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RITE AID CORPORATION: AN UNCERTAIN FUTURE[1]

The shareholders for Rite Aid Corporation (Rite Aid) were frustrated and outspoken at the annual meeting on October 30, 2018. The shareholders had not only turned down a US$3 million[2] bonus proposed for John Standley, the chief executive officer (CEO) of Rite Aid, but had also elected a new independent board chair, Bruce G. Bodaken.[3] As the new chair of the Pennsylvania-based Rite Aid, the third largest drugstore chain in the United States, Bodaken had a difficult task ahead of him—how best to ensure Rite Aid's survival.

For the past three years, Rite Aid had been planning to be acquired. However, regulators had dismissed a plan to sell Rite Aid to Walgreens Company (Walgreens) in 2015, and the amended plan, to sell over 2,300 stores to Walgreens in return for cash, took nearly three years to complete. A second deal to sell the remaining stores to Albertsons Companies Inc. (Albertsons), a US grocery gain, was scrapped in early August 2018 when it became clear that shareholders were not likely to approve the acquisition.[4] Having dealt with falling sales, shrinking profits, the sale of over half of its stores, and, most recently, the news that Amazon.com Inc. (Amazon) had acquired the online pharmacy PillPack, Rite Aid seemed to be facing challenges from all sides. Bodaken needed to revisit management's strategy for the drugstore chain if it were to survive.[5]

THE DRUGSTORE AND PHARMACY INDUSTRY

The United States had about 30,000 pharmacies and drugstores, and the two largest pharmacies were CVS Pharmacy (CVS), with 9,778 stores in 2017, and Walgreens, with 9,560 stores in August 2018.[6] With 2,548 stores in March 2018, Rite Aid was the third largest player; the remaining market was made up of large grocery chains and a collection of direct-to-consumer programs and smaller pharmacies (see Exhibit 1).[7]

The health care distribution value chain was complex and involved drug manufacturers, third-party payers and health plan providers, pharmacy benefit managers (PBMs), wholesalers, and pharmacies. Drug manufacturers—for example, Johnson & Johnson, Merck & Co. Inc., and AbbVie Inc.—spent considerable resources researching and developing patentable drugs.[8] Third-party payers included the US state-sponsored Medicaid and Medicare Part D plans, which covered the costs of a limited range of medication for eligible participants.[9]

Health plan clients such as private and public corporations offered privately funded drug coverage for their employees. These companies typically bought plans from insurance companies or worked with PBMs, which were third-party administrators, to offer drug programs. PBMs had a variety of roles: they oversaw formularies or lists of medicines that benefit plans were willing to pay for negotiated bulk discounts with drug manufacturers, passed a portion of these savings on to their clients, and worked with retail locations—pharmacies— to ensure drugs could be widely available. Some PBMs, such as Express Scripts Inc. (Express Scripts), offered mail-order delivery for drugs. PBMs also processed and tracked drug claims.[10]

Wholesalers such as AmerisourceBergen Corporation, Cardinal Health Inc., and McKesson Corporation (McKesson) purchased drugs in bulk and distributed them—and other products—to pharmacy chains and independent drugstores.[11] Margins earned by each of the players in the pharmacy industry varied (see Exhibit 2).

Drugstore chains supplemented their sales of prescription and over-the-counter (OTC) drugs with other products including health and beauty care items, packaged food, and drinks. For a typical drugstore, about 53 per cent of revenues were from branded prescription drugs; 18.7 per cent from generic drugs; 5.1 per cent from OTC drugs; and 4.8 per cent from personal health supplies. The remaining revenues came from groceries, cosmetics, supplements, and other categories (see Exhibit 3).[12]

RITE AID

Thrift D Discount Center, founded in 1962 in Scranton, Pennsylvania, by Alex Grass, later became known as Rite Aid Corporation.[13] By the time Grass turned over the leadership of Rite Aid to his son, Martin Grass, Rite Aid was one of the largest drugstore chains in the United States. However, under Martin Grass's leadership, Rite Aid took on significant debt to fund acquisitions and corporate spending. In 2002, Rite Aid ran into trouble: Martin Grass and several other executives were charged and later convicted of accounting fraud.[14]

After several failed attempts to recover from high levels of debt and a lack of investor confidence, John Standley was appointed president of Rite Aid in 2008.[15] Between fiscal years 2010 and 2018, Standley made significant progress in helping Rite Aid to recover. Net income rose from a loss of $526 million to a net income of $943 million, long-term debt declined from $6.0 billion to $3.3 billion, and shareholders' equity increased from −$2.2 billion to $1.6 billion during these same eight years (see Exhibit 4).[16] After returning the business to profitability and lowering the total debt of Rite Aid, Standley began to look for a strategic partner to acquire the troubled drug retailer.[17]

In 2015, Walgreens agreed to buy Rite Aid for $17.2 billion.[18] However, nearly two years later, government regulators would approve only a $4.4 billion deal for 1,932 Rite Aid stores.[19] Then, in February 2018, Albertsons, one of the largest US grocery chains, agreed to merge with Rite Aid.[20] At the time of the announcement, Rite Aid had a market value of $2.3 billion.[21] However, six months later, the merger was called off due to a lack of shareholder support.[22]

Rite Aid's stores sold prescription drugs and a wide assortment of other merchandise, also known as front-end products. In fiscal 2018, prescription drug sales accounted for 65.9 per cent of total drugstore sales.[23] Rite Aid had a distribution agreement with McKesson to source and distribute branded and generic drugs. McKesson provided daily, direct-to-store delivery to Rite Aid stores. This agreement was set to expire at the end of March 2019.[24] In August 2018, the issue of scale in driving purchasing efficiencies was brought to the forefront; Rite Aid announced that drug purchasing efficiencies were expected to be $80 million lower than estimated.[25] Rite Aid, with 2,500 stores in the United States, had a smaller store footprint than its two larger rivals—CVS and Walgreens.[26] Brian Tanquilt, an analyst for Jefferies Group LLC (an American investment company), noted: "Rite Aid sold half its stores to Walgreens. When you do that, you have less purchasing power. It's really a reduction in purchasing scale."[27]

Supplementing Rite Aid's sales of prescription drugs was its line of front-end products in various categories. These included OTC medications and other products that customers would buy in a drugstore or a convenience store. Rite Aid sold health and beauty aids, personal care products, cosmetics, household products, food, and beverages. To capture a larger share of its customers' wallets, a growing number of Rite Aid stores had a broader range of health-related items. The average Rite Aid store was 13,600 square feet; 64 per cent of its store network had been remodelled into "Wellness Store" formats, which featured higher-end fixtures, a larger range of clinical pharmacy services, and wellness products. To build customer loyalty, Rite Aid had a "wellness+ rewards" loyalty program. The company also worked with partners to augment its offering: about 59 per cent of all Rite Aid stores had a GNC Holdings Inc. (a vitamin and mineral supplement retailer) store within its footprint.[28]

Aside from its Rite Aid branded stores, the company had a chain of 39 retail clinics named RediClinic LLC (RediClinic). Acquired in April 2014 and run as a subsidiary, RediClinic had certified health practitioners who could treat up to 30 common medical conditions and provide medical services such as screenings, tests, immunizations, and physical exams. RediClinic aimed to support a local network of physicians who were affiliated with a health care system in a particular market.[29]

In April 2014, Rite Aid purchased Health Dialog. This subsidiary provided supplementary health care coaching and disease management advice that health plans and employers could offer their members. These services, staffed by nurse practitioners, were accessible by plan members via telephone and a web interface.[30]

In February 2015, Rite Aid further expanded its services when it purchased Envision Pharmaceutical Services LLC (EnvisionRx), a full-service PBM, from TPG, a private equity firm, for $2 billion in cash and stock. At the time of its purchase, EnvisionRx had $5 billion in revenues.[31] EnvisionRX provided PBM services and had software that was licensed to other PBMs in the United States. The company offered mail, specialty, and other pharmacy services through its EnvisionPharmacies service. Through its insurance and national drug plan services, EnvisionRx was positioned to serve the fast-growing Medicare Part D market.[32]

EnvisionRX "covered about 500,000 lives."[33] In contrast, CVS Caremark's PBM had 20 million medical health plan members.[34] Observers characterized EnvisionRX as "a small, struggling regional PBM with limited growth. Its revenues in 2017 have been declining. There also appears to be no material synergies between Rite Aid's retail pharmacy business and its Envision PBM."[35]

RITE-AID'S NEW STAND-ALONE STRATEGY

In 2018, Rite Aid announced that it would focus on three key initiatives—expanding health care services, leveraging its PBM, and store remodels.[36]

Rite Aid wanted to expand the role of pharmacists to include delivering wellness services that went beyond filling prescriptions—such as the wellness services offered through Rite Aid's immunization programs. Another service for customers was OneTrip Refills, in 2017, which allowed patients to refill all of their monthly maintenance medications in a single trip to the pharmacy.[37] Rite Aid's wellness+ rewards was a loyalty program with 13 million customers. In 2018, over 60 per cent of transactions involved a wellness+ rewards card. As part of its efforts to offer a wider range of health clinic services through pharmacies, Rite Aid launched RediClinic facilities inside Rite Aid stores, offering health advice; care for minor illnesses such as coughs, colds, and flu; medical tests; and immunizations.[38] Rite Aid was also expanding Health Dialog's services to third-party payers and employers and providing automated wellness advice and medication therapy management.[39]