The impact of the COVID-19 pandemic on the U.S. retail pharmacy industry: A case of CVS Health

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Abstract. Since the new coronavirus swept through the United States in 2020, a wide range of industries have been hit to varying degrees. The COVID-19 pandemic has had a number of implications for the retail pharmacy sector: Politically, the enactment of the stay-at-home Orders and the COVID-19 related acts have reduced the foot traffic in pharmacies; Economically, the pandemic led to a major business shutdown, causing unemployment to peak and GDP to fall into negative growth, which led to a reduction in commercial membership in the health insurance business and an increase in Medicaid numbers for government programs; Socially, the epidemic has made people more aware of insurance and has changed consumption patterns and care patterns; Technologically, telemedicine became the main form of care during the pandemic, with pharmacies such as CVS Health increasing their investment in this area. This paper analyzed the financial indicators of CVS Health and found that the company's profits generally showed an increasing trend during the pandemic period and were not significantly negatively impacted. By analyzing the strategy of CVS Health, this paper suggested that other pharmacies should be sustainable in the post-pandemic era through efforts to actively transform and diversify their businesses, increase investment in telemedicine and actively develop ESG strategies.

Keywords: COVID-19; Retail pharmacy industry; PEST analysis; Financial indicators analysis; Telehealth; ESG strategy

1. Introduction

Since 21 January 2020, when the first indigenous case of COVID-19 was announced in the United States, the cumulative number of confirmed COVID-19 cases in the United States has risen to number one in the world in a short period of time (BBC, 2020). The pandemic has not only put people's health at risk, but also disrupted daily life. The fight against the New Coronavirus was a top priority for all countries and industries were forced to stop work and production, and the US economy was at a standstill. The retail pharmacy sector played an extremely important role in the fight against the New Coronavirus, as it was negatively affected like any other sector, but also benefited from its specific involvement in the fight against the pandemic, and it can be said that the impact of the pandemic on the sector was two-sided. CVS Health, the nation's largest pharmacy, has managed to grow steadily during the pandemic without much negative impact from the pandemic, and its approach to the pandemic and growth strategy is worthy of reference for other companies in the industry.

This paper will analyse the impact of the COVID-19 pandemic on the US retail pharmacy industry and the industry's outlook in the post-pandemic era, using the PEST model and financial indicators, with CVS Health as the subject of the study.

2. PEST analysis

This section focuses on analysing the macro impact of COVID-19 on CVS Health through the PEST model in four areas: political, economic, social, and technological.

2.1 Political factors

Enactment of the COVID-19 Stay-at-Home Orders

Influenced by the rapid spread of new coronavirus, a world public health crisis, since March 2020, states in the US have enacted stay at home orders to promote working from home (Hunter et al., 2020). Not only did the decree drastically reduce customer traffic to CVS’s pharmacies and affect sales revenue, but labour shortages also brought pharmacies operations to a standstill for a while. According to the decree, non-essential care and procedures were delayed or even cancelled, which prevented companies such as CVS from implementing clinical initiatives to follow up on their clients' illnesses in a timely manner and manage the risk of health insurance claims, which undoubtedly increased the cost of claims. Enactment of COVID-19 Related Acts

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The legislative and regulatory environment for the retail pharmacy sector is dynamic and frequently changing due to the sector's relevance to livelihood and public health issues. In response to the challenges posed by the COVID-19 pandemic, the United States enacted the CARES Act and the American Rescue Plan Act in 2020 and 2021, respectively (Haagensen, 2022). The Acts require companies with health insurance, such as CVS, to expand the coverage of health insurance benefits and require these companies to provide more medical services related to COVID-19 (United States Securities and Exchange Commission, 2020). Although the Acts provide financial assistance to health care providers, these funds may not fully cover the high costs incurred in the provision of services. The Acts also requires companies with health insurance to be lenient in paying premiums to customers and to pay employees and suppliers as soon as possible, which may result in companies not having sufficient cash flow to meet the challenges posed by COVID-19.

2.2 Economic factors
GDP contraction
To control the spread of COVID-19 pandemic, the government forced businesses to shut down production, leading to a struggling economy and a 3.5% contraction in US GDP in 2020 (Crutsinger, 2021). CVS' clients have had to cut costs by choosing to reduce or stop offering benefits such as health insurance to their employees to weather the economic crisis, which has resulted in 848,000 fewer commercial members in the company's health insurance business year-on-year in 2019 (United States Securities and Exchange Commission, 2020). Unemployment rate reaches record high
The government's responses to the COVID-19 pandemic has hit service industries such as restaurants and airlines hard, creating a large number of unemployed people, with the US unemployment rate reaching an all-time high of 14.7% in April 2020 (U.S. Bureau of Labor Statistics, 2020). The large number of unemployed people falling into poverty and enrolling in Medicaid plan, the federal health insurance plan for low-income groups with health insurance companies, has led to a significant increase in the number of insured members of the companies that have this plan.

2.3 Social factors
Increased awareness of health insurance among the public
The COVID-19 pandemic has exposed gaps in health coverage and made people more aware of the importance of having health insurance, and is an opportunity for pharmacies that have health insurance. During the pandemic, it was found that health insurance could play a very limited role in risk protection and financial compensation. The underwriting capacity of the health insurance division is challenged by the need for the company to introduce more comprehensive and detailed insurance products that seek to cover a wider range of people.
Shifts in consumer preferences
During the pandemic, people stop working and are isolated at home, giving rise to a new economic form - the "stay-at-home economy". Consumers are now more inclined to avoid the crowds and opt for online shopping, which has led to a significant reduction in traffic to CVS's pharmacies.
CVS decided to address this problem by launching a strong online presence to help customers get their medicines delivered to their homes by post, as well as actively undertaking COVID-19 diagnostic tests and vaccinations for the population. As of December 31, 2021, CVS had performed more than 32 million New Coronavirus tests, more than 59 million New Coronavirus vaccines and sold more than 22 million OTC test kits (United States Securities and Exchange Commission, 2021). Moreover, vaccination customers will also tend to choose to shop at CVS retail shops, and these businesses compensate to some extent for the lack of traffic in the pharmacy's traditional business.
Transformation of the care model
The high cost of health care and poor quality of care has been a long-standing backlog in the US health care system. To address this, CMS has been working to transition the healthcare payment system from the traditional FFS (fee-for-service) to value-based care. FFS is based on how much service is provided to determine the fee, but organisations driven by profit to provide care in such a model may add unnecessary procedures to overcharge, leading to inefficient and ineffective care. Value-based care, on the other hand, is outcome-oriented and improves the patient's experience of care to a greater extent.
COVID-19 pandemic accelerates this transition even more, with CMS issuing guidance in September 2020 for states to implement value-based care in their health systems and to provide incentives to organizations that provide value-based care (CMS, 2020). The shift in care models is both an opportunity and a challenge for pharmacies such as CVS.

2.4 Technical factors:
Telehealth promotion
Following the pandemic, most companies have had to face a transition from traditional to remote working and the frequency of digital offices has increased dramatically. Drug retail companies such as CVS need to solve not only the problem of digital offices, but also the challenges of asking for advice online, tracking and monitoring customer health data, and accurately predicting insurance claims. The inability to see patients offline made telemedicine the main form of care, and during the pandemic, 30% of visits were provided by telemedicine (Amato, 2021). As a result, pharmacies such as CVS have invested heavily in IT to capture the telehealth market.
3. Financial Indicators Analysis

3.1 Profitability analysis

3.1.1 Total revenue and revenue growth

As of December 31, 2021, CVS Health has four divisions, Healthcare, pharmacies services, Retail Stores and Corporate Business. As shown in Table 1, CVS’ total revenue growth rate is 31.96% in 2019, 4.65% in 2020 and 8.71% in 2021. Such an outstanding growth rate for CVS in 2019 is due to the company’s acquisition and integration of Aetna, adding a new business - healthcare services. Revenue growth in 2020 will be driven primarily by a combination of growth in the healthcare and retail sectors. Revenue growth in the healthcare sector is driven by an increase in the number of government Medicare and Medicaid plan members, partially offset by a decrease in commercial membership. Revenue growth in the Retail segment was driven by the addition of the COVID-19 diagnostic test business to the Company. Further growth in total revenue in 2021 compared to 2020 is also driven by inflation in branded drug prices and the addition of the COVID-19 vaccination business in the retail segment. Sales of vaccinations, diagnostic tests and OTC test kits contributed approximately 45% of the division’s revenue growth compared to the previous year.

3.1.2 Gross profit margin

As can be seen from Table 2, from 2019-2021, the gross profit margin of CVS is basically maintained at around 18%, indicating that the company has good control over the cost of sales. The impact of the epidemic in 2020 resulted in the postponement or cancellation of the majority of care, which reduced the cost of claims in the healthcare sector, as shown in Table 3.

The medical cost ratio is calculated as the cost of claims divided by premium income and represents the percentage of premium income spent on medical claims for the company’s insured persons. The medical cost ratio reflects both the company’s ability to control claims costs and the effectiveness of the company’s use of premiums to enhance the quality of client care. Claims costs decreased in 2020 due to delays or cancellations of medical services, but in 2020-2021 the Company added COVID-19 diagnostic testing and vaccination business to its retail division, however, under the Act, the new business did not increase premium revenue for the corresponding business, so claims costs increased again in 2021.

3.1.3 Operating profit margin

As can be seen from Table 4, the operating margin of CVS shows a trend of increasing and then decreasing from 2019 to 2021, but the overall fluctuation is not significant, indicating that the Company has good control over its operating costs.
The rise in operating profit margin in 2020 was driven by a reduction in medical claims expenses, in addition to the fact that the company has good operating capacity. The company experienced a labour shortage in the early part of 2020 due to the epidemic, but management responded proactively by quickly moving the business online and rewarding staff with allowances so that the company could operate normally.

The decline in operating margin in 2021 is related to the company’s strategic transformation plan in addition to being driven by increased claims costs and COVID-19 expenses. A strategic review of the company’s retail operations by management beginning in 2021, with plans to close approximately 900 retail shops over the next three years, resulted in a shop impairment charge of $1.4 billion and a goodwill impairment charge of $431 million in 2021 (United States Securities and Exchange Commission, 2021).

### 3.1.4 Net profit margin

![Net profit margin graph](image)

**Table 5: Net profit margin**

CVS’s net profit margin shows a flat growth trend for 2019-2021, indicating that the company's interest and tax expenses are well managed. The company has been reducing its interest expense for the last three years as it has been actively repaying its debt, but lost an additional US$1.44 billion in 2020 due to early repayment of debt.

### 3.2 Liquidity analysis

![Liquidity ratios graph](image)

**Table 6: Liquidity ratios**

As can be seen from the two tables above, days sales outstanding increase slightly in 2020-2021 due to the company’s grace period for customers to submit premiums in accordance with the requirements of the newly enacted CARES Act and the American Rescue Plan (ARP). The remaining three indicators have fluctuated less over the three-year period, indicating that CVS is operating at a better capacity.

### 3.3 Operating capacity analysis

In 2019-2021, CVS’ current ratio is trending downwards, indicating that the company's current assets are slow to realise, and its short-term debt repayment capacity is weak. This was due to an increase in the company's current liabilities for pharmacy claims payable during the epidemic and an increase in accrued expenses as the CARES Act allowed the company to defer tax payments. CVS's quick ratio has remained largely unchanged over the past three years, but is below the industry average of 0.71, indicating that the company is illiquid. CVS issued $4 billion of unsecured senior notes in March 2020 to maintain its liquidity in response to the uncertainty posed by COVID-19 to the industry (United States Securities and Exchange Commission, 2020).
3.4 Solvency analysis

Table 9: Debt and solvency ratios

<table>
<thead>
<tr>
<th>Year</th>
<th>Debt to asset ratio</th>
<th>Interest coverage ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>0.71</td>
<td>4.03</td>
</tr>
<tr>
<td>2020</td>
<td>0.70</td>
<td>4.75</td>
</tr>
<tr>
<td>2021</td>
<td>0.68</td>
<td>5.99</td>
</tr>
</tbody>
</table>

CVS took on significant debt and interest costs because of the acquisition of Aetna in 2018 and management decided to pay off the debt early each year thereafter in order to improve the balance sheet by reducing leverage. As seen in Table 9, CVS' debt ratio shows a downward trend, and the interest coverage ratio shows a significant upward trend from 2019-2021. This indicates that its management has made the right decisions and that the company's long-term debt servicing capacity has increased.

3.5 Return on Equity

Table 10: ROE

<table>
<thead>
<tr>
<th>Year</th>
<th>ROE</th>
<th>Net profit margin</th>
<th>Asset turnover</th>
<th>Equity multiplier</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>10.36%</td>
<td>2.50%</td>
<td>1.23</td>
<td>3.47</td>
</tr>
<tr>
<td>2020</td>
<td>10.35%</td>
<td>2.67%</td>
<td>1.19</td>
<td>3.31</td>
</tr>
<tr>
<td>2021</td>
<td>10.54%</td>
<td>2.74%</td>
<td>1.26</td>
<td>3.09</td>
</tr>
</tbody>
</table>

ROE is one of the key indicators of a company's profitability and is the most important indicator for investors. To better analyse ROE, this paper will use the DuPont analysis. In the DuPont analysis, the indicator of return on equity is broken down into three components, namely net profit margin, asset turnover and equity multiplier. As can be seen from Table 10, CVS' ROE remains largely unchanged from 2019-2021. This indicates that the company's overall profitability has been relatively stable and little affected by the outbreak, thanks to its good operating capacity and the fact that it has been actively servicing its debt in order to reduce its leverage.

4. Conclusions and outlook for the post-pandemic era

4.1 Conclusions

4.1.1 Conclusions from PEST analysis

This paper uses the PEST model to conclude that the impact of COVID-19 on the retail pharmacy industry is in the following areas.

- **Political factors**
  In response to COVID-19, the US government enacted the CARES Act and the American Rescue Plan, both of which would increase the cost to pharmacies of fulfilling their obligations under the Acts, such as claims costs.

- **Economic factors**
  The US GDP went into negative growth during the pandemic, resulting in companies being unable to afford health insurance for their employees and a consequent reduction in the number of commercial members of pharmacies who have health insurance. However, a large influx of unemployed people into the pharmacies' Medicaid plan made up for the loss of income.

- **Social factors**
  COVID-19 has led to a shift in care patterns and consumption preferences, as well as increased awareness of health insurance among the population. These changes are important for pharmacies and if they can seize the opportunity to make a positive shift, the company can achieve new growth.

- **Technological factors**
  COVID-19 accelerated the integration of IT and various sectors, and for pharmacies, telehealth was a new area of development spawned during the pandemic.

4.1.2 Conclusions from the analysis of financial indicators

Combining PEST analysis and financial metrics, it is easy to see that in 2019-2021, CVS' margins have not been greatly affected by the impact of the COVID-19, both in terms of net profit margin and ROE, which have generally shown an increasing trend over the last three years, reflecting the resilience of the US retail pharmacy industry during this pandemic.

COVID-19 pandemic was a public health crisis with global implications, but the crisis was more of a test than a disaster. With the crisis still ongoing today, the US retail pharmacy industry should not see a single crisis as a disaster, but pay attention to the opportunities it contains, which requires the company's management to have a strategic vision to seize opportunities and meet challenges in a crisis.

4.2 Outlook

As the impact of COVID-19 on people's lives wanes, we will move into the post-pandemic era. In the future, what are the changes brought about by the COVID-19 that will continue to be the trend, and how is the retail pharmacy industry going to develop in the post-pandemic era, I see the following points.
4.2.1 Active transformation

In recent years, the profit margins of retail pharmacy and PBM businesses have been squeezed as the cost of drug imports has risen, generic drug manufacturers have increased their bargaining power and health insurance negotiations have limited drug price increases. CVS, one of the US-based pharmacies giants, entered the healthcare industry in 2018 with the acquisition of Aetna, aiming to create a "PBM + pharmacies + health insurance + healthcare services" healthcare delivery system. We can also see from the above financial analysis that health insurance income has become a new revenue growth area for CVS over the last three years. The insurance market is still promising as people become more risk-averse. Retail pharmacies may therefore consider adding a new business in healthcare services.

4.2.2 Development of telehealth

During the pandemic, around 30% of care was provided by telemedicine and even if the pandemic is gradually brought under control in the future, telemedicine will continue to be an important way of delivering healthcare, thanks to developments in IT technology and a shift in the customer's model of care. In the telehealth sector, e-commerce companies such as Amazon are also launching their own telehealth services in 2022 (Palmer & Coombs, 2022), all of which indicate a promising and competitive telemedicine market.

4.2.3 Developing ESG strategies

According to the OECD (2021), COVID-19 has led to a greater focus on social issues and a greater expectation that companies will be socially responsible, and investors are concerned about whether a company has an ESG strategy in place. In the post-pandemic era, ESG strategies will become the new dimension for measuring company performance, especially in the pharmaceutical retail sector, which is closely related to people's livelihood and public health.

References

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