REPORT

The road ahead for Retail Pharmacy

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Introduction

While the world may have closed the book on 2020, the aftershocks of that unprecedented year will linger for a long time yet. Personal experiences may have varied, but the spread of COVID-19 touched every corner of the globe to some degree, forcing radical action from governments and sweeping changes in consumer behaviours as a result.

As those shifts took place, businesses around the world attempted to keep pace with an increasingly fluid "new normal". And while some sectors have suffered dramatic swings towards growth or collapse others have been experienced a more nuanced fate. This is undoubtedly the case for Retail Pharmacy.

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A first glance might suggest that the pandemic's effects were muted and — potentially even advantageous — to the sector. Considered to be providing an essential service, Retail Pharmacies joined grocers as some of the few stores to remain open during even the hardest moments of the outbreak. This consistent presence will have helped those businesses capture some of the incremental spend traditionally reserved for peripheral specialty competitors, such as beauty stores, salons, wellness stores.

A closer look at the financial performance of the Retail Pharmacy however, reveals the roiling currents beneath the surface. Significant shifts in customer behaviour have accelerated existing trends, forcing banners to quickly adapt or risk being left behind.

In this paper, we look at those trends, their current and predicted future impacts on the sector, and how Retailers can prepare today for a very different tomorrow.

A Look at the Sector

> From a global perspective, four large operating models currently exist within the sector.

Retail Pharmacy Business Segments and Operating Models

McKESSON — Wholesale Franchised Pharmacies

- Franchisees are small independent pharmacies with limited front-end business, heavily prescription and service driven aligned to wholesaler
- Wholesaler provides purchasing agreements, private label products, technology solutions

CVS pharmacy — Prescription-Led Broad Offer Pharmacies

- Chain drug retail stores with strong prescription business relative to front-edit (70/30)
- Format dominates US prescription business & retailers with smaller footprint

Boots — Health/ Beauty-Led Pharmacies

- Drug retail with highly developed beauty and health segments and derives significant revenue relative to pharmacy (30/70)
- Premium national and own brand products

dm — Health/ Beauty-Led Drug Retail

- Health & Beauty businesses with no prescription business
- Separation from pharmacy is usually regulatory driven

The predominant differentiators are the balance of prescription and non-prescription business, the mix of products offered, and the level of investment in clinical services. And the extent to which these offerings meet changing Customer needs is clearly reflected in the performance of each model.

While sales of cosmetics declined as orders to stay at home came into effect, and OTC medicine sales fell due to a decline in seasonal ailments, wellness and personal care categories improved – and prescription revenues for acute medications dropped off with lower doctor visits and communal interaction, while chronic medication rose as customers stocked up. Depending on specific areas of focus, revenues were dramatically affected, both positively and negatively.

From behavioural change to strategic transformation

During the past 12 months, six major trends have driven change in the Retail Pharmacy sector. Each has fuelled a shift in Customer behaviours and required Retailers to undergo strategic transformation to manage effectively.

Covid-19 has accelerated customer behavioral change

CUSTOMER TREND	BEHAVIORAL SHIFT	STRATEGIC TRANSFORMATION
Localization	Reduced number of Retailers shopped with heightened expectation of choices	Evolve into a destination
Health & Hygiene	Personal health needs initiate a holistic approach to maintaining clean & healthy environment	Overhauling merchandise to support whole-being health
Importance of Value	Record unemployment and uncertain economy leads to choiceful shopping habits	Investing in price perception levers to increase relevancy
Omnichannel Expansion	Customers driven to digital means of shopping to reduce exposure risk	Creating seamless customer experience to meet the needs across online and store channels
Role of Community Health	Stronger connection & coordination with organisations impacting overall wellness	Crafted health solutions through understanding of broader customer needs
Strategic Partnerships	Leveraging capabilities of others to speed and expand current capability	Compartmentalizing internal efforts and collaborating to expedite change

Perhaps the greatest indication as to how Retail Pharmacies have adapted to these trends lies in the numbers. Below are recent financial results from some of the world's largest H&B and Retail Pharmacies (most recent available numbers).

Rite Aid	+12%
FEMSA H&B	+6.4%
Shoppers Drug Mart (Largest Canada)	+6.3%
Walgreens	+5.7%
CVS	+3.5%
Boots	-11.5%
AS Watson H&B	-11%
Dairy Farm H&B	-35%

The huge range in performance here can be attributed to a number of factors and conditions, of course. But the acceleration of the six trends above has also served to uncover the strengths and weaknesses of each banner's go-to-market approach. This begs the question as to the continued relevance of certain strategies, as well as how Retail Pharmacies can forge a new path while continuing to address rapidly evolving Customer expectations.

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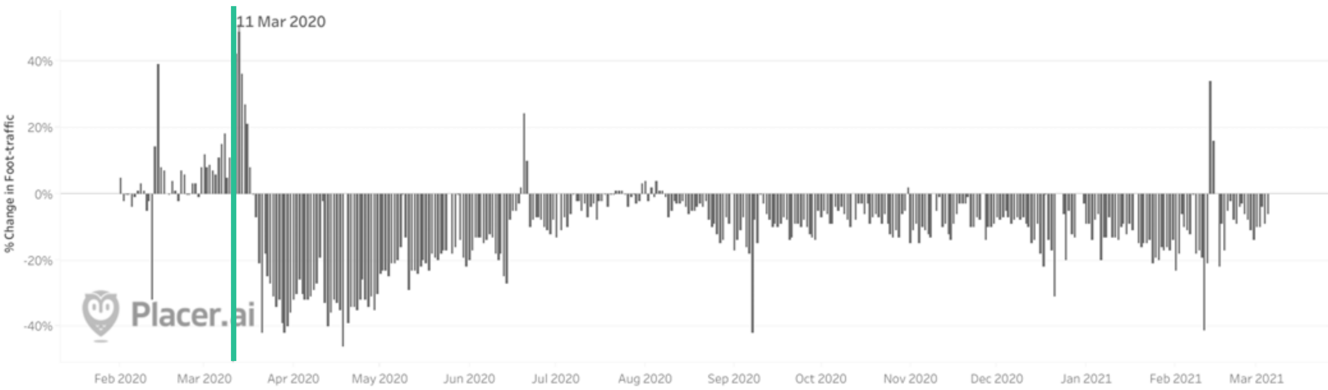
Localisation

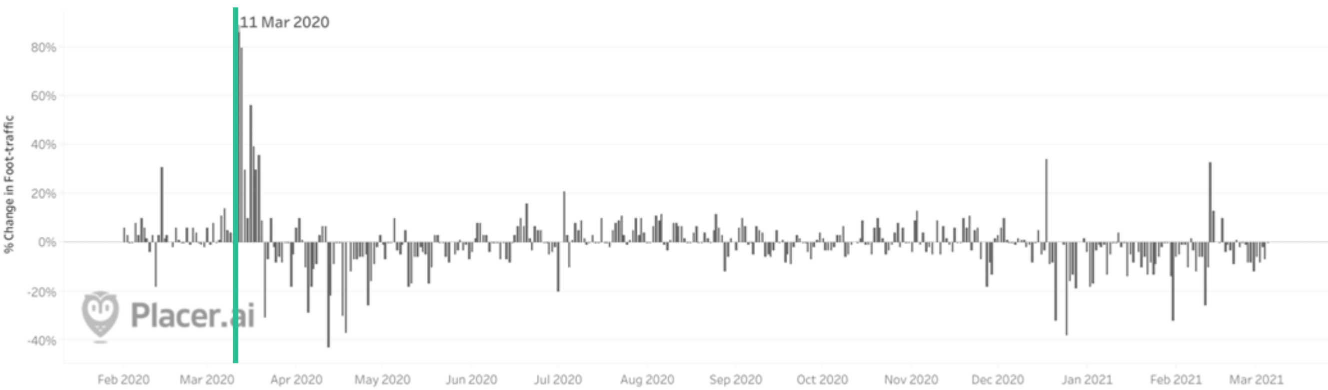
One of the defining Retail trends of the pandemic has been an overall reduction in the number of stores shopped; Customers have cut down on both the number of stores they frequent, and the distance they're willing to travel to reach them.

For Retail Pharmacies, while this trend was somewhat off-set by a rise in basket sizes, the drop-off in foot traffic was markedly higher than for comparable sectors. By way of example, after the spike, subsequent shutdown, and temporary summer recovery, Walgreens foot traffic remains 15% below that of pre-pandemic levels. Relative to Kroger, customer attrition has begun to structurally settle in for one of the largest, most conveniently located, pharmacy chains. Despite maintaining a broad range capable of addressing multiple convenience and health and beauty (H&B)/Rx needs, this reduced traffic persists.

Walgreens, Nationwide - Foot-traffic year over year



Kroger, Nationwide - Foot-traffic year over year



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Given the impact on even Retail Pharmacies armed with a diverse product offering, those with narrower ranges have been even more susceptible to this consolidation. While skincare departments saw short-term uplifts as speciality retailers began to close their doors, a reduction in cosmetics demand overall has resulted in a general decline for that line of business over the longer term.

As might be expected, Retail Pharmacies aligned more closely with health and well-being lines were better insulated. Even then, the desire to limit shopping trips and a generally light flu season has negatively impacted those businesses. Given the decline in traffic relative to performance at Walgreens, one can infer more dramatic reductions still at weaker chains.

As Customers continue to settle into a new pattern of shopping, Retail Pharmacies will need to keep a close watch on their changing behaviour. Most Pharmacies have been emphasising H&B and over-the-counter (OTC) categories, and gradually phasing out convenience items. While this strategy has generally proven effective to date, COVID-19 has strongly impacted the demand for beauty categories, and reduced SKU counts have caused a deselection of many Pharmacies from consumer shopping patterns.

Retail Pharmacies must understand exactly the types of products customers in this environment expect. Additionally, new offerings must be introduced to evolve the role of the business, maximize Customer engagement, and entice new shoppers to make the Pharmacy a vital destination once again.

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Health & Hygiene

In an era in which daily life now requires a conscious effort to safeguard ourselves and others against infection, it is difficult to overstate the important of the health and hygiene categories to Retail Pharmacy.

At the time of writing, the global COVID case count has just passed 110m, with casualties exceeding 2.4m. Masks, sanitiser, and social distancing have become ubiquitous, and the need to stay healthy – both physically and mentally – will likely be part of Consumer mindsets long after the vaccine has become similarly commonplace.

In this respect, the coronavirus has helped to supercharge a strategic shift toward an expanded and enhanced range of products and services that address growing Customer focus on proactive wellness and condition maintenance and treatment. From a product perspective, assortments are being adjusted to reflect this emerging priority; legacy merchandise categories are typically being reduced or eliminated in order to make room from healthier products and services for fitness, immunity, and alternative medicines.

Beyond product, the introduction of expanded clinical services and consultations has emerged as another strategic shift. Walgreens has invested $1B in Village MD with a commitment to open 500-700 full service primary care clinics in the next five years. Shoppers Drug, the largest Pharmacy in Canada, opened its first primary care operation in 2019 and has designated a number of stores as ‘Wellwise’ locations that carry specific products for older customers.

Arguably the most dramatic example of this newfound focus on services is the vertically integrated health organisation known today as CVS Health. CVS Health boasts the 6th largest managed care organisation in the US, the largest Pharmacy benefits manager, and the largest (by number of locations) Retail Pharmacy offering.

Collectively, the organization generated $230B in revenues last year, of which a mere 7% came from front-end sales. Undeniably complex though it may be, CVS Health offers a clear vision of how Retail Pharmacy can evolve beyond the classic model: a hybrid provider of medical and Retail that, once fully integrated with Pharmacy benefit management and health insurance divisions, becomes a unique customer solution.

The clear benefit of a multifaceted strategy of this kind is that it creates an intricate relationship with a Customer that competitors will find difficult to replicate or break down. While it may serve a narrower group, it does so more comprehensively, and to Customers who are likely to have a much higher lifetime value than casual shoppers.

As true for CVS as any other Retail Pharmacy though, is the fact that this kind of shift requires strong repositioning with Customers. Consistent, precise, communication to the most valuable must occur in order to help them understand these changes, rather than an unfortunate realization that some items are no longer stocked.

After decades of precedent, sweeping change takes time to communicate effectively.

Value

Global stimulus may have blunted some of the worst economic impacts of the pandemic, but the financial consequences have still been keenly felt. Economies have shown a K-shaped recovery, with certain groups and markets recovering well while others continue to struggle. And despite this divergent situation, an overarching sense of unease remains, fuelled by continuing uncertainty about the full impact of the pandemic over the longer term.

Given this situation, Customers are looking to Retailers for safety and the reassurance that they are making intelligent purchasing decisions. This means providing great products and services at the right quality and price. There's also the opportunity to expand their private brand offering, to create a point of difference with Customers, while also improving profitability and negotiating power with branded suppliers

While Retail Pharmacies have generally maintained a level of trust with the public, that is likely to come under greater scrutiny now that the relationship is beginning to transcend Retail and move further into health. At the same time, Retailers have the opportunity to reinforce the narrative on value through unique product and service offerings. A deep dive on Customer wants and needs can help inform the broader strategy of what to offer, and how to offer it.

The premise of moving into healthcare has been driven by the objective of reducing healthcare costs while maintaining quality and adding convenience. Implementing this strategy successfully will not only grow credibility, but provide Retailers with a way to connect Customers and patients to specific Pharmacies in a much stronger way.

Omnichannel expansion

Even as the pandemic pushed some industries down, it pushed others to new heights. In just one year, digital Retail has taken strides that would have taken years to achieve. Shipping, delivery, and curbside pickup have become the norm – not just from the point of view of convenience, but that of safety as well.

The Pharmacy sector is no different. CVS reported a 500% increase in delivery of prescriptions from Q1 to Q2 of last year[1], while Boots.com has grown 106% from one year ago. Globally, the growth in digital has increased in multiples, with what was once a low single digit portion of the business doubling or tripling its importance as a percentage of sales.

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While this is an important trend in and of itself, digital growth will also play an increasingly crucial role in Retail Pharmacy survival. That's because digital effectively levels the playing field in terms of geographic spread, providing Customers with the ability to order and receive goods quickly, uncoupled from the size and physical location of the Retailer.

Convenience – something that was once solely about store location and layout – is now being redefined by factors such as digital experience, delivery options, and experiential substitutes like augmented reality product trials and virtual conversations with health and Pharmacy professionals. While these technologies have existed for several years, the pandemic has pushed them into the spotlight in a world in which physical interaction has become greatly limited.

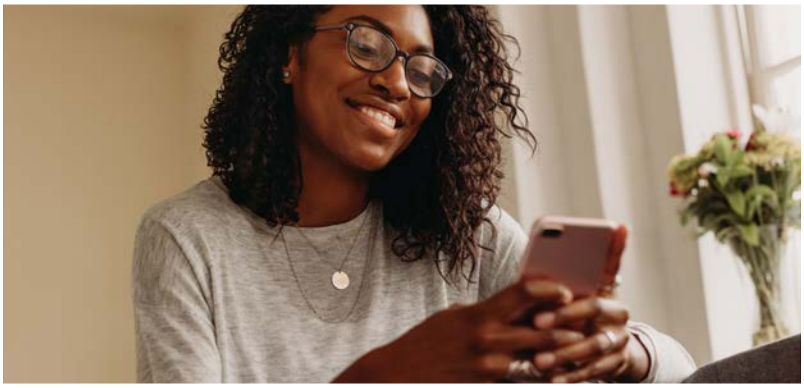
Additional efforts to compete against both legacy and pureplay operators include the introduction of marketplaces that allow for greatly expanded product, service, and information offerings, broadening out the solutions offered Customers but still closely aligned to the Retail Pharmacy's overall strategy and objectives.

The current end goal with regard to omnichannel expansion must be to position the Retailer as a trusted source for a wider set of solutions, offerings that can both attract new Customers and grow engagement with existing ones at the same time.

We have seen that the majority of new online shoppers are actually existing Customers who have augmented their in-store behaviours as opposed to simply switching from one channel to another. While traditional shopping will likely recover to an extent, the wide adoption of digital channels will persist well beyond the end of the pandemic.

A digital offering requires much of Retail Pharmacies in order to be successful. How well can shoppers find the products and services they are looking for? Which areas of the website drive the most conversions? What are the right marketplace offerings to attract new Customers and strengthen relationships with existing ones? When does Customer behaviour truly change from single channel to omni-channel, and how can I help encourage that shift?

As Customers continue to focus in on a smaller number of trusted Retailers for their pharmaceutical needs, it is imperative that Retail Pharmacies fully embrace and continuously optimise their omnichannel solution as a full and integrated component of their business.



[1]https://www.cnbc.com/2021/01/10/drugstore-disruption-cvs-walgreens-and-rite-aid-have-a-new-playbook.html

Role of Community Health

In the wake of the pandemic, US Retail Pharmacies have played a major role in expanding testing capabilities by leveraging their many physical outlets for easy access to consumers in order to be checked for the virus.

With the initial stages of the vaccine rollout now underway, these Pharmacies are front and centre once again, actively dispatching vaccination professionals to the nation's many thousands of assisted living facilities surrounding their respective locations. CVS and Walgreens alone collectively administered 3 million shots by end of January[2].

This activity represents a pragmatic, but extremely critical application of a larger strategy to keep Retail Pharmacies relevant in the minds of Customers. In the pivot towards an increased focus on health and well-being, Retail Pharmacies have sought to deepen their understanding of what actually drives those qualities.

The Social Determinants of Health are a wide-ranging set of factors that impact a customer's well-being. While most of those factors have sat far outside the purview of traditional Retail Pharmacies, some banners are making creative inroads in order to move beyond the transactional activities that put them in direct competition with efficiency experts such as Amazon and Walmart.

By breaking down social determinants, Retail Pharmacies can potentially leverage their community-oriented structure to connect with customers beyond the Retail format (both physical or digital) and provide value across a wide range of activities.

[2]https://www.thedenverchannel.com/news/national/coronavirus/cvs-walgreens-complete-first-round-of-covid-19-vaccinations-at-skilled-nursing-facilities

Customer Health Outcomes are driven by numerous interrelated influences

While Retail Pharmacies cannot solve for all factors, in-depth understand and creative actions to improve adherence can be devised that will have a significant impact.

DETERMINANTS OF HEALTH	COMPONENTS
Healthcare	• Access to diagnosis • Access to treatments
Environment	• Housing • Locations
Economics	• Income • Work environment
Food	• Cost & quality • Variety
Education	• Understanding of condition • Understanding of treatment requirements
Social	• Quarantine influences • Secondary impacts

In an attempt to address issues related to vulnerable populations for instance, CVS has invested in affordable housing schemes that provide supportive services and no-cost preventative screening that can proactively identify risks prior to them becoming life-threatening. And the company's Health Hub locations, which offer an expanded range of services, assist in the education and maintenance of existing conditions and improved health.

Not all Retailers will be able to deliver dramatic activities such as of course. But that does not mean that they cannot implement more modest and thoughtful adjustments in areas such as their H&B assortment, partnerships with local institutions, or the expansion of service delivery to the community.

The localised footprint of Pharmacies provides them with a competitive advantage, one which capitalizes on a close-knit geographical relationship with their Customers. Fine-tuning their offering to best leverage their strengths and their customer's needs can yield a wealth of new information about your most valuable Customers, while simultaneously transcending the traditional role of a Retail Pharmacy into stronger and more uniquely defensible operation.

Strategic Partnerships

With an environment as volatile as the one experienced over the past year, there is an ever-increasing need to move quickly and decisively.

The best plans and approaches are only as valuable as the extent to which they can be realized, and even the most technologically advanced Retail Pharmacies see the need to push innovation forward as quickly as they can.

Partnering with experts in key growth areas is one way in which to facilitate this. Understanding what is truly needed to grow sales, make better decisions, improve customer loyalty, and increase collaboration can require deep specialist expertise; Walgreens investment in VillageMD and Rite Aid's partnership with Instacart serve as visible and valuable examples of solution partnerships.

Deep insight is vital, too. Underpinning their operations with Customer Data Science can give Retail Pharmacies a better understanding of their Customers and enable partners to gain a singular view of their needs and behaviours. This can allow for extremely detailed decision making on issues ranging from the reaction to product and service pricing to how to create seamless digital experiences.

Armed with this information, better, stronger, and more rapidly effective partnerships can be formed, helping Customers to live their lives better.

The road ahead

While few of the trends described above are truly new, their importance has undeniably increased over the past 12 months, and their impact on current business models has been equally significant. The fundamental truth here is that the businesses which have been able to adapt quickly have better equipped to weather the storm.

While the gradual rollout of a COVID-19 vaccine offers hope, it's clear that a return to normalcy is still many months away. And even Customers are finally able to live their lives as they were before the pandemic, many of their behavioural changes will linger on. Retail Pharmacy will still have a huge role to play when life as we used to know it returns, but legacy strategies will no longer stand up to scrutiny as they once did.

As we move into a second year of life in a pandemic, Retail Pharmacies must have a deep and clear understanding of their customers' needs and wants as they continue to evolve – and take clear and decisive action in response.

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dunnhumby is the global leader in Customer Data Science, empowering businesses everywhere to compete and thrive in the modern data-driven economy. We always put the Customer First. Our mission: to enable businesses to grow and reimagine themselves by becoming advocates and champions for their Customers.

With deep heritage and expertise in retail — one of the world's most competitive markets, with a deluge of multi-dimensional data — dunnhumby today enables businesses all over the world, across industries, to be Customer First.

The dunnhumby Customer Science Platform is our unique mix of technology, software and consulting enabling businesses to increase revenue and profits by delivering exceptional experiences for their Customers – in-store, offline and online. dunnhumby employs over 2,000 experts in offices throughout Europe, Asia, Africa, and the Americas working for transformative, iconic brands such as Tesco, Coca-Cola, Meijer, Procter & Gamble, Raley's, L'Oreal and Monoprix.

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