts its overall conclusion as follows:

We are not persuaded by the theoretical arguments that have been made against the natural proposition that greater freedom to supply will tend to improve customer service. But this is in the end an empirical issue. Consequently, the OFT commissioned three pieces of empirical research analyses in order to explore the relationship between entry and access. (para 5.35, p 55)

This key conclusion is supported by empirical evidence of three kinds:

1. Three case studies of areas where new entry had occurred, which show that in none was access reduced and no pharmacy closed.
2. An analysis of *all* areas where entry took place from 1997 to 2001. This found that in nearly all cases the total number of outlets rose. In other words, an opening did not usually lead to a closure.
3. A statistical modelling exercise of high levels of new entry: this did suggest that there would be closure of existing outlets but because of the clustering effect only a small reduction in access.

Studies such as these cannot prove that serious reductions in access cannot occur: as with all measures of deregulation, there is an element of 'suck it and see'. Critics of deregulation have suggested that removing restrictions will for example result in pharmacies moving between GP surgeries and existing pharmacies or that GPs themselves will enter on a

large scale. None of these responses can be predicted with greater confidence precisely because the existence of controls means that there is no direct evidence as to how the market will work if it is freed up. However implicit in the OFT's analysis is the expectation that there will be some closures of outlets. From the competition viewpoint that is the price to be paid for the benefits expected to accrue to consumers.

While the OFT clearly considers that competition will prove beneficial, it also acknowledges the need for safeguards.

It is nonetheless vital that effective safeguards against substantial loss of access are in place. This point is independent of deregulation and, as discussed above, the control of entry regulations do not directly deliver this important policy objective anyway, as they impede rather than encourage entry. There are, however, alternative mechanisms for maintaining good access that are well targeted and effective, such as the Essential Small Pharmacies Scheme (ESPS). (para 5.58, p 61)

It does not attempt to spell out how such a scheme would work if it had to be deployed more widely and what it would cost by way of direct subsidy.

However one of the supporting papers (D) suggests:

Regardless of the location of pharmacies, there will always be a core group of people who, because they are housebound or suffer significant mobility problems, find getting to a pharmacy difficult regardless of its proximity. For such individuals, the need to rely on others may be lessened by further development of services like collection and delivery schemes. (para D.27, p 87)

The report acknowledges that pharmacists act as advisers to consumers and that this part of their role is expected to expand. The report does not consider the links between the proposed change and this change of role in any detail, but it is easy to infer that the OFT would argue that if the NHS wants such roles to develop they should ensure that they are properly financed directly through suitable contracts and do not depend on restrictions which harm consumers in other ways.

Workforce Considerations

If service levels defined in terms of opening hours are to increase, then,

pending changes to the rules governing pharmacy supervision, more pharmacists will be required as well as other trained staff.

The OFT report does not go into this issue in any detail but notes merely that it need not constrain entry over the longer term. However a report commissioned by the OFT and published as Annex H notes that a number of factors are tending to reduce the supply of pharmacists while other sources of demand are growing. This suggests that short of changes in the way that pharmacy services are supplied, workforce considerations will act as a brake on the speed of change. However the evidence on which this conclusion is based is poor, as the author of this annex acknowledges.

Supporting Data and Analysis

The OFT report is backed up by a large amount of detailed evidence, some of which has been cited above e.g. that pertaining to the workforce as well information on the ownership of community pharmacies, regulation in other countries and the impact of entry.

Some of the central features of the OFT's defence of competition stem from some of this supporting analysis and the information it embodies. Some features are identified below which bring out the nature of that support and hence the degree to which the conclusions of the report are underpinned.

Electronic Map

Consultants prepared for the OFT an electronic map holding data on the geographical position of each community pharmacy. This allowed a number of conclusions to be drawn e.g. about clustering, the distance people have to go to find a pharmacy and the relationship between pharmacies and general practices. It shows for example that community pharmacies are generally sited near other pharmacies and near to GPs. This basic finding is crucial to the report findings on the likely impact of competition on access while the mapping exercise was a key input to the further work reported below as it provided the essential basis for estimating changes in access resulting from entry of new outlets.

Economic Analysis

Consultants attempted to assess the likely behaviour of new entrants or existing pharmacies changing location, in particular the scope for leapfrogging i.e. moving to locations near GPs which reduce the existing catchment areas of more distant pharmacies.

They examine four arguments:

- Leapfrogging would result in clustering and monopoly power.
- It would reduce investment in quality.
- It would result in wasteful sunk costs.
- It would allow GPs to auction off space in their premises.

Apart from the last argument which they accept as a possibility while dismissing its significance, the consultants find it hard to come to clear conclusions. They conclude that theoretical arguments show that there might be benefits or disbenefits, but they cannot demonstrate on theoretical grounds along which is the more likely. What little empirical evidence they find (or were offered by stakeholders) bearing on these arguments they conclude is insubstantial - in effect challenging those who take the leapfrogging argument to better substantiate their case.

Access Analysis

The consultants modelling produced the following results:

- When new pharmacies were assumed to enter, with no subsequent exit, there was an increase in access (a reduction in distance travelled) of approximately 350 metres for those consumers affected. A maximum of 12% of the population was found to be affected.
- When there was displacement, so that each entering pharmacy resulted in the exit of one existing pharmacy, there was a small change in average access for those affected, of between plus 90 metres to minus 170 metres depending on the scenario. A maximum of 24% of the population was found to be affected.
- When there was net exit, so that each entering pharmacy resulted in the exit of two existing pharmacies, there was a slightly larger reduction in access for those affected, of between 50 and 300 metres depending on the scenario. A maximum of 31% of the population was found to be affected.

(Frontier Economics, *The Access implications of entry and exit of pharmacies*, Executive Summary p vi)