A CASE STUDY IN CORPORATE RESPONSIBILITY:

REMOVAL OF TOBACCO PRODUCTS BY CVS HEALTH

BY

DEBRA ANN DROOPAD

A Thesis Submitted to The Honors Thesis

In Partial Fulfillment of the Bachelors degree
With Honors in

Business Management

THE UNIVERSITY OF ARIZONA

MAY 2015

Approved by:

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STATEMENT BY AUTHOR

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Abstract

Many companies are investing in improving business ethics and corporate social responsibility, because it enhances their reputations and creates a better environment for their stakeholders. One example is CVS Health that recently made a decision to remove tobacco products from all of the stores. In order to understand the reasoning behind this strategy and the ramifications of this decision, one must explore the overview of the company along with its history, industry analysis, and business model. This study analyzes the ethics and corporate social responsibility by applying the methods of utilitarianism, Kantian ethics, maximization of profits, moral minimum, stakeholder interests, and corporate citizenship. Also, the competitive advantage of CVS Health is described in comparison to the competitors such as Walgreens and Rite Aid with their reactions.

Keywords: CVS, tobacco products, removal, corporate social responsibility, ethics

Introduction

On February 5, 2014, the nation's largest drugstore chain in terms of overall sales and pharmacy sales, CVS Caremark, announced that the company will stop selling cigarettes and tobacco products by October (Strom, 2014). This strategy was considered controversial since it was predicted that it would cut down $2 billion in sales from tobacco products (Strom, 2014).

The purpose of this paper is to analyze the strategy of removal and the ramifications of this action. This paper will explore the overview of the corporate social responsibility and ethics that a corporation is strategizing for the sake of the reputation and good of the society. Then this thesis will dive in depth into the investigation of CVS Health removal of tobacco products by exploring the history of the company, application of Porter's five forces to the industry the company is in, business overview, the reasoning behind the decision of eliminating tobacco products, and the impacts of that removal on the company and its competitors. With this analysis, the strategy that CVS Health implemented regarding the elimination of tobacco products can be determined to be a success or not in terms of its sales and reputation.

Business Ethics

Business ethics is defined as principles and values that employees use to govern their activities and decisions within their business environment. Ethical principles may be overlooked by many corporate employees, because they often have other priorities like marketing and financing to consider (Varma, 2013). However, business ethics has a greater impact on the existence of a business than most people think. It can create a positive image of the business to increase the growth and sales through the gain of the consumer trust. In this paper, business ethics is involved when it comes to the decision of removing tobacco products from the stores. This impacts the consumers and the business, because it deprives the access to these products from them. It is considered unethical for drug retailers to sell tobacco products in the stores, because it promotes smoking through advertising. Smoking causes at least 480,000 deaths each year in the United States, according to the U.S. Department of Health and Human Services (2014). Also, smoking is the leading preventable cause of death in the United States. Since there are negative impacts contributed from smoking, it is considered to be unethical to sell tobacco, especially when it is being sold in the same place that promotes smoking cessation programs, because pharmacies are supposed to be dedicated to protecting assumed and promoting the health of the consumers. That is why CVS has stopped selling tobacco. In fact, the CVS Health Executive Vice President (VP) and chief medical officer, Troy Brennan MD, stated that:

> “The appropriateness of selling cigarettes in pharmacies is not a new issue. The American Pharmacists Association has for years said that it was unethical to sell tobacco products in a pharmacy. I’ve been vocal about it and a number of people in the company, especially our CEO, agreed that as we started thinking of ourselves more and more as a

> health care company, we needed to end tobacco sales. In terms of the products we sold, tobacco was the number one threat to the health of consumers" (Arnst, 2014, para.7).

Brennan also believed that health is "the most important thing in terms of what we do for our customers" and that "tobacco just doesn't fit in" (Arnst, 2014, para.5). By making the choice of eliminating tobacco products, they are following their principles of providing best health care to the consumers in the business environment, thus maintaining the ethical aspect of tobacco products.

Corporate Social Responsibility

Corporate Social Responsibility (CSR) is defined, according to Investopedia, as "corporate initiative to assess and take responsibility for the company's effects on the environment and impact on social welfare" (Corporate Social Responsibility, 2015, para. 1). This is important in many businesses, because companies have a lot of power in the community and national economy, where they control most assets and much cash at their disposal for social impact programs. Companies are gearing towards CSR for increased customer loyalty, lower employee turnover, and better public relations. So, right now, many companies are not only in business for making a profit, but also they are contributing to the environment through the CSR programs. Consumers may depend on the corporations for products and services it offer, but it is the level of competition that helps them make decisions on which company to purchase products or services from based on several factors, *especially* how well the corporation is performing outside the workplace (Thorpe, 2013). Many consumers today care much more about how the corporations are positively impacting the community and are basing their loyalty based on it. Companies rely on corporate social responsibility (CSR), which is a way that companies deal with its environmental and social impacts while operating, because doing so gives the corporations better public images. According to Cone Communications, "nine-in-10 American consumers say they not only have a more positive impression of companies that support CSR (93%), but they are also more likely to trust (90%) and be more loyal (90%) to those companies" (2013). When consumers buy products from companies that focus on CSR, they feel good about it since they know that the businesses are helping the community. In addition to a better public image, corporations get better and more media coverage when demonstrating CSR. The coverage helps create good reputations for the corporations and embodies the corporations as good

Samaritans. Lastly, CSR helps foster a positive workplace environment. Employees enjoy working for a company that has good public image and has positive media coverage. Happy employees result in positive output for the business (Thorpe, 2013).

CVS Health announced in February 2014 that it was planning on the elimination of tobacco products from every store, because the company found no reason to sell tobacco in a place where health is primarily the main concern, the media immediately jumped on it, analyzing and recording every one of its move (Hudson, 2015). Also, this strategic move resulted in great media coverage that acquired a seat in the White House for the CEO, Larry Merlo for the State of the Union with President Barack Obama (Hudson, 2015). In his State of the Union address, Obama praised CVS Health and encouraged other companies to do the same, “I'm also asking more companies to follow the lead of companies like CVS and UPS and offer more educational benefits and paid apprenticeships” (Crandall, 2015). CVS Health has evolved dramatically from the day it opened in 1963 as Consumer Value Store, specializing in sales of beauty and health products.

Introduction to CVS Health

CVS Health is a “pharmacy innovation company helping people on their path to better health” (CVS Health Corp., 2015b). CVS Health operates at least 7,800 retail pharmacies, 900 walk-in medical clinics, and a leading pharmacy benefits manager with over 65 million plan members. This company has a unique business model that is designed to increase access to affordable quality care and lower healthcare costs (CVS Health Corp., 2015b).

History of CVS Health

In 1963, the first CVS in Lowell, Massachusetts, specializing in the sales of beauty and health products, was founded by the brothers Stanley and Sidney Goldstein along with their partner, Ralph Hoagland (CVS Health Corp., 2015b). The original name for CVS was Consumer Value Store. Then in 1964, the chain grew to 17 stores and the original CVS logo was created, which featured a CVS banner in a shield with the words, “Consumer Value Stores” below the shield (See Appendix A for picture). This logo was displayed on the exterior of all the stores for the first time. Continuing to 1967, CVS began to include pharmacies in the stores, operating in new locations, Warwick and Cumberland, Rhode Island. Then in 1969, the company was sold to Frank Melville for expansion. Melville was an entrepreneur that sold discount footwear. To add to the Melville Corporation and increase the stock, he expanded CVS by operating 100 stores in the Northeast and New England. As a strategy, Melville contracted with Clinton Drug and Discount Stores that doubled CVS in size by acquiring 84 of the Clinton stores in the Midwest and Northeast in 1972. CVS then achieved over $100 million in annual sales in 1974. To continue the expansion, CVS acquired the New Jersey-based Mack Drug Chain that had 36 established stores in 1977. Since the establishment of the company, CVS found success and differentiated itself from the competition by opening small health and beauty aids stores in enclosed shopping malls in 1978. In 1981, CVS established its presence in Rhode Island (CVS Health Corp., 2015b).

In 1984, Senior Vice President of Marketing, Harvey Rosenthal, was named President and Chief Executive Officer (CEO) of CVS, and succeeded Stan Goldstein to become Executive Vice President of Melville Corporation. 1985 marked a monumental point for CVS when it reached $1 billion in annual sales. One year later, CVS co-founder Stanley Goldstein was named president and Chief Operating Officer (COO) of Melville Corporation. Then in 1987, Stanley Goldstein took over as chairman and CEO of Melville Corporation. Towards the end of the 80s, CVS celebrated its 25th anniversary with a count of 750 stores established and sales that are nearly $1.6 billion.

In the early 90s, CVS acquired 500 stores from People's Drugs that established the company in new mid-Atlantic markets located in Washington D.C., Maryland, Virginia, and Pennsylvania. As a division of Baxter, the Health Care Corporation that launched the first National Hemophilia Home Service in 1978, Caremark tapped its expertise in health care cost management to provide prescription benefit management services and in 1992, it established itself as its own company with its own drug formulary and clinical intervention programs distributed out to hospitals and home care. Caremark set up offices in California and expanded product lines in 1994, while CVS launched PharmaCare, which is a pharmacy benefit management company providing services to employers and insurers. In 1996, Melville Corporation underwent restructuring and became CVS Corporation that was established as a standalone company that was publicly traded on the New York Stock Exchange (NYSE) under the CVS ticker. During that time, Caremark entered a new marketplace with new disease programs. Late in the 90s, CVS completed the largest acquisition in the history of the U.S. retail pharmacy industry of more than 2,500 stores from Revco that created CVS presence in the Midwest and Southeast, as well as 200 more stores from Arbor Drugs in Michigan, bringing the total to 4,100 stores across 24 states. Caremark, at that time, merged the prescription benefit management business and the biotech business. Then it launched the online prescription refills. CVS Corporation changed chairman to Tom Ryan, succeeding Stanley Goldstein. At this time, CVS Corporation made plans to enter Florida by building stores in Tampa. The company launched CVS.com, becoming the first fully integrated online pharmacy in the U.S. in 1999.

In early 2000s, Rick Krieger, along with his medical team, founded QuickMedx that was renamed MinuteClinic and was acquired by CVS corporation to open in the stores due to high demand for walk-in convenience allowing for quick growth. Also CVS Corporation acquired Stadlander pharmacy that made CVS ProCare the largest specialty pharmacy in the U.S. Then expansion continued into Illinois (Chicago), Florida (Fort Lauderdale and Orlando), Texas (Houston and Dallas), Nevada (Las Vegas), Minnesota (St. Paul and Minneapolis) and Arizona (Phoenix). To increase the customer loyalty, CVS/pharmacy launched the ExtraCare Card that was the first loyalty card program in the national pharmacy retail industry, reaching more than 44 million customers. Then CVS finished another acquisition of 1,268 Eckerd stores and Eckerd's mail order business that allowed CVS to open a customer care center in Nashville to serve the rapid growth in the use of mail service offerings. In 2006, MinuteClinic became the first retail clinic to be accredited by the Joint Commission (CVS Health Corp., 2015b). At the same time, another acquisition has occurred: 700 stand-alone Sav-On and Osco drugstores from Albertsons, increasing its presence in California and the Midwest. In 2007, a merger between CVS Corporation and Caremark RX created CVS Caremark, which became the nation's premier integrated pharmacy services provider. At the end of 2009, MinuteClinic enhanced access to high-quality, affordable health care services and the company celebrated the opening of its 7,000th CVS/pharmacy in Minnesota (See Appendix B for timeline).

In 2011, Larry Merlo succeeded Tom Ryan as President and CEO of CVS Caremark. Then in 2012, the company announced that it surpassed $100 billion in revenues. Then on February 5, 2014, CVS Caremark announced that it would stop selling cigarettes and tobacco products in all of its stores by October 1, 2014. Later that year, by September 3, 2014, CVS Caremark halted the sales of cigarettes and tobacco products one month earlier than planned and launched a national smoking cessation program. In addition, the company name was changed to CVS health to reflect its commitment to health care (CVS Heath Corp., 2015b).

Company Value

In order to understand the value of CVS as an entity, the industry of CVS Health will have to be analyzed using the Porter's five forces model, along with the establishment of the stock.

Industry

The five forces model, created by Michael E. Porter as a way to describe the nature of the competition in the industry, is composed of 5 factors that help managers identify the opportunities and threats, when determining on a strategy to succeed (Hill and Jones, 2004). The factors that shape competition within an industry are: (1) the barrier of entry by potential competitors, (2) the intense rivalry among the established competitors, (3) the bargaining power of buyers, (4) the bargaining power of suppliers, and (5) the closeness of substitutes to the industry's products (Porter, 2008). This model will be applied to the drug retail industry along with its competitors such as Walgreens, Rite Aid, and Walmart.

Barriers to Entry

The barriers to entry are the factors that make it costly for companies to enter an industry (Porter, 2008). Examples of barriers include brand loyalty, absolute cost advantage, economies of scale, customer switching costs, and government regulations. In this industry, there are a lot of popular brand name items that help maintain the loyalty in consumers. Also, the technology used within the pharmacy retail is becoming more unified and advanced. For example, Walgreens has a new computer system, Intercom Plus that links all of the stores into one network and fills prescriptions. This technological advancement involves cost advantages that result from computerized logistics network, thus increasing revenues for better logistics in the drug retail industry. In addition, another barrier to entry is the economies of scale. The industry has many large chains with a broad purchasing volume. The switching costs are low, because there are online shopping that hold more items than the retail stores. Because of that, there is very little switching over. There are a few occasions where the buyers switch over such as transferring prescriptions over as anew customer; a new profile would have to be created with updated information. However, the costs are minimal. Finally, the government has strict regulations over the sale of the drugs due to the process of acquiring licenses to perform pharmaceutical sales. However, that does not stiffen the competition among the drug retailers like Walgreens, CVS Health, Rite Aid, and Eckerd.

Rivalry

There is a high intensity of rivals within the retail drug industry. The notable rivals are Walgreens, CVS, Rite Aid, and Eckerd. There are other competitors that include supermarkets such as Walmart and Costco. Pharmaceuticals are a profitable industry with high margins that are constantly decreasing and the competition is keeping up with the changing approaches.

Rivalry is the competitive struggle between companies within the same industry to battle for market share. The retail drug industry is a fragmented industry due to the competing companies and superstores. This industry values new consumers with increased age demographics needing drugs to maintain their wellness. The size of the market is expanding, so new growth is a goal for the competitors as a way to avoid losing market share (See Appendix C for market share). The largest barrier to exiting is the stores and locations, which are fixed assets that are hard to liquidate. So competitors stay in the industry with new strategies to improve upon. To maintain the consumers' interests, they are turning to technology to have customers order the products that are unavailable in the stores to ship to them, while the physical locations are quick access to get medication right away. Nonetheless without buyers, the rivals would not have anything to compete for and establish their places in the industry.

Bargaining Power of Buyers

The bargaining power of buyers means the buyers have the ability to bargain down prices charged by the companies in the industry or to raise costs by demanding better quality and service (Hill and Jones, 2004). Buyers want to have options to choose from and better close interaction with the pharmacists. Consumers always require service, demand lowering prices and often look for the availability of drugs that can be covered by accepted insurances. The companies in this industry would have to continue improving its guest services and increase the availability of drugs to make the patients happy in order to stay in the industry. The buying power of the consumers is relatively low due to the large consumer market and the prices cannot be lowered by one company due to demand, but the industry lowers the prices due to demographic demand and consumer response. Individual consumers do not have bargaining power, but as a consumer base, it can decide the status of the industry. The buyers would not have a selection of products if it were not for the suppliers, which are key to gaining preferred products to satisfy the customers.

Bargaining Power of Suppliers

The bargaining power of suppliers means that suppliers have the ability to raise input prices or increase the costs of the industry by providing poor quality inputs or service (Hill and Jones, 2004). For example, a few major drug companies determine the prices and availability of the prescription drugs. The bargaining power of theses suppliers is greater than the bargaining power of the generic market. These competitors work in both the generic and prescription drug market segments. The bargaining power of some larger pharmaceutical companies is greater than the generic, because some drugs are exclusive to treat ailments with no substitutions. The generic companies would respect that. In the retail drug industry, the generic market has high bargaining power. In a case where a generic manufacturer does not want to sell the products to a particular retailer, there are other suppliers that can be substitutes such as Watson and Teva. Generic drugs have less exclusivity than prescriptions, so suppliers must give in to the consumer demands. With suppliers, buyers and rivalry set, there is still one more factor to overcome, which are the substitutes that could potentially decline the market for the drug retail industry.

Threat of Substitutes

The threat of substitutes is when the products of different businesses can satisfy similar customer needs (Porter, 2008). The direct substitutes for the competitors such as Walgreens, CVS and Rite Aid are the distribution channels, which they compete for. Online retailers and foreign retailers are the threats to substitution that comply with the shipping companies such as UPS, FedEx, and Airborne Express. Walmart is known for its retail distribution system that is cost savings while distributing products in an efficient way. So Walmart is a threat, because it is a supercenter that fulfills all of the consumers' needs. The threat of substation is incredibly high and the government can keep any regulation on the number of drug retailers to comply with the FDA laws.

In conclusion, the Porter's Five Forces model reveals that in the drug retail industry, the risk of entry by potential customers is low because the barriers to entry are highly established (Porter, 2008). The barriers include loyalty, economies of scale, customer switching costs, and government regulations, which could be costly for new entrants to try and build a reputation among the consumers. The intensity of rivalry is moderate and the bargaining power of buyers is low when it is individualized, but the greater demographic has a large influence on the power of buying. The bargaining power of suppliers is high in the brand prescription market but low in generic market. The threat of substitutes is very high due to increasing number of manufacturers that can substitute for a brand drug to gain savings. The number of substitutes will continue to grow even though the government has the power of regulation. Margins are currently high so there is more room for other new competitors if the strategy is right to utilize in this unattractive industry (See Appendix E for Porter's Five Forces visual).

Stock Information

Establishment

In 1996, CVS was a division of Melville Corporation (Conaway, 1996). After a strategy of divesting Melville Corporation's subsidiaries such as Linen 'n Things, in November, Melville formally revised the name to CVS Corporation and publicly traded on the New York Stock Exchange (NYSE) with the symbol "CVS" with an initial offering of 13 million shares at $15.50 per share. The proceeds of the offering were to be used for expansion plans (Conaway, 1996). The current price of a share is now 103.87 (CVS Caremark, 2014).

Trends

There are many trends that contribute to the profitability of the drug retail stock such as the aging of baby boomers, economic slowdown, health reform and generic medications.

Aging of *Baby Boomers*

As the baby boomers are getting older, they are more likely to need prescription medications. Also, Medicare Part D has expanded coverage to uninsured patients with new regulations that make it harder to prescribe brand name expensive drugs, shifting the product mix towards the generics.

Economic Slowdown

CVS revenues come from both retail and pharmacy sales. Generic medications are less vulnerable to an economic downturn and the company tends to gain more profits due to reimbursement from the third parties for the generics (Kavilanz, 2010).

Health Reform

The Affordable Care Act encourages drug utilization, which indirectly boost sales of the pharmacy. The previously uninsured patients will utilize the drugs more under new mandated insurance, thus increasing the sales of the profits that results in profits (Dennison, 2010).

Generic Medications

Most brand name medications are losing patent protection, which allow the generic manufacturers to sell the medications cheaper that contain the same active ingredients as the brand ones (Kavilanz, 2010). So many consumers are gearing towards the generic, because it works the same way as the brand medicine in terms of mechanism and is slightly cheaper.

Business Overview

CVS Caremark is now the largest pharmacy health care provider in the United States with 65,000 retail pharmacies in the network and currently operates 7,822 of its own pharmacies. As of 2014, CVS was ranked 12th on the Fortune 500 list with a 3% bump in sales last year driven by increased pharmacy services and retail pharmacy sales.

In order to perceive where the sales and expenses are coming from, the three segments of the business would have to be analyzed: retail pharmacy, pharmacy services, and corporate. This analysis will help comprehend the business model of CVS Health that is set up for the decision of tobacco removal.

Retail Pharmacy Segment

CVS currently operates 7, 822 retail drugstores in 44 states, Puerto Rico, and the District of Columbia (D.C.). CVS retail stores are strategically placed to get the best of the consumer base and currently operate in 92 out of the top 100 U.S. drugstore markets (CVS Health Corp, 2015a). The retail pharmacy segment generates revenues in Pharmacy, MinuteClinics, and Front Store. In 72% of the locations, CVS offers 24-hour or extended service for the pharmacies and in 60% of the locations, the company offers a “drive-thru” pharmacy. CVS accounts for 20% of the U.S. retail pharmacy market, filling close to almost 700 million prescriptions (CVS Caremark, 2012).

Pharmacy

Pharmacy revenues represent 68% of the retail pharmacy revenues. Third party benefit revenues account for at least 90% of pharmacy revenues. Third party benefit planners include managed care organizations, government-funded health care organizations, care programs, and commercial employers. CVS was the first company in the industry to use Drug Utilization

Review (DUR) technology that checks for harmful interactions with other prescription drugs, over-the-counter (OTC) drugs, and herbal remedies. CVS appears to be one of the quickest, most convenient options for customers looking to fill or refill prescription drugs due to DUR technology and CVS Rapid Refill that enables customers to order prescription refills anytime through a smart phone.

MinuteClinic

CVS currently operates 963 MinuteClinic locations in 44 different states. Since the introduction of the clinics into CVS pharmacies, over 2,000 nurse practitioners and physician assistants have provided care to at least 10 million patients (CVS Health Corp, 2015a). Currently, MinuteClinic collaborates with CVS's pharmacy services segment to provide programs that help improve member health and lower costs while meeting the needs of CVS Caremark plan members. The typical MinuteClinic services include: minor illness exams (Approximately $79-$89), minor injury exam ($79-$89), skin condition exams ($79-$89), wellness and physical exams ($27-$69), health condition monitoring ($59-$89), and vaccinations ($30-$127). Many locations have gone into treating chronic conditions, entering a new market for CVS. MinuteClinic offers unique experience by offering walk-in care, which means that appointments are not necessary, 7 days a week during holidays and evenings. 80% of the services are covered by a third party and MinuteClinic has proven to be a cost-effective convenient way to get medical attention since at least 50% of the patients reported that they do not have a primary care physician.

Front Store

CVS front store sales include products such as OTC drugs, cosmetics, general merchandise, personal hygiene products and CVS store brand products. CVS currently carries over 5,000 CVS/pharmacy and proprietary brand products that accounts for at least 20% of front end sales. To help with the customer loyalty, the ExtraCare program allows CVS to give discounts on products through customized coupons, ExtraBucks, and automatic sales prices. Examples of the coupons are: 25% off Olay beauty products, 50% off CVS brand vitamins, $2 off Zyrtec Allergy Medicine, and many more offers. ExtraCare currently has approximately 70 million active cardholders, making it the most successful retail loyalty card programs in the country.

Pharmacy Services Segment

CVS currently operates 27 retail specialty pharmacy stores, 11 specialty mail order pharmacies, four mail order dispensing pharmacies, and 86 branches and six centers of excellence for infusion and enteral services located in 40 states, Puerto Rico, and D.C. The pharmacy services segment generates revenue from a range of PBM services such as plan design, formulary management, Medicare Part D services, mail order, specialty pharmacy, infusion services, and disease management services. The clients include employers, insurance companies, unions, government groups and other sponsors of health benefit plans across the United States.

Retail Pharmacy Network

CVS dispenses prescription drugs through a network of 68,000 pharmacies. When a customer fills a prescription in a retail pharmacy, that pharmacy sends the data electronically to CVS from point-of-sale. The data is registered with CVS's proprietary prescription management systems that check the plan eligibility of the customer while performing DUR to evaluate the safety of the drug and confirmation that the pharmacy will receive payment. Since CVS has a large network of pharmacies it covers through Caremark, CVS is able to negotiate discounts with these retail pharmacies for inclusion into their PBM plans. These discounts are partially passed to CVS's clients and the rest is profit to the pharmacy services segment.

Mail Order Pharmacy

CVS currently operates four automated mail services pharmacies in the U.S. Plan members can submit prescriptions or requests for refills to mail order pharmacies via phone, fax, and internet. Maintenance Choice, which is an extension of the mail order pharmacy program, allows eligible plan members to pick up their maintenance drugs for their chronic conditions such as AIDS or diabetes from CVS pharmacies or through mail order pharmacies without any increase in co-pay or pricing. The program allows members to obtain a 90-day supply instead of 30-day supply. This implementation is due to the studies that plan members are more likely to drop off of the medication when it fills for 30-day supply (approximately 12 times a year) than the plan members who fill for 90-day supply (four times a year).

Medicare Part D Services

CVS participates in administering the drug benefit added to the Medicare program under Part D of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 through the provision of PBM services to our health plan clients. In 2011, CVS acquired the Medicare prescription drug business from Universal American Corp. for $1.3 billion. This helped double the size of CVS's Medicare Part D program, totaling 3.6 million beneficiaries through the insurance companies such as Accendo, Silverscript and Pennsylvania Life.

Specialty Pharmacy

CVS special pharmacies include 11 specialty mail order pharmacies and 27 specialty retail pharmacy stores. Specialty pharmacy is CVS's fastest growing segment and is expected generate over $15 billion in revenue in 2015. These pharmacies are strategically placed throughout the country where specialty drugs are highly demanded (CVS Caremark, 2012).

Corporate Segment

CVS Caremark's corporate segment provides management and administrative services that support and oversee the operations of the company. The segment includes executive management, corporate relations, legal, finance, compliance, corporate information technology and human resource departments (CVS Health Corp, 2015a).

With a key understanding of business model of CVS Health, the logic of the decision of the elimination of tobacco products in terms of sales and expenses can be rationalized.

CVS's Removal on Tobacco Products

This section describes the decision on eliminating tobacco products from all of the CVS Health stores along with the reasoning behind the change in the company name from CVS/pharmacy to CVS Health. Then the analysis lists the results of the decision including the trends of customers, sales: front end versus pharmacy, and stock. Adding on, the corporate social responsibility and ethics are applied to this decision to assess the morality. Also, the reactions of the competitors are evaluated along with understanding the current competitive advantage of CVS Health.

Overview

On February 5, 2014, CVS Caremark announced that it would stop selling cigarettes and tobacco products in all of its retail stores by October 1, 2014 (Davis, 2014). Then by September 3, 2014, CVS Caremark halted the sales of cigarettes and tobacco products one month earlier than planned. It became the first large chain to stop tobacco sales. Also, CVS launched a national smoking cessation campaign that helps assess the smokers' readiness to quit, educate them, and offer medication support to help curb the addiction to tobacco and coaching to help people staying motivated and avoid relapses. Larry J. Menlo stated, "I think everybody came to the right the decision. It is a real contradiction to talk about all the things we're doing with people to help them on their path to better health and at the same time sell tobacco products" (Davis, 2014).

Change in company name

On September 3, 2014, CVS Caremark Corporation announced that it was changing its corporate name to CVS Health. The reason behind it is that the company wants to promote a healthy world and "reflect its broader health care commitment and its expertise in driving the innovations needed to shape the future of the health." According to Larry J. Merlo, President and CEO of CVS Health, stated:

> "For our patients and customers, health is everything and CVS Health is changing the way health care is delivered to increase access, lower costs and improve quality… As a pharmacy innovation company at the forefront of a changing health care landscape, we are delivering breakthrough products and services, from advising on prescriptions to helping manage chronic and specialty conditions" (Castel and DeAngelis, 2014, para.2).

CVS Health is known as a tobacco-free, reinventing pharmacy that takes their places among the leaders in the healthcare industry, according to Merlo (Castel and DeAngelis, 2014).

Analysis

The decision to remove tobacco products from the stores was made despite the stated belief of Larry Merlo that the company profitability would suffer due to lack of sales of tobacco products at the front end service. This loss was an estimated loss to be $2 billion in total sales ($1.5 billion from cigarettes sales (Donnelly, 2014), in annual revenue, which is 2% of the company's total revenue of $126 billion, however, due to pharmacy benefits management and specialty pharmacy programs, the losses have been counteracted (Landen, 2015).

Trends after removal

Customers

Due to the Affordable Care Act, there has been an increase in newly-insured patients that resulted in a rise in paying customers for treatments and medications (Japsen, 2015). Newly-insured patients have led to an increase in pharmacy customers, which boosted the sales for the fourth quarter, after CVS removed the tobacco products. The result was a 21.7% increase in pharmacy sales compared to third quarter, which was before the elimination of tobacco products (Japsen, 2015).

Sales (Front End vs. Pharmacy)

CVS Health has achieved record sales in 2014, especially with a major rebrand and removal of tobacco products (Hower, 2015). It was stated earlier that CVS Health was expected to lose about $2 billion in revenues annually from loss of tobacco sales. However:

> "The new financial numbers from CVS show that net revenues increased 12.9 percent to a record $37.1 billion in the Fourth Quarter 2014. Operating profit increased 4.7 percent to $2.3 billion. The company made up for its tobacco sale losses with increases in its pharmacy services business, which posted 22 percent increase in revenue to $23.9 billion for the three months through December 31. This was driven in large part by growth in its Medicaid programs" (Hower, 2015, para. 3).

The fourth quarter has rose more than four percent and the CVS Health stated that the growing demand for expensive specialty drugs have helped increased the revenue from its pharmacy benefits management by nearly 22% (Associated Press, 2015). That helped offset the front sales that decreased by 7.3% reflecting the absence of tobacco products (Cortez, 2015).

Stock

The stock (NYSE: CVS) price has changed dramatically since the removal of tobacco products. According to Speights, CVS Health announced that curbing tobacco products would result in a loss of $0.06-$0.09 per share from its 2014 earnings (2014). With the expedited implementation of the no-tobacco policy, it could potentially be on the higher end of that range. However, after a few months following the removal, the market has shrugged off CVS' tobacco decision. As of September 2014, the shares were up 22% (Speights, 2014). This positive increase is due to a few factions such as:

> "CVS hint[ing] in February that it "has identified incremental opportunities, [which is] expected to offset the profitability impact". One of those 'incremental opportunities' could be related to the company's major initiative to promote smoking cessation. Of course, products to help cigarette smokers kick the habit are available at CVS stores nationwide. The second potential reason for overall market optimism could be that the long-term impact of CVS' repositioning might be more beneficial than some think. Employers, insurers, and accountable care organizations, or ACOs, are all looking for ways to promote good health as a way to control healthcare spending" (Speights, 2014, para. 7).

Also, as of March 2015, the current market price is at least $104.49, which is 39.09% change over the year (See Appendix D). The stock will continue to increase due to a surge of decisions geared towards creating better health through programs, because there are many stakeholders who are concerned about the health of many consumers and wish to promote living better.

CSR: Application

Corporate social responsibility (CSR) is the act of duty owed by businesses to act socially responsible in produce and selling goods and services (Robbins, Coulter, Cheeseman, Gilliland, 2004). CVS Health, in its CSR report, mentioned that cigarettes and tobacco have no place in a health care delivery setting (2013). It is considered inconsistent with CVS's purpose of helping people on their path to better health to sell tobacco products. In addition, smoking impacts the economy in terms of cost. The U.S. Department of Health and Human Services surveyed the annual smoking-attributable economic costs to the U.S. are about $289 billion, including $132 billion for medical care, $151 for lost productivity due to premature death, and $5.6 for lost productivity due to exposure to secondhand smoke (CVS Health Corp., 2015b). Thus, CVS is socially responsible for reducing the health and economic impacts of smoking by eliminating the tobacco products from the stores. Also, CVS Health has launched a national campaign to help with tobacco cessation programs for many smokers (See Appendix E for logo). There are four theories of the social responsibility: maximizing profits, moral minimum, stakeholder interests, and corporate citizenship. CVS fulfilled three degrees of social responsibility while unsatisfying the profit aspect of the theories.

Maximizing profits

Maximizing profits is one of the theories of social responsibility that says a corporation owes a duty to take actions that maximize profits for shareholders (Robbins et al, 2004). CVS Health did not advocate for the maximization of profits, because cutting tobacco products was expected to result in a loss of $2 billion (Landen, 2015).

Moral minimum

Moral minimum is a theory of social responsibility that states that a corporation has the duty to make a profit while avoiding harm to others (Robbins et al, 2004). CVS sold tobacco products that caused harm to others and to correct the social injury, CVS halted the sales of the products by making them unavailable to the consumers. CVS has met its moral minimum duty of social responsibility.

Stakeholder interest

Stakeholder interest is another theory that enables a corporation to consider the effects of its actions on people other than its stockholders (Robbins et al, 2004). CVS's internal and external stakeholders include employees, customers, suppliers, government and environmental groups (CVS CSR Report, 2013). For the employees, the goal is to raise awareness of their opportunities to reduce environmental impacts at work and beyond. CVS Health is also providing products that are less harmful to the environment while reducing the impact for consumers. For the suppliers, the company collaborates to reduce environmental footprint of the products being sold at CVS Health. For the government and environmental groups, the legislation and policies are monitored for improvements in the environment along with approaches to reducing footprint (CVS CSR Report, 2013). The removal of tobacco products appeals to the environmental groups and customers that are interested in the welfare of the citizens. The company is considering the other stakeholders such as upholding the laws of the government as well as keeping interests of employees and customers in mind to make an impact.

Corporate citizenship

Corporate citizenship is a theory of social responsibility that says a business has a responsibility to do good (Robbins et al, 2004). CVS Health felt responsible to promote a healthy society by removing tobacco products and promoting the smoking cessation programs. Looking from the personal aspect, CEO Larry Merlo lost his father to a tobacco-related cancer, and Executive Vice President of CVS Health Helene Foulkes's mother died from lung cancer (Yousef, 2014). Both felt that something has to be done. According to Eileen Howard Boone, the SVP of Corporate Social Responsibility and Philanthropy, she said:

> "As a health care provider, our purpose is helping people on their path to better health and put simply, the sale of tobacco products is inconsistent with this purpose. It is also the right thing to do for our customers and the communities we serve – and we are committed to making it easier for them to make healthy choices and that includes helping them to live tobacco-free lives" (2014, para. 2).

Ethics: Application

Ethics are moral principles that govern a corporation's behavior (Robbins et al, 2004). People are saying that selling tobacco products are unethical, because it does not match with CVS's rebranding strategy as a healthcare provider. There are two moral theories that will help understand the reasoning behind the ethical decision that includes utilitarianism and Kantian ethics.

Utilitarianism

Utilitarianism is a moral theory that dictates that people must choose the action or follow the rule that provides the greatest good to society (Robbins et al, 2004). Utilitarianism is used to choose the greatest amount of happiness for the largest segment of the stakeholders. For the stakeholders, there are major benefits and costs to this decision. The managers and executives who are in charge of the operations of the company would benefit from the removal of tobacco products. The general public would be impressed that they are looking out for the welfare of the society. There would be trust and confidence for the company to maintain, and even gain. The cost would be the loss of revenue, which could result in loss of potential jobs and decrease of salaries. For the employees, they could potentially lose a job. Stockholders could be in danger of losing profits and shares due to price decreases. Even though there is a loss of $2 billion due to the removal, that is considered minor since it is only two percent of the company's revenues. The company is maintaining an ethical culture in the stores by promoting health through the cessation programs and unavailiability of the tobacco products (Brauza, 2014).

Kantian Ethics

Kantian ethics, as known as duty ethics, is a moral theory that says that people owe moral duties that are based on universal rules such as the categorical imperative "Do unto others as you would have them do unto you" (Robbins et al, 2004). Some consumers may argue that it was not ethical for CVS to sell tobacco products in stores, because they are harmful to everyone's health. However, people who bought tobacco fully understood the health risks of the tobacco products. On the other hand, consumers argue that everyone has the right to do whatever they choose to do, stating that it is unethical for CVS to remove tobacco products, because the company should not make it more difficult for a customer to purchase these products. To conform to the ideas of the Kantian theory, CVS would need to focus on the making the customers feel welcome and important in the stores (Brauza, 2014). With ethics and corporate social responsibility in mind, CVS has created a competitive advantage.

Competitive Advantage

Competitive advantage is what a company has that sets an organization apart, which is its distinct edge (Robbins et al, 2004). American Cancer Society has been pushing for the ban of tobacco products in the healthcare stores such as Walgreens, CVS Health and Rite Aid. As of September 2014, CVS Health became the first company to halt the sales of tobacco products in all of its stores as well as to remove completely. That is considered a competitive advantage over the other retail pharmacies in the industry.

Competitors' Reactions

The actions of CVS Health have challenged the rivals to do the same: removing the tobacco products from the stores (Gilblom and Cortez, 2014). The rivals are saying that helping tobacco users quit is enough with the smoking cessation programs. They do not plan to follow CVS and halt the sales of tobacco products. Even though CVS showed that it is possible to get out the tobacco industry and thrive. The rivals do not have any pharmacy benefit management units and they have some form of debt from services or acquisitions. This may change if they gain more profits. The pressure is even higher, because there are anti-smoking groups and elected officials encouraging the rivals to imitate CVS. CVS was able to eliminate tobacco products from the stores, because it was about 1.6% of the revenues, whereas in the other pharmacy chains, the tobacco sales account for at least 4% of the total revenues (Gilblom and Cortez, 2014).

Conclusion

The first part of this thesis focused on explaining the fundamentals of business ethics and corporate social responsibility (CSR), by describing the relevance of the decision of selling tobacco products in a store that is dedicated to promoting good health. Proceeding to the theoretical background section on ethics and CSR on selling tobacco products, the question was justified, as it focused on the importance of companies acting responsibly and contributing to the society.

CVS Health was chosen for this case study as the company recently made a decision to remove tobacco products from all of the stores. This strategy was analyzed in terms of ethics and CSR. Based on the analysis, CVS Health implemented the strategy to match the mission of the store and pharmacy to cater to good health of the consumers. This decision has resulted in a decrease in the front end sales while the pharmacy sales have increased to compensate for the loss of $2 billion dollars due to lack of sales of tobacco products. This led to a noticeable large increase of 39% over the last year.

Not only its profits have increased, but the decision impacted the consumers, employees and the company as a whole. The reputation has improved for CVS after taking off the tobacco products. The mission as a health care provider makes sense and the consumers understand the point. The employees are more empowered to continue working towards providing the best care for the consumers. CVS is the first company to make a bold move and its social responsibility is more defined. Now it is up to the others to see if they will do the same thing, knowing that CVS ended up with increased profits, an improved reputation, and a better understanding of its mission to care for the consumers. However, the rivals are saying that helping tobacco users quit is enough with the smoking cessation programs through therapy and medication. They do not plan to follow the path of CVS and remove the tobacco products. They want to provide choices for consumers, believing that consumers have the right to make a choice regarding their health. Even though CVS showed that it was possible to get out of the tobacco industry and thrive. It will be a bit difficult to do so since the rivals do not have any pharmacy benefit management units and they have some form of debt from services or acquisitions. This may change if they gain more profits or change their operations. If they can find other areas to make profits from, then surely they can promote CSR as well as looking out for the society in terms of ethics. The profits will decrease in a small margin, but the moral minimum, stakeholder interest and corporate citizenship will flourish, because the society is all about being healthy and maintaining a strong environment. The pressure is now even higher, because there are anti-smoking groups and elected officials encouraging the rivals to imitate CVS. The question is, “What will the rivals do now?”

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Appendix A

First logo of CVS

Source: www.cvs.com

Appendix B

Timeline

1960s

1963: First CVS store in Lowell, Massachusetts by brothers Stanley and Sidney Goldstein and partner Ralph Hoagland

1964: Chain grew to 17 stores and CVS logo is developed (see Appendix A)

1967: Began operation of first stores with pharmacy departments, opening locations in Rhode Island

1969: CVS was sold to Melville Corporation

1970s

1970: CVS operated 100 stores in Northeast and New England

1972: CVS doubled in size with acquisition of 84 Clinton Drug and Discount Stores

1974: CVS achieved $100 million in annual sales

1977: CVS acquired New Jersey-based Mack Drug chain of 36 stores

1978: CVS/pharmacy differentiated itself from the competition by opening small health and beauty aids stores in enclosed shopping malls

1978: Baxter Health care Corporation launches the first National Hemophilia Home Service

1980s

1981: CVS broke ground on the Store Support Center in Woonsocket, Rhode Island

1984: Senior Vice President of Marketing Harvey Rosenthal became President and CEO of CVS, succeeding Stan Goldstein who was named Executive Vice President of Melville Corporation

1985: CVS reached $1 billion in annual sales

1986: CVS co-founder Stanley was named president and COO of Melville Corporation

1987: Stanley Goldstein took over as chairman and CEO of Melville Corporation

1988: CVS/pharmacy celebrates its 25th anniversary, finishing the year with nearly 750 stores and sales of about $1.6 billion

1983: Hemophilia Patient Home Health Care is launched

1985: Baxter tapped its expertise in health care cost management services. As a division of Baxter, Caremark launched Mail Service Pharmacy, IGIV Home Care Services, and Growth Hormone Distribution and Services

1990s

1990: CVS acquired 500 stores from People's Drug that established the company in mid-Atlantic markets including Washington, D.C., Pennsylvania, Maryland, and Virginia

1994: CVS launched PharmaCare, a pharmacy benefit management company providing a wide range of services to employers and insurers. That same year, Tom Ryan was named President and CEO of CVS/pharmacy, who began as a pharmacy intern in 1974

1996: After restructuring of Melville Corporation, CVS became a standalone company trading on NYSE under the CVS ticker, with Stanley Goldstein as the company's first chairman

1997: CVS completed acquisition of 2,500+ stores from Revco- largest acquisition of Revco in U.S. retail pharmacy industry, giving CVS key locations in the Midwest and Southeast

1998: CVS acquired 200 stores from Arbor Drugs in Michigan, bringing total of stores to 4,100 across 24 states

1999: Tom Ryan was named CVS Corporation chairman, succeeding Stanley Goldstein. The company announced its intention to enter Florida, with stores initially planned for Tampa market. CVS/pharmacy launched CVS.com, the first fully integrated online pharmacy in the U.S.

1991: Caremark purchased Prescription Health Services (PHS)

1992: Caremark spun off from Baxter and Caremark Formulary was developed and Clinical Intervention Programs was introduced

1993: Caremark established offices in Redlands, California

1994: Caremark expanded product lines and set up additional offices in Northbrook, Illinois.

1995: Caremark launched CarePatterns® Disease Management Programs

1996: Caremark entered the multiple sclerosis marketplace

1997: Caremark merged prescription benefit management and biotech business

1998: Caremark defined pharmaceutical services as its core operating unit and established a National Pharmacy and Therapeutics Committee

1999: Caremark launched online prescription refills

2000s

2000: CVS Corporation acquired Stadlander pharmacy, making CVS ProCare the largest specialty pharmacy in the U.S. at the time. CVS/pharmacy announced plans to enter the Chicago market and continue expansion in Florida with stores slated for Fort Lauderdale and Orlando

2001: CVS/pharmacy introduced ExtraCare card, becoming the first national pharmacy retailer to launch a loyalty card program

2002: Continued to grow, announcing plans to enter Texas market with stores targeted for high-population-growth markets such as Dallas and Houston as well in Phoenix and Las Vegas

2003: 40th anniversary and announced to enter Minnesota market- ExtraCare had 44 million cardholders

2004: CVS completed acquisition of 1,268 Eckerd stores along with its mail order and pharmacy benefit management business

2005: CVS/pharmacy partnered with MinuteClinic, announcing three clinics to open in the stores

2006: CVS acquired 700 stand-alone Sav-On and Osco drugstores from Albertsons, growing in Midwest market. CVS Corporation acquired MinuteClinic, America's leading operator of in-store health clinics

2007: CVS Corporation and Caremark Rx, Inc. completed their merger, creating CVS Caremark, the nation's premier integrated pharmacy services provider

2008: CVS Caremark marked the first anniversary of successful merger and acquired 541 stores from Longs Drug in the West

2009: The company celebrated the opening of its 7,000th CVS/pharmacy in Minnesota

2003: Caremark Rx and Advance PCS announced strategic combination to created a $23 billion company

2004: CVS ProCare became part of PharmaCare

2005: Caremark Rx, Inc. opened a Customer Care Center in Nashville to serve rapid growth in use of mail service offerings

2000: Rick Krieger and partners Douglas Smith, M.D., Steve Pontius and Kevin Smith, RN, FNP founded QuickMedx, the retail health care centers that became MinuteClinic

2002: Demand for walk-in convenience led to quick growth with several large employers asking their health plans to include QuickMedx in their networks. QuickMedx was renamed to MinuteClinic at the end of the year.

2005: MinuteClinic became the first retail clinic to be accredited by Joint Commission

2009: MinuteClinic began a series of affiliations with major health systems across the U.S. to enhance access to high-quality affordable health care services

2010s

2011: Larry Merlo succeeded Tom Ryan as President and CEO of CVS Caremark, who joined the company in 1990 through the acquisition of People's Drug

2012: CVS Caremark exceeded $100 billion in revenues in 2011

2013: Announced that it will purchased Coram, the specialty infusion services that enteral nutrition business unit of Apria Healthcare Group Inc

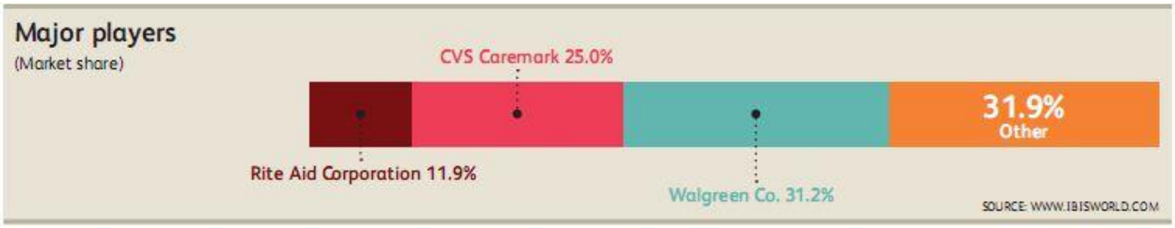
2014: CVS Caremark announced that it would stop selling cigarettes and tobacco products in all stores by October. The company halted the sales in September, one month earlier, and launched a comprehensive national smoking cessation program. In addition the name was changed to CVS Health to further reflect its broader commitment to health care

MinuteClinic reached the new milestone of 21 million patient visits and 850 clinics in 29 states

Source: www.cvs.com

Appendix C

Market Share of Drug Retail Industry



Source: www.ibisworld.com

Appendix D

Stock Trend over 1 year

Removal of Tobacco Products

Source: http://money.cnn.com/quote/quote.html?symb=CVS&source=story_quote_link

Stock Trend since establishment

Source: www.finance.yahoo.com Removal of Tobacco Products

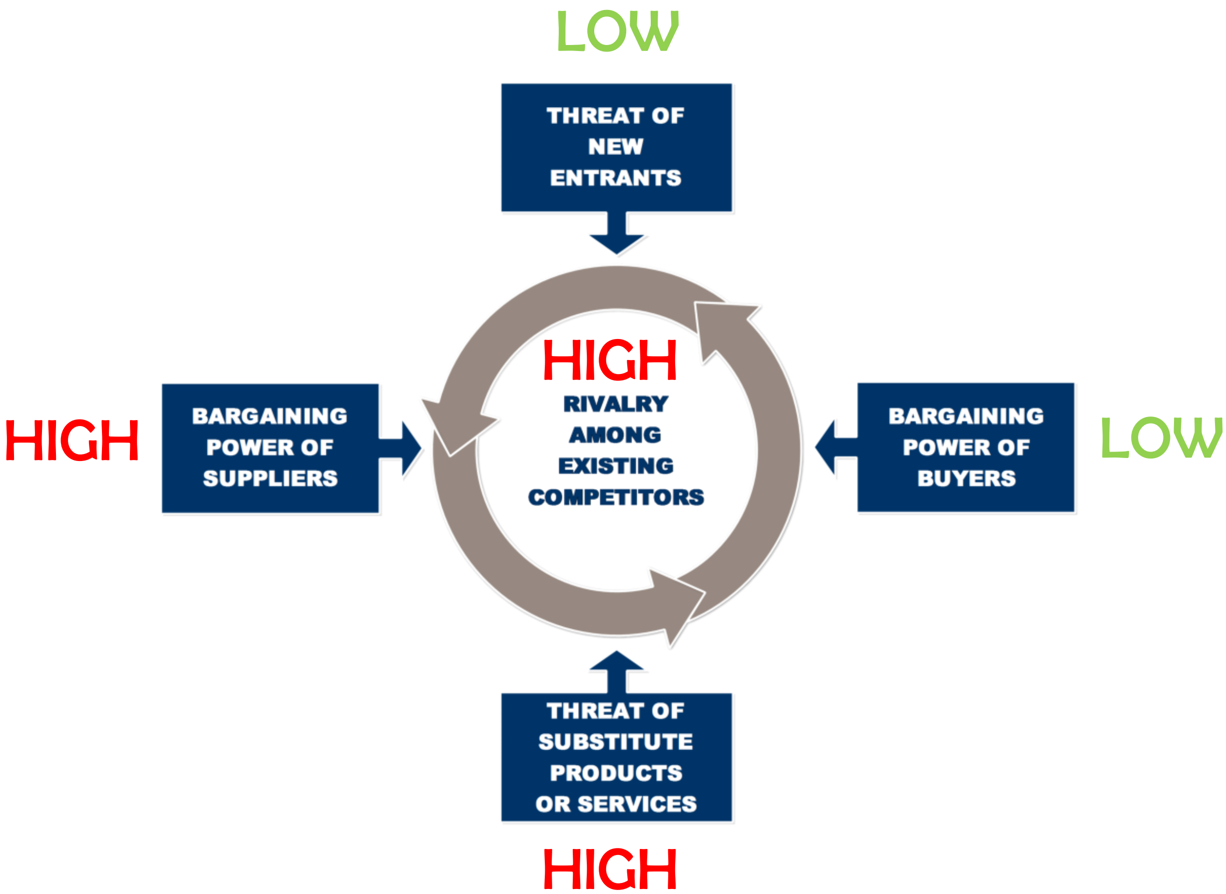
Appendix E

Logo of CVS Quits Program

Source: www.cvs.com

Appendix F

Summary of Porter's Five Forces for Drug Retail Industry



<u>Conclusion</u>: Unattractive industry

Source: Porter, 2008