Amazon: Pharmacy Disrupter or Tough Going?

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THE MID-MAY ANNOUNCEMENT that Amazon plans to enter the pharmacy market was met with many divergent views. While many are convinced that Amazon will be a market disrupter that is too big and savvy to fail, one only needs to remember the Amazon Fire phone to realize that Amazon is not infallible. Amazon has long been a market leader in e-readers, and recently purchased Whole Foods to extend its reach into the grocery sector. Amazon continues to offer new services such as online TV and movie streaming. Unlike these sectors, pharmacy is a highly regulated industry with complex laws, regulations, and licensing requirements. We are going to analyze both sides of the coin on Amazon pharmacy. Will it be a disruptive force, or not? Let's first focus on factors that would facilitate a successful Amazon pharmacy market entry.

PHARMACY DISRUPTER

Historically, disruptive innovation has come from outside industries by organizations that identify unmet needs or reframe the value proposition. This is brought about, in part, because industry leaders are invested in the status quo and try to maintain their dominant market positions. Can this disruption be introduced into the pharmacy market by Amazon? By creating pharmacies in a few of its distribution centers, Amazon could easily leverage its existing supply chain to provide prescriptions.

Over 90% of prescriptions in the $400 billion prescription market are paid for by a third-party plan, such as a commercial, Medicare Part D, or Medicaid plan. This market is payer centric, as patients and providers are required to adhere to the payer's benefit plan design, formulary, and utilization management edits. The third-party business is segmented into retail 30 and retail 90 networks with different pricing discounts, mail service, and specialty pharmacy networks. Amazon, if it is able to contract with payer networks, would most likely be slotted as a mail-service pharmacy. Our theory is that payers have their own preferred mail-service and specialty pharmacies and would erect barriers for network participation for Amazon wherever possible.

The $40 billion cash market has few barriers to entry for Amazon, once the appropriate state board of pharmacy licensing has been obtained. The cash market is very competitive, with organizations such as Blink Health and GoodRx driving price competition and challenging traditional pharmacies' cash pricing strategies. Amazon could immediately compete in the cash marketplace, and has been willing to sell at a loss in new markets to gain a foothold.

If Amazon focuses solely on the cash market, it will not be concerned with managing its cash pricing to prevent invoking the "lower of" clause in third-party network agreements. This clause requires the pharmacy to pass along a lower cash price when compared to the negotiated network rates. Amazon has an estimated 80 million Prime members; it could immediately market its pharmacy to these consumers for their prescription and OTC needs.

MOVING FORWARD

Amazon would likely initially focus on the cash market and offer add-on sale suggestions for products customers may need based on their prescription profile. This is a consumer-centric market and would enable Amazon to learn the pharmacy business and pilot new services beneficial to consumers. Amazon would bring a fresh perspective and could leverage its existing technology to engage consumers in managing their drug therapy and lifestyle.

At a future time, Amazon could dramatically grow its business through a PBM (pharmacy benefit manager) acquisition. A PBM acquisition could provide access to millions of lives overnight and undercut traditional pharmacy retailers. The $40 billion cash market is an attractive target for Amazon, and Prime members are the easiest avenue to begin with.

IT'S TOUGH IN THE PHARMACY MARKET

Express Scripts, CVS Caremark, Prime Therapeutics, and OptumRx dominate the PBM space. These companies own mail-service pharmacies and would not allow Amazon into their commercial networks. Amazon could enter into a Medicare Part D (any willing provider provision) market, but would likely face substantial enrollment hurdles, including accreditation requirements established by the PBMs for network participation.

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Without mail-service contracts, Amazon would struggle in the third-party arena, unless it also plans to establish, acquire, or partner with a PBM to provide prescription benefit services. Amazon could choose to operate its own PBM to administer drug benefits for its 350,000 employees to learn the PBM business before deciding on a future direction.

MANUFACTURERS

Manufacturers may love the thought of another potentially large pharmacy player entering the market, especially if Amazon buys direct and bypasses the wholesale channel. The three major generic buying groups control approximately 85% of generic product purchases. But manufacturers must abide by their "best price" clauses in their payer contracts (e.g., the CMS Medicaid Drug Rebate Agreement) effectively putting a floor on purchase prices. If a new best price is established, the lower price must be passed on to these customers. This scenario may prevent manufacturers from providing Amazon with prices that undercut the existing market.

PATIENTS

Based on a 2015 *Medscape* article, patients over the age of 65 use 40% of all prescription drugs. On average, Americans ages 65 to 69 fill 14 prescriptions per year. However, only 20% of Amazon Prime's U.S. customers are older than 60 years. While young baby boomers tend to be more tech savvy, a large portion of the prescription market does not use the internet or shop online. No matter how low Amazon's prices are or how great its service offerings, if the target market is not visiting its website, Amazon will not be able to sell them prescription services.

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Like other mail-service pharmacies, Amazon will also face challenges with shipping speeds for acute-care medications. Amazon Prime offers two-day shipping, but it will never be able to compete with the speed of a local retail pharmacy. With e-prescribing, many patients can now visit their local retail pharmacy and within an hour after their doctor's appointment pick up their medications. Amazon cannot replace this type of speed yet (think drone delivery). For patients seeking acute medications, mail-service pharmacy will never be the gold standard. Moreover, many patients, especially seniors, value the face-to-face interactions with their pharmacists. Even with video chats and phone calls, Amazon cannot replicate this experience.

EXISTING COMPETITION

The top retail pharmacy chains will aggressively respond to Amazon's entry in the pharmacy market, and could quickly replicate new strategies and tactics. Recall the industry response when Walmart launched its $4 generic program in 2006. It took some time to assess the impact of the program, but once traditional pharmacies saw the lost business, they responded with similar offerings. The major retail pharmacy chains will not easily relinquish their market share.

BOTTOM LINE

The pharmacy market is more complex than any of Amazon's previous undertakings. Regulations, licensing, insurance, drug manufacturer contracts, PBM relationships, and breaking patient routine are all hurdles that Amazon must overcome to disrupt the pharmacy market. The ultimate success for Amazon will depend upon its target market to gain a foothold. The cash market has fewer barriers to entry, and Amazon can access its Prime membership for new patients. The third-party market will prove challenging, absent a strategic acquisition that bypasses likely barriers erected by industry leaders. Time will tell which direction Amazon chooses. However, its entry will only increase the competition and margin pressure for retail pharmacies. **CT**

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