Nicotine Replacement Therapy

VAT reduction and sales of NRT

Report commissioned for ASH

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Executive Summary

The benefits of using nicotine replacement therapies (NRT) to aid stopping smoking successfully are widely accepted. However, the cost of quitting smoking may also be an issue for some consumers. In recognition of this, the Government reduced the rate of VAT on NRT products for one year from July 7th 2007.

This report analyses data from a variety of independent market research sources in order to examine the short term impact of this measure on the retail market for NRT. In addition to secondary research data, a small sample of retail outlets was surveyed and the results compared to a similar survey conducted 3 years previously.

NRT sales have been steadily increasing over the years, but the sales increase in mid 2007 was exceptional. However, there were many different factors influencing this, as smoke-free legislation was implemented in England amid much publicity at exactly the same time as the rate of VAT applied to NRT was reduced from 17.5% to 5%.

It seems clear that the VAT reduction was widely passed on to the consumer as reflected in lower everyday prices, not just in the form of periodic promotional activity.

However the data studied in this report cannot predict the price elasticity of NRT and the degree to which lower prices alone were responsible for the significant sales increase.

So while short term indications are all positive, a longer time period in which there are less unusual influences from the external environment (eg government legislation) is required in order to track underlying sales trends and to draw conclusions regarding the impact of lower pricing.

Contents

1. Background

The government has been committed to widening the take-up and accessibility of nicotine replacement therapy (NRT) since the Choosing Health White Paper in 2004. As part of this commitment, HM Treasury reduced the VAT on NRT products from 17.5 per cent to 5 per cent for a period of one year from 1 July 2007 “to encourage great use of this proven aid to successfully stopping smoking” (Lords Hansard).

With a 7-day course of nicotine patches costing around £15 (pre VAT reduction) the actual cost of quitting, although not cheap, appears significantly less than the £35 that the average 20-a-day smoker will spend over the course of a week. However in order to improve success rate it is now frequently recommended that quitters use a combination of products. One option for patients who have previously used nicotine replacement but still failed to stop smoking is to use the patch as well as another form of nicotine replacement, such as gum or lozenge. The patch provides background nicotine replacement and the gum deals with "breakthrough" urges. This can significantly increase the cost of quitting for some individuals.

Moreover, while many smokers may not consider the cost of their habit, seeing it as a necessary expenditure, they may view paying for nicotine replacement therapies (NRT) in a slightly different light. “Having made the decision to give up, many smokers may resent the fact that, if they decide to use NRT to help them with their attempt, they will not initially see the full financial benefits that they feel should be one of the major plus points to giving up. This may lead to a significantly lower proportion of attempts being made without the use of any NRT products than would otherwise be the case” (Mintel 2006)

The premise is that lower retail prices will encourage sales of NRT. The purpose of this report is to explore the impact that the reduction in VAT has had on retail pricing and the uptake of nicotine replacement products.

The report draws on information from the following sources:

- IRI : retail sales of NRT
- IMS: Xponent Micromarketer: NRT dispensed information
- Nielsen retail audit: retail pricing
- Mintel: Cigarettes and Smoking Cessation Aids-UK-April 2006
- In November 2004, a field survey was conducted in a small sample of retail outlets as part of a review of the NRT market commissioned by ASH. In December 2007, some of these stores were revisited, and prices and promotions were noted (see Appendix 1 and 2).

2. Review of market developments 2005-2006

In order to put 2007 in context, it is useful to examine the underlying trends in the market for nicotine replacement therapies prior to the introduction of smoke-free legislation and the reduction in VAT in 2007

a) The NRT Market

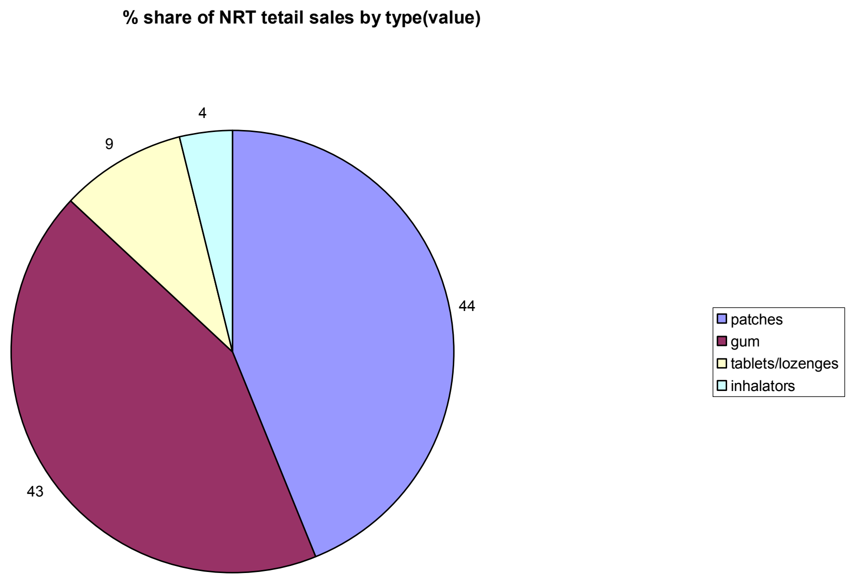
The NRT market is divided between over the counter (OTC) sales and NHS prescriptions. Most forms of NRT are available from retail outlets (general sales list (GSL) products) but others require the smoker to speak to a pharmacist (Pharmacy only (P) products).

In 2006, IRI Infoscan reported retail sales (OTC) worth £92.2m through Health and Beauty outlets, up 4.3% on 2005. IMS reported the value of NRT prescriptions at £54.3m (at wholesale prices) in 2006, giving a total market value of £146.5 m.

Within the OTC market, sales are split 60:40 between pharmacy outlets and grocery. Sales through the impulse channel are less than 1% of the market (IRI Infoscan)

The value figure given for prescriptions of nicotine replacement therapies excludes other tobacco dependence drugs such as Champix, which was introduced at the end of 2006.

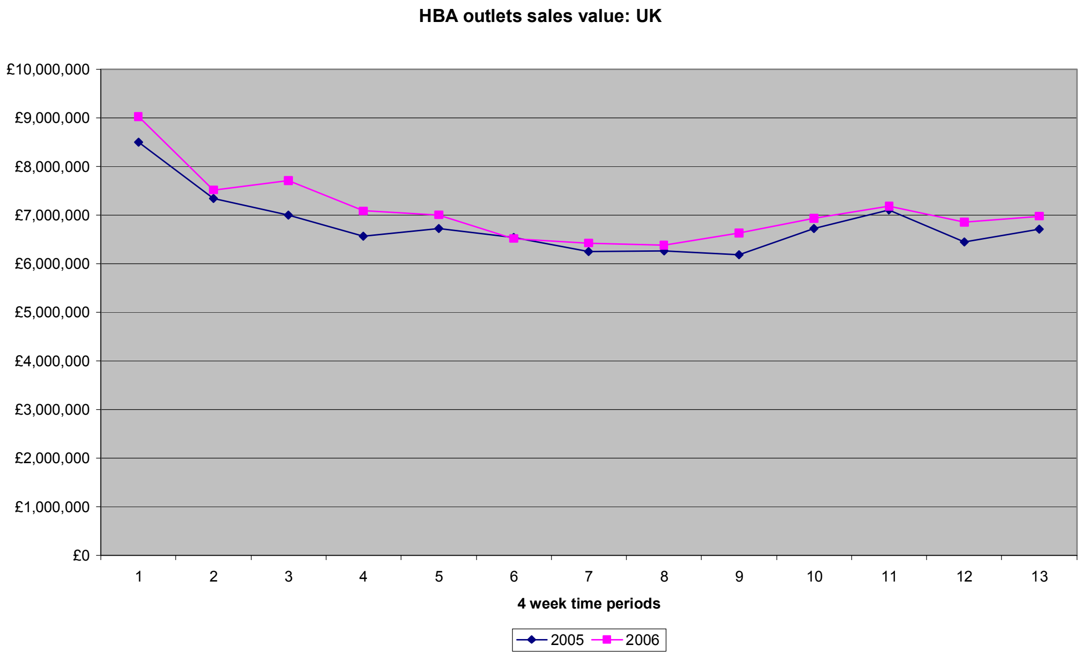
Patches and gum dominate sales of NRT accounting for 87% of retail sales in 2005 (Mintel), with sales of tablets and lozenges showing fast growth from a small base.



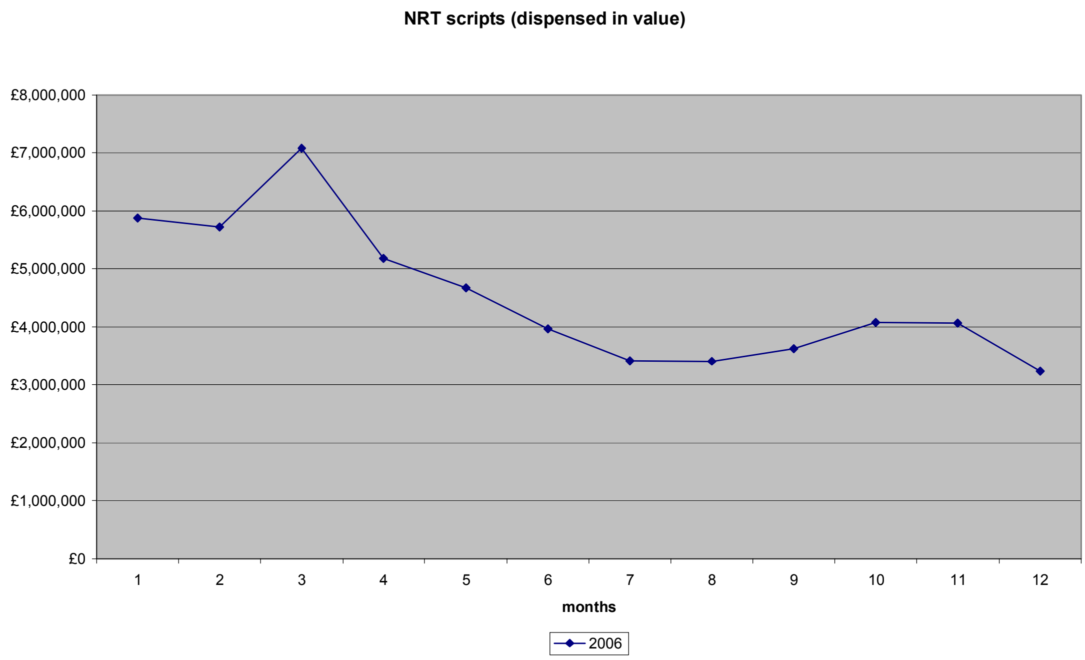
source: Mintel

b) Sales pattern

Sales of NRT typically peak at New Year and No Smoking Day in March, with prescriptions experiencing a more marked peak for No Smoking Day. (*Note that the IRI data shown below is reported in 13x4-week periods per year, while the IMS dispensed data is collected by calendar month*)



Source: IRI



Source: IMS Xponent Micromarketer

3. NRT in 2007

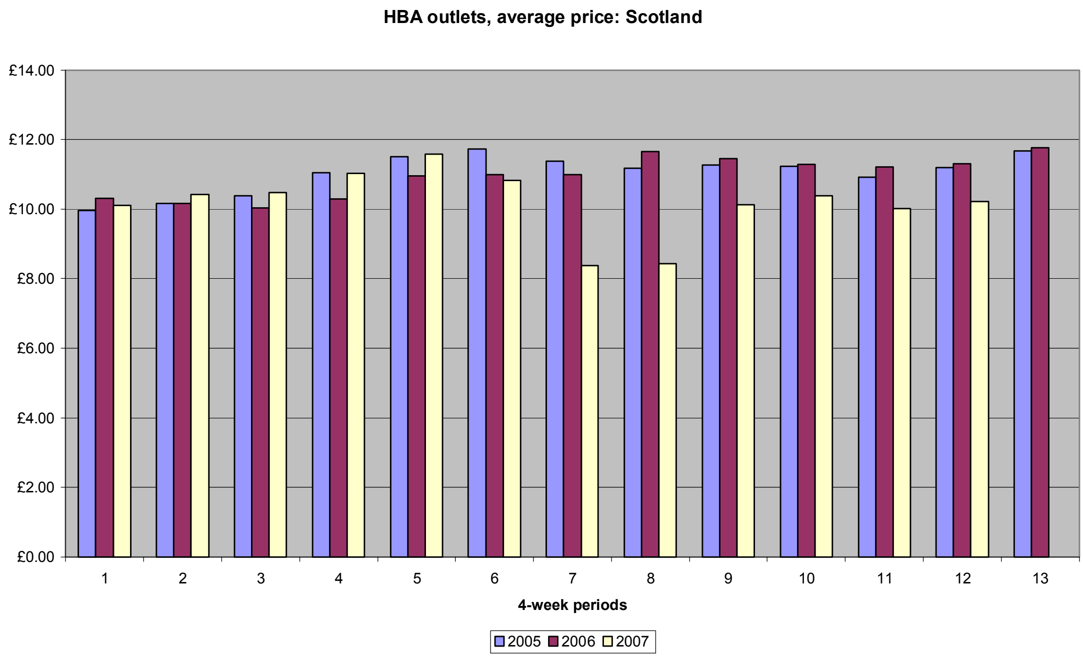
2007 saw two major events impacting the sales of NRT in the UK: the implementation of smoke-free legislation banning smoking in indoor work places on England, and the reduction in VAT from 17.5% to 5%, both of which took effect on July 1st 2007.

Scotland (March 2006) Northern Ireland and Wales (April 2007) already have smoke-free legislation in place.

Sales of NRT in Scotland account for around 9% of total UK retail sales (IRI). The impact of Scottish smoke-free legislation in 2006 seems to have been to increase Scotland's share of sales, but in 2007 the volume share has settled back to 2005 levels. However, while in 2005 the average price of NRT was lower in Scotland than in the rest of the UK (as value share was slightly lower than volume share), this is no longer the case. This suggests that either NRT used to be cheaper per unit in Scotland than the rest of the UK, or consumer units purchased were smaller, but it is now in line with the rest of the UK.

Scotland as % UK sales	Volume (Units)	Value (£)
2005	8.7%	8.4%
2006	9.9%	9.4%
2007	8.8%	8.8%

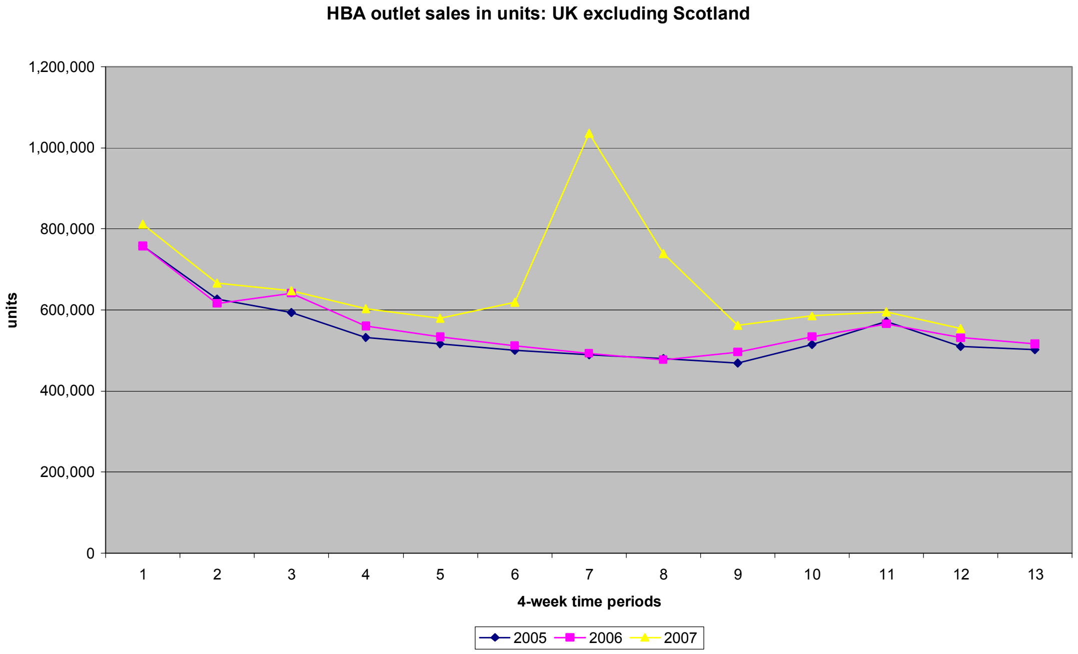
Average prices showed some reduction reflecting the smoke-free legislation in March 2006, but even more so when English smoke-free legislation plus VAT reduction were introduced in July 2007.



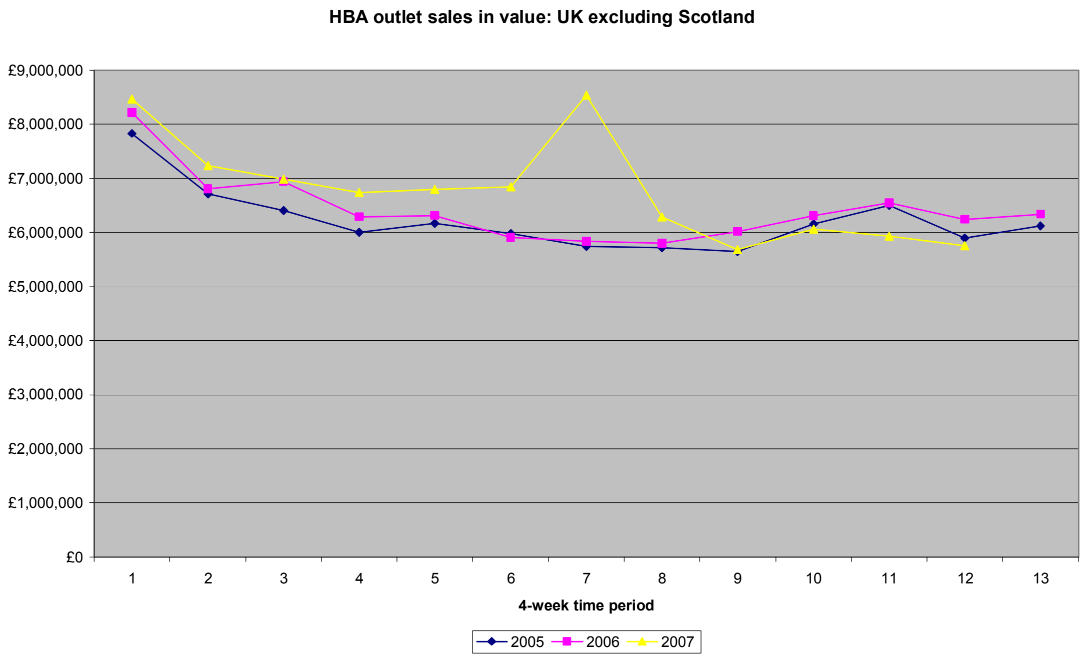
Source: IRI

a) Retail sales in the UK, excluding Scotland

Retail sales of NRT hit an all-time high in July 2007 (IRI). This was at a time of intense promotional activity and discounting around the introduction of smoking legislation. Unit sales (i.e. the number of packs purchased by consumers) have remained ahead of previous years, though data for the final period of 2007 is not yet available.

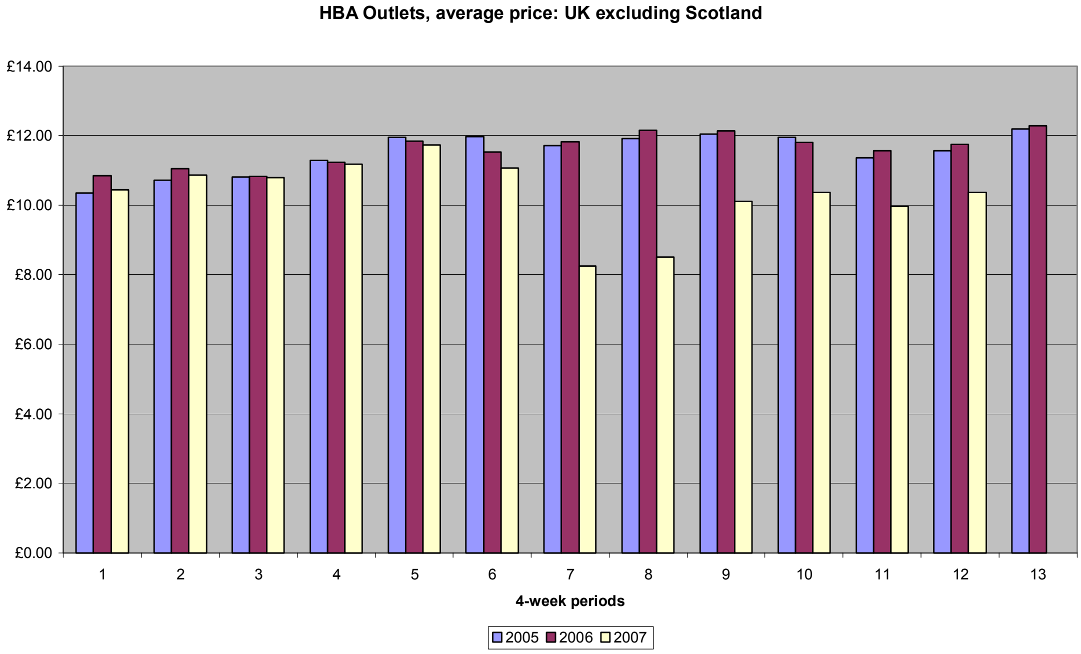


Source: IRI.



Source: IRI

While unit sales are ahead of previous years, the value of those sales is lower due to a decline in average price. After a drop of some 30% in average price in July, in November 2007 average price remained 13.8% below the same period in 2006.



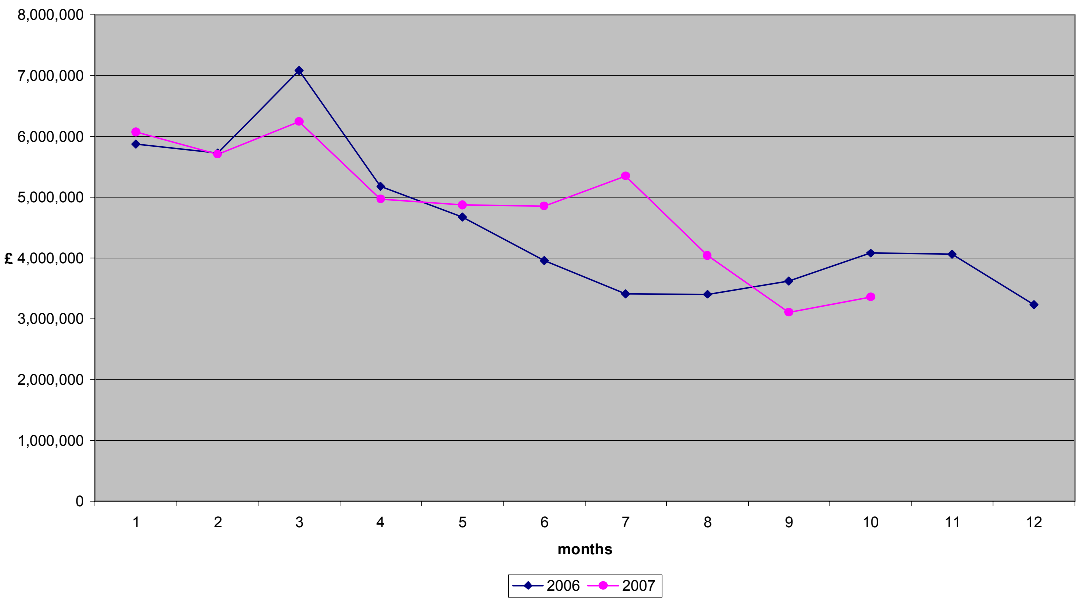
Source: IRI

This data covers all NRT products and pack sizes. Since November 2004, new pack sizes and new products had been introduced: for example small packs of 12 pieces of gum, big packs of 204/210 pieces of gum, and Asda’s lozenges. Small pack sizes and retailer own-label will tend to depress average price per consumer unit, larger pack sizes have the opposite effect. So the change in average price will be influenced to some extent by the “mix” effect.

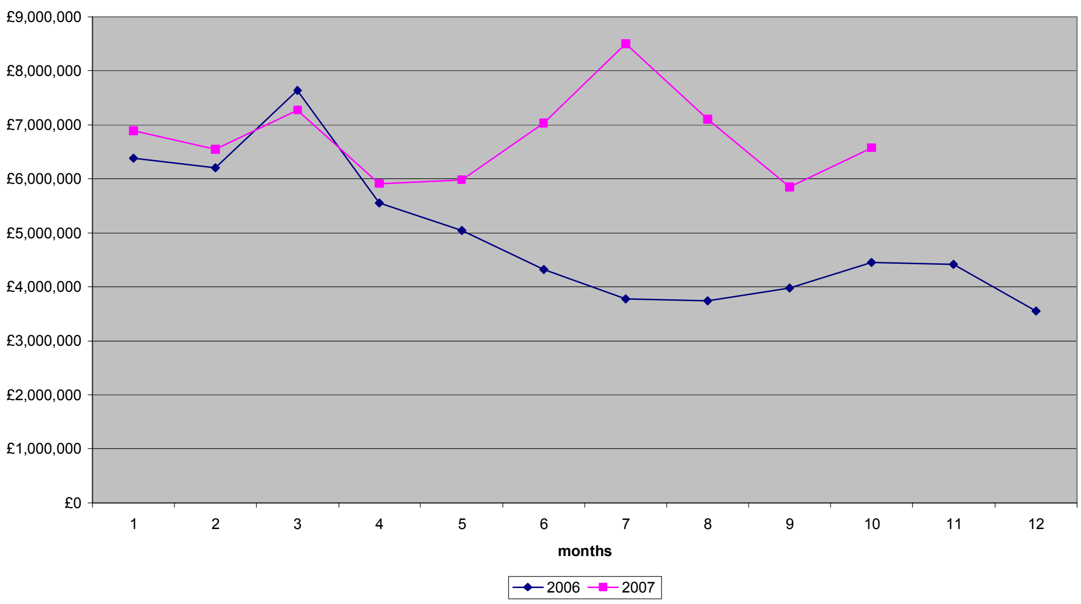
b) Dispense/prescriptions

As noted for retail, uptake of NRT on prescription increased in July 2007 but interestingly, not to the levels of No Smoking Day in either 2006 or 2007. The explanation for this probably lies in the increasing consumer-led demand for Champix. Champix (varenicline) tablets work by reducing craving for a cigarette and by reducing the effects felt if you do have a cigarette. Like Zyban (bupropion) Chamix is only available on prescription, and is not a nicotine replacement therapy.

Total scripts (dispensed in value): NRT



Total scripts (dispensed in value): Total Tobacco Dependence including Champix & Zyban



Source: IMS

c) Retail prices

Smoke-free legislation introduced an additional promotional period that had not occurred in previous years and for some retailers the promotional period started in June. Promotional discount activity varies by individual retailer but tends to follow a similar pattern. The major retailers run promotional discounts based on their own promotional calendars and so not all brand promotions occur at exactly the same time or for the same duration.

While this combination of factors makes it difficult to isolate the impact on consumer pricing of the VAT reduction, analysis of Nielsen unit price data can provide an indication of the trends in consumer pricing by product and pack type.

Nielsen's audit database covers the Multiple Grocery channel, Pharmacies and the Impulse sector (including co-ops, independent and symbol grocers, garage forecourts, off licences, WH Smith, Woolworths etc). These 3 channels combined represent the total OTC market for Great Britain.

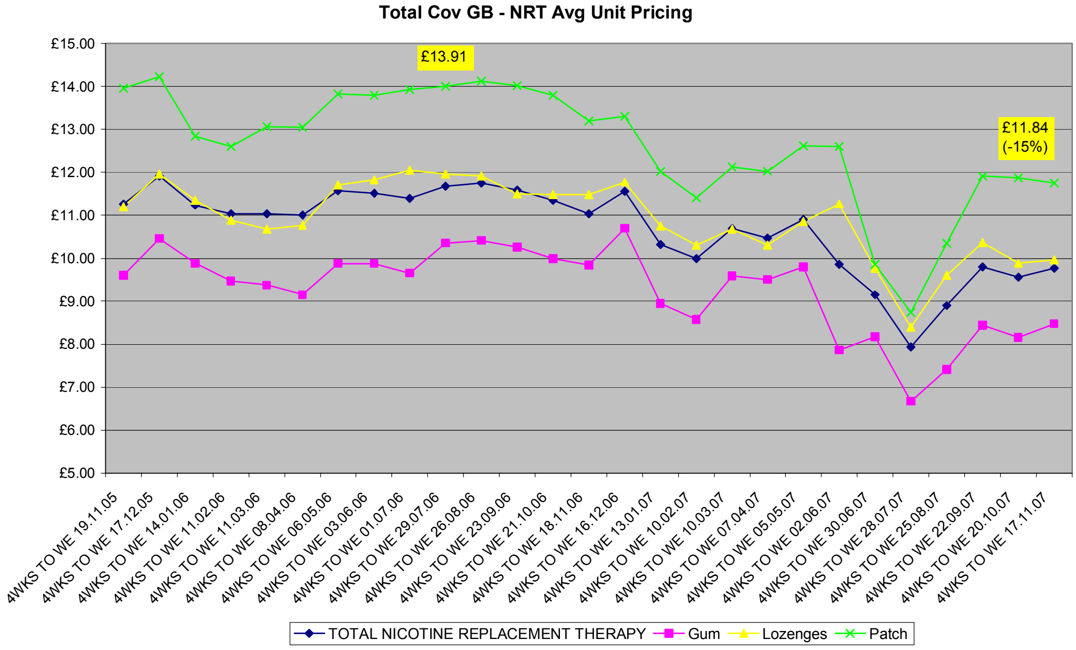
As seen previously, patches are the most commonly used NRT format. A comparison of the average unit price for patches for the quarter to July 2006 (when little promotional activity was being undertaken) with the quarter to November 2007 (when the Smoke Free promotional activity had stopped) gives an indication of the evolution of NRT consumer prices. This comparison shows that

- For the total OTC market, the average price of patches was reduced by 15%
- For the Pharmacy channel, average price was reduced by 18%
- For the Multiple grocer channel, average price was reduced by 12%

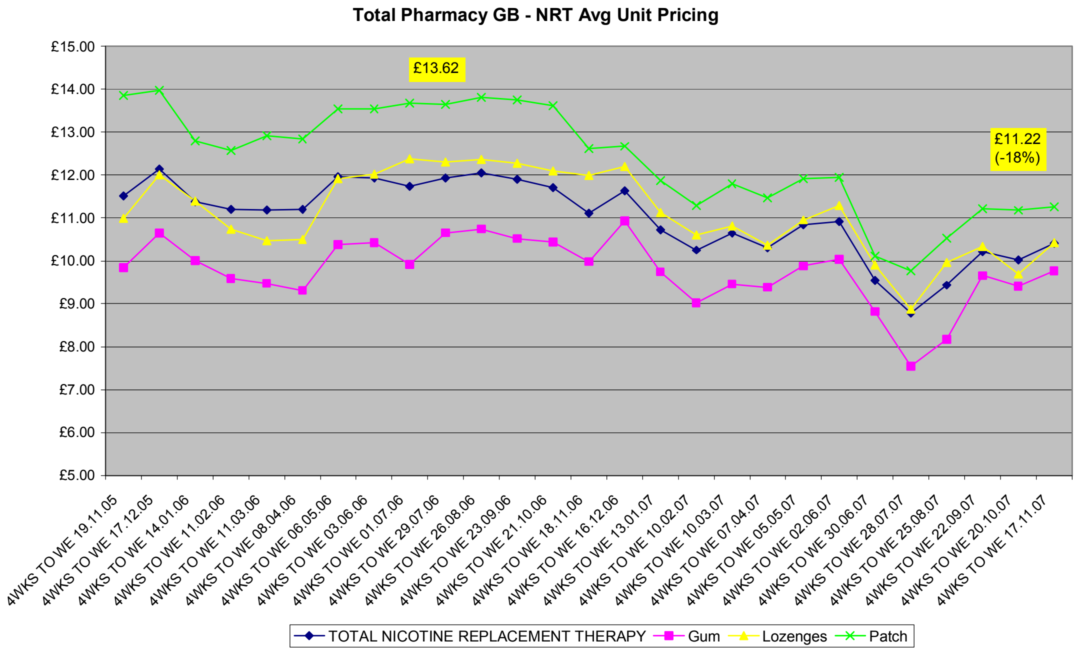
In each case this is in excess of the 10.6% reduction attributable to the lower rate of VAT*

** A product costing £1 would retail at £1.175 at the old rate of VAT, and £1.05 at the new rate. The difference between these prices, expressed as a discount from the old rate, is (1.175-1.05)/1.05 = 10.6%*

NRT in 2007

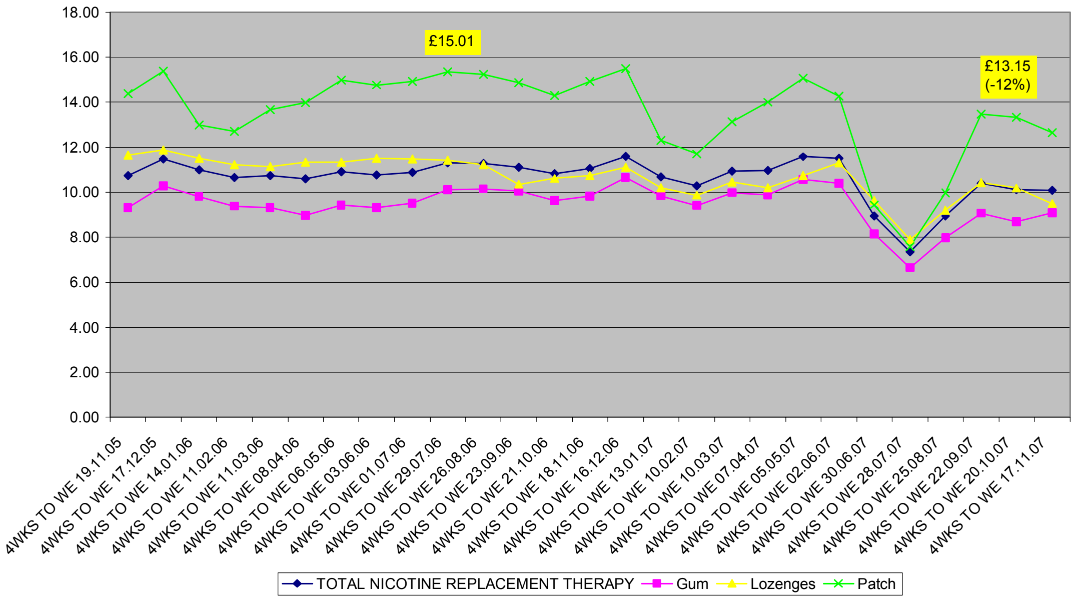


Source: Nielsen



Source: Nielsen

Total Grocery GB - Ave NRT Unit Pricing



At the total OTC market level, all formats have experienced a price decline in excess of 10.6%. However, for gum in both Pharmacy and Grocery channels, the quarterly average price to November 2007 price is higher than the "calculated price" (price less the VAT reduction)

		Qtrly ave unit price July 2006	Calculated unit price at lower VAT rate	Qutrly ave unit price Nov 2007	Discou nt
		VAT @17.5%	VAT @5%	VAT @5%	
Total GB covered	Total NRT	11.53	10.30	9.71	-16%
	Gum	9.96	8.90	8.35	-16%
	Lozenge	11.94	10.67	10.07	-16%
	patch	13.91	12.43	11.84	-15%
Total Pharmacy	Total NRT	11.86	10.60	10.21	-14%
	Gum	10.33	9.23	9.61	-7%
	Lozenge	12.23	10.93	10.15	-17%
	patch	13.62	12.17	11.22	-18%
Grocery multiples	Total NRT	10.98	9.82	10.20	-7%
	Gum	9.64	8.62	8.94	-7%
	Lozenge	11.47	10.25	10.04	-12%
	patch	15.01	13.42	13.15	-12%

Note that in the Impulse channel, gum prices dropped by 58% over this period, driven mainly by the introduction of smaller packs (Nicorette 10-pack). So while the Impulse sector only accounts for 1.9% of NRT gum sales in the latest year, it brought the total GB average price for the format to -16%.

The lower discount than expected in Pharmacy and Multiple Grocers may reflect some gum-specific promotions during summer 2006. In our field survey, a comparison of December gum prices in individual stores with 3 years ago indicates that with a few exceptions, the price has been reduced by at least the 10.6% expected from the impact of VAT:

(2007 promoted prices highlighted in red)

Pharmacy

Gum 2mg	pieces	*Boots Oxford 2004*	*Boots Cowley 2007*	*%change*	*Lloyds Pharmacy 2004*	*Lloyds Pharmacy 2007*	*% change*
Nicotinell	12						
	24	5.29	5.79	9.5%			
	96	14.49	11.65	-19.6%			
	204						
Niquitin CQ	24	5.69				4.46	
	96	14.99			14.99	13.4	-10.6%
Nicorette	10		2.49				
	30	5.69	5.14	-9.7%			
	105	15.59	13.99	-10.3%	15.59	15.99	2.6%
	210		22.33				
NicAssist	30		4.46				
	105	13.99	10.99	-21.4%			
4mg							
Nicotinell	24	5.79	5.79	0.0%			
	96	17.99	12.99	-27.8%	17.99		
Niquitin CQ	24	5.69				4.46	
	36					13.4	
	96	14.99	13.40	-10.6%			
Nicorette	30	6.99	6.25	-10.6%	6.99		
	105	18.99	16.97	-10.6%	18.99	15.99	-15.8%
	210		26.80				
NicAssist	30	5.69	4.79	-15.8%			
	105	15.99	10.99	-31.3%			

Source: Field Survey Nov 2004/Dec 2007

Multiple grocers

Gum 2mg	p'ces	*Tesco Cowley 2004*	*Tesco Cowley 2007*	*% change*	*Asda High Wyc 2004*	*Asda High Wyc 2007*	*% change*	*JS Oxford 2004*	*JS Oxford 2007*	*% change*
Nicotinell	12		2.99							
	24		3.79		4.48	3.50	*-21.9%*	4.75		
	96				9.94	8.98	*-9.7%*		8.99	
	204					19.00				
Niquitin CQ	24				4.12	2.98	*-27.7%*			
	96				12.32	9.98	*-19.0%*	14.99	13.40	-10.6%
Nicorette	10								2.23	
	30	4.23	5.08	20.1%		6.00		5.69	5.08	-10.7%
	105	15.59	13	-16.6%		13.00		15.59	13.00	-16.6%
	210								23.23	
NicAssist	30									
	105									
4mg Nicotinell	24				4.88			5.20		
	96				12.38	10.98	*-11.3%*		10.99	
Niquitin CQ	24					2.98		4.99		
	36		6.19							
	96				12.32	9.98	*-19.0%*	14.99	13.40	-10.6%
Nicorette	30		6.24		5.48					
	105	18.99	16.96	-10.7%		16.16		18.99		
	210								28.59	

Source: Field Survey Nov 2004/Dec 2007

4. Observations from field visit

As the market grows and evolves, both brand manufacturers and retailers are finding new ways to improve their competitive position. A number of dynamics influence the way the NRT market is developing, which complicate the interpretation of top-line data.

- Retailer strategy. Different retailers have different strategies which influence their approach to all products including NRT.
    - Pricing strategy: consumer prices cannot be dictated to retailers as this would constitute price fixing. While on average the VAT reduction has been passed on to consumers, the reduction in price is not uniform across packs as retailers choose to focus resources on their key objectives.
    - The multiple grocers (Asda, Tesco, Sainsbury) are not only concerned about price position versus their competitor retailers, but also about trading customers up to larger pack sizes to improve profitability. Promotional activity and deep price discounts are concentrated on key strategic SKU's (stock keeping units).
    - Pharmacy outlets such as Boots are concerned about value for money but also adding value through services to gain loyal customers.

- New pack sizes. For example:
    - Previously Nicorette's gum range was almost exclusively 30's in the Impulse channel but they have now launched 10s into this trade sector. This has increased their sales within this sector but brought down the average price.
    - At the other end of the scale, we see the introduction of larger sizes, eg Nicorette gum in packs of 210. A trend towards larger pack sizes increases the average price.
    - Pack innovations respond to new and different consumer needs and behaviours. For example, the introduction of smoke-free legislation may increase the demand for a "nicotine fix" bought on impulse, to cope with that long meeting at work or social night out in the pub when smokers need a nicotine boost to help them through. On the other hand, those who are committed to a long term course of NRT will appreciate the price advantage of buying in bilk as a planned purchase with the weekly shop.

- New products and brands. For example:
    - The NRT market has reached sufficient size and growth rate to attract the interest of retailers. Boots' brand has now been joined by Asda's range of sugar-free lozenges, with Tesco believed to be about to enter the market. Competition from retailer own labels will put increasing pressure on branded manufacturers' prices.

While top-line data on sales by unit and value is useful for charting overall trends, an analysis of detailed data (by trade channel, product and pack) is required to gain an understanding of the dynamics of the evolving NRT market.

Conclusions

2007 was a buoyant year for NRT, with sales peaking in July coinciding with the implementation of smoke-free legislation and a reduction in the rate of VAT levied on OTC products. Following this abnormal peak (compared with the normal sales pattern for smoking cessation products) unit sales are still running ahead of previous years. This probably indicates an underlying increase in uptake; however it is still early days.

There is a lot of evidence to show that the average price that consumers pay for nicotine replacement therapies over the counter has fallen, and in most instances the level of discount is higher than that which can be directly attributed to the reduction in VAT from 17.5% to 5%.

In addition to data from Nielsen database, we have the evidence from a small sample of stores to suggest that the reduction in VAT was passed on to the consumer in 2007 and has resulted in lower everyday prices.

However it is not possible to draw firm conclusions on the direct impact this price reduction had on volume sales, as a number of other factors influenced sales. Crucially, the intense promotional activity and publicity over the smoke-free legislation made 2007 an unusual year, and it is too early to tell if the legislation itself will result in higher sales of NRT in the longer term.

To gain an understanding of the price sensitivity of NRT, it would be necessary to carry out further research, either by tracking sales over a longer period of time or in a controlled test where the impact of different factors can be estimated.

References

IRI Infoscan data: provided by J&J

IMS Xponent Micromarketer data: provided by J&J

Lords Hansard text for 18 July 2007.
http://www.publications.parliament.uk/pa/ld200607/ldhansrd/text/70718w0004.htm

Mintel. Cigarettes and Smoking Cessation Aids-UK. April 2006

Nielsen audit data: provided by GSK

Field Survey: retail prices and promotion

A comparison of prices by pack and by format can be found in appendix 2. Comments on promotions and merchandising found in December 2007 are below.

Boots

- Some items (Nicquitin 2mg lozenges and Nicorette 2mg microtabs) marked "lower price" and compared to the price at July 3rd 2007. This corresponds to a 6-month promotional sales plan running from August to December
- The larger packs of Nicorette gum are part of the Boots Healthclub offer. So "pay ½ marked price every time you shop when you join the Boots Health Club"
- Pharmacy items microtabs and inhalators are displayed on open shelves (but with security device so have to pay at pharmacy). Nasal spray in pharmacy area.

Lloyds

- Save £4 on Nicotinell 14-day patches, while stocks last (period 9 of their promotional plan, finishing Dec 27th)

Tesco

- Merchandising policy has changed since 2004, when NRT was behind the counter in the cigarette kiosk. This changed "when we did the refit". A limited range of NRT is now on open shelf, at eye level next to cough and cold remedies.
- According to media reports, Tesco is preparing to launch a range of own-label nicotine replacement therapies. It has registered Quit-Aid and is believed to be phasing in a range of gums, nasal sprays, tablets and lozenges and inhalers under the brand name. Launch was anticipated in 2007.

Asda

- Own label sugar-free Asda Nicotine lozenges
- "Roll back" promotional prices on own label, Nicotinell and Niquitin lozenges
- Product on shelf is in security bags, and stocks seemed low on shelf, due to problem with theft.
- This store also has a pharmacy: prices not always consistent between open shelves and pharmacy as stock comes from different sources. Pharmacy stock from AAH wholesaler, open shelf stock from Asda central warehouse

J.Sainsbury

- Product on open shelves. But much is security protected. Sign says "Please ask the colleague at the checkout to remove the security device". And "To maintain great prices, this product has been protected with a security device".
- Security packaging is supplied by manufacturers at the request of retailers.