

Brands Make A Comeback

OTC Market Resilient During Recession

As the recession winds to an end in 2010, the OTC market is expected to see a slowdown in sales growth of private label products and, as advertising and promotional spending by major brands increases, these brands are expected to begin to recover market share lost during the recession.

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» The U.S. OTC market is often a challenging market to make predictions about. There are so many instances where companies, brands, consumers, and even regulators buck trends that there are often reasons to look at things on a case-by-case basis. However, when it came to predicting the impact the economic recession of 2008-2009 would have on the industry, Kline turned to our vast historical data to make predictions.

Kline & Company has published "Nonprescription Drugs USA" for 30 consecutive years, preceded by periodic reports conducted since 1965. Based on this historical annual study, we were commissioned by our clients to undertake our assessment, entitled "Impact of Recessions on the U.S. OTC Market," which was published in June 2009.

Using past recessionary periods as a benchmark, including 1980-1982, 1990-1991, and 2001-2002, the study's objective is to provide historical perspective on industry performance during past recessions in order to assess the expected impacts of the current economic recession from 2008-2009 on sales performance and provide actionable forecasts for the future. Sales data and GDP data were adjusted for inflation.



A RESILIENT OTC MARKET

Overall, our analysis finds that the U.S. OTC market is not largely impacted by recessions. Sales of OTCs continue to grow even during recessions, albeit at a slower rate than during non-recession periods. The overall OTC market grew 3.2 percent during non-recession years and 1.2 percent during recession years. When adjusted to exclude the effects of Rx-to-OTC switches, the overall OTC market grew 2.1 percent during non-recession years and only 0.8 percent in recessions. Furthermore, we found that the impact of recessions on the OTC market mainly comes from erosion of branded OTC sales by private-label products and

is reflected in slower growth rates or even declining dollar sales.

Overall private-label products are able to retain most of the market-share gains made after the recession ends, as shown in Figure A. This suggests that consumers are generally satisfied with the efficacy and

Figure A: Market Share Gains During a Recession

Recession Period	P/L Market Share % Year Before	P/L Market Share % Year After
1980-1982	4.08%	12.26%
1990-1991	14.58%	18.48%
2001-2002	20.78%	20.91%
Current	20.17% (2007)	21.23% (2008)

Kline predicts that 2010 will start to see sales growth in the 3 percent to 5 percent range, with yearly increases expected over the next several years.

price of private-label OTCs and that a majority of consumers who trade down from their brands to private-labels during the recession remain with private-labels even after the recession ends.

This shift towards lower priced private-label products lowers dollar growth of the total market. The degree of private-label erosion varies by product class and category. Generally, private-label has higher erosion in: allergy relief, asthma, and sinus medications; cough and cold preparations; digestive products; internal analgesics; and nutritional products. There is limited erosion in other products, which includes sleeping aids, home diagnostic test kits, and smoking-cessation aids, and topical products. The least private-label erosion occurs in the feminine products class. Growth of pediatric private-label products does not seem to benefit from recession as much as adult private-label products, as parents may be less willing to trade down to private-label products for their children than for themselves.

Private-label OTCs gained substantial market share during the

1990-1991 recession because the penetration was low then and mass merchandisers were also in an expansion period. Market-share gains were less during the 2001-2002 recession as private-label OTCs were already well-entrenched by this time.

However, Rx-to-OTC switches, major innovations, and new product launches with related promotion that occur during recessions help to cancel the effect of private-label erosion, help to maintain sales, and can even lead to significant growth in categories. This was the case for categories such as allergy relief products, antidiarrheal preparations, contraceptive products, and fungicidal preparations.

IMPACT OF INVESTMENT

Despite the gains made by private labels during recessions, branded OTC companies that continue to invest in new product development, Rx-to-OTC switches, and advertising and promotions for their brands during these times are those that will be well-positioned for future growth. During tough economic times, it is understandable for companies to be conservative with ad spending levels and new product development costs; however, it is precisely those firms that continue to invest in those areas that were able to offset the impacts of past recessions.

Future switches will nonetheless be even more challenging than those that have already occurred. Most of the obvious switch candidates have already been approved for OTC sale and remaining switch candidates are unique and will present greater challenges to gain approval. Despite this challenging climate, Rx-to-OTC switches

are expected to deliver the most significant source of growth for the OTC industry over the coming years, regardless of recession, as they convert previously prescription users of the drugs to the OTC market.

Savvy OTC marketers will continue to seek future opportunities for Rx-to-OTC switches. The entry of major pharmaceutical companies like Pfizer, Merck, and Sanofi-Aventis to the OTC market through their respective acquisitions of Wyeth, Schering-Plough, and Chattem may help to increase the number of switches brought to market given the deeper resources of these larger organizations. These mergers also signify the importance of consumer healthcare divisions' expertise for overall lifecycle management and sustained revenue streams for these organizations.

Other impacts from past recessions on this industry are fewer price increases from marketers during recession periods. In the 1990 recession, price increases were actually below inflation to encourage sales due to the slow economy. Unit volume increased by 2.5 percent in 1990, and dollar sales in current value increased 3.9 percent. However, when the inflation factor is taken away, the sales in dollar value declined with 1.4 percent, concluding that inflation made the greatest contribution to industry growth in current value.

In past recessions, ad spending alone didn't seem to change. By contrast, during 2008 a 6.0 percent decline in ad spending for the overall OTC industry was noted. This is likely a result of OTC marketers seeking to control their costs in light of the uncertain economy; however, these marketers may have actu-

ally helped private-label products to grow by such high levels this past year. Sales of Rx-to-OTC switch brands are either not affected or are less affected than regular OTC brands by recession.

SELF-MEDICATING OPTIONS

Some OTC categories such as asthma medications actually benefit from recession as prescription abandonment increases during recession because consumers avoid physician visits, co-pays and higher costs associated with Rx medicines. Asthma medications' average growth became positive during recession, partially because consumers are more price-sensitive and switch to OTC drugs, which are priced lower than Rx medicines. The use of OTC asthma medicines help consumers save co-pays accompanied with prescription drugs and physician visits. Also, consumers who have lost employment, and associated health insurance during recession turned to self-medicating alternatives. These consumers would otherwise use prescription medicines during non-recessionary periods.

Hair regrowth treatments' sales declined most of the time while this category had small gains during recessions, likely because consumers may forgo more costly surgical procedures in favor of OTC hair regrowth treatments. During recessions, men seeking employment are more concerned about their appearance and may increase the usage of these products in order to remain competitive.

Recommendations for the future include the following for branded OTC companies:

- OTC marketers should maintain a sustained level of ad spending

and new product introductions, including line extensions, because both are necessary to combat the impacts of private-label erosion on major brands

- Furthermore, retailers expect high levels of ad support and new product launches from their OTC partners
- "Value messages" for major brands will resonate with consumers who are price sensitive during and post-recession
- Opportunities for future switches exist; however, many will be more challenging to gain approval for than in the recent past

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- Expanded OTC distribution to retail channels that offer consumers value such as mass merchandisers, warehouse clubs, dollar stores, and online will continue to drive sales in the future
- Marketers that employ a diverse mix of media to reach consumers and grab their attention will be successful in the future

So what does all this mean for the future performance of the OTC industry? The recession is expected to subside during 2010 and as a result private-label market share is expected to continue at current

levels; however, private-label sales growth will slow down once the recession ends. During 2010, we expect to see gradually increasing levels of advertising and promotional spending by major brands, and an increased number of innovations and line extensions will enter the market.

Recently approved Rx-to-OTC switches in the digestives category, including Novartis' Prevacid 24HR and Merck's Zegerid, are forecast to drive incremental growth in this category, bringing Rx users to the OTC market. Future Rx-to-OTC switches are also expected to drive strong growth for the industry beyond 2010 and possibly expand the OTC market to include new categories that do not currently exist. There is the potential for further regulatory restrictions on OTC ingredients, and these are expected to constrain dollar growth for the industry somewhat in the future. Private-label OTCs will continue to be a tough opponent for branded OTCs, impeding dollar growth. Overall, Kline predicts that 2010 will start to see sales growth in the 3 percent to 5 percent range, with yearly increases expected over the next several years, with some years poised for even higher growth depending on the levels of regulatory approvals of Rx-to-OTC switches. Altogether, the OTC landscape looks challenging, but bright. <<

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