Community Pharmacy England

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Briefing 011/25: Margin Explainer: Background Briefing

Funding arrangements for community pharmacies, particularly the processes around delivery of retained margin, are not straightforward and it can be difficult for pharmacy owners to predict the impact of any changes on their businesses. This background briefing from Community Pharmacy England's Funding Team aims to demystify the processes around the distribution and management of margin delivery.

What is 'margin'?

Simply, 'margin' is the difference between the prices that pharmacies pay to procure medicines, and the prices that the NHS will reimburse them for dispensing those medicines against NHS prescriptions.

For example, if a generic Category M medicine costs a pharmacy £3.00 to purchase (after any wholesaler discounts are factored in), and has a reimbursement price of £5.00 (after discount deduction is factored in), then the pharmacy would retain £2.00 in margin when dispensing the medicine against an NHS prescription.

How does 'margin' fit into the wider funding picture?

In 2025/26 the total value of the contract sum used to pay pharmacies for activities provided as part of the Community Pharmacy Contractual Framework (CPCF) will be £3,073m (this excludes funding delivered through the Pharmacy First budget, which is separate).

This CPCF funding is allocated in two ways:

a) Fees and allowances (remuneration)
b) Margin

The allocation to 'fees and allowances' is £2,173m. The allocation to 'margin' is £900m. Together these comprise the £3,073m total allocation for the core CPCF in 2025/26.

'Fees and allowances' encompasses all the itemised payments pharmacies receive for providing services. This includes all dispensing fees (such as the Single Activity Fee), clinical service fees, Pharmacy Access Scheme (PhAS) payments, Pharmacy Quality Scheme (PQS) payments, etc.

All these payments are drawn from the same allocation of £2,173m. This means that if there is an increase in spend on a specific fee (e.g. NMS fees, Blood pressure fees etc.) the funding available for other elements that are also funded from this allocation is restricted.

'Margin' is the profit that community pharmacies are allowed to retain through cost effective purchasing of medicines for dispensing against NHS prescriptions. Pharmacies are incentivised to purchase medicines at lower prices, in order to maximise the amount of margin they retain. In addition to delivering margin to pharmacy contractors, this mechanism helps to keep medicine prices low, which benefits the NHS and taxpayers.

The amount of margin that the pharmacy sector retains is measured through a 'Margins Survey'.

What is the Margins Survey?

As part of the pharmacy funding agreement, pharmacy margin levels are monitored and adjusted with the aim of delivering a specific level of margin to the community pharmacy sector each year (this is set at £900m for 2025/26).

The Margins Survey measures the margin levels obtained by a sample of independent pharmacies throughout the year, and this is used to estimate the overall cash margin delivered to the sector. The survey was developed by professional statisticians engaged by both the Department of Health ad Social Care (DHSC) and Community Pharmacy England, and has recently been reviewed by a prestigious university. Community Pharmacy England has worked with DHSC since the implementation of the survey in 2005 to further improve the accuracy and timeliness of margin results.

If Margins Survey results indicate that margin delivery for any period is not in accordance with the agreed parameters, then corrections to pharmacy margin levels will be enacted via the adjustment of Category M reimbursement prices.

Detailed information about Margins Survey processes is available on the Community Pharmacy England website.

What is the relationship between 'margin' and Category M?

Category M was introduced into the Drug Tariff in April 2005, when the community pharmacy contractual framework was launched which officially recognised Margin as an income stream for community pharmacies. It is the mechanism used to set the reimbursement prices of over 600 medicines.

It broadly contains the most common / high usage generically available medicines, and is the principal price adjustment mechanism to ensure delivery of the retained margin guaranteed as part of the contractual framework.

DHSC use their legislative powers to gather information from suppliers on volumes and prices of products sold, plus information from the NHS Business Services Authority (NHSBSA) on dispensing volumes, to set prices each quarter.

Community Pharmacy England has a team dedicated to closely monitoring Category M and the Margins Survey to ensure that the scheme operates correctly. Through our interventions and corrections we have routinely saved hundreds of millions of pounds for pharmacy owners.

How do Category M adjustments work?

There are 2 types of adjustments that occur in quarterly Category M price lists:

a) Systematic movements due to changes in underlying buying prices in the market
b) Margin adjustments due to the findings from the margins survey

Margin adjustments and adjustments due to the underlying market changes are separate, and occur independently of each other.

Even if there was no margin adjustment being made in a quarter, Category M prices will still be updated based on the latest market movements. If medicine prices rise or fall in the market, then this will still be reflected in what happens to Category M prices.

The intentional margin adjustments, and systematic adjustments due to underlying market movements, can be in the same direction or opposite directions, positively or negatively. If in opposite directions, they can act to cancel each other out so overall changes to reimbursement are minimised. If they occur in the same direction, changes to reimbursement are amplified.

All the adjustments in play for a given quarter affect the 'Target Net Ingredient Cost (NIC)' for that quarter, which is the overall amount of reimbursement that DHSC are aiming to deliver in the quarter when setting the Category M price list.

For example, if there were 2 adjustments in play for an upcoming quarter such as:

a) Systematic underlying adjustment: +£30m
b) Margin adjustment: -£20m

Then the overall Target NIC for the quarter would have a net increase of +£10m, compared to the Target NIC for the previous quarter.

Systematic price adjustments

DHSC gathers market information from the supply chain every quarter, using its legislative powers. This information tells them how much of every product has been sold into the market and at what price.

DHSC uses the data it has gathered from manufacturers specifically to calculate an average manufacturers' selling price into the market for every product. This is weighted by how much each manufacturer sold and at what price. This price is compared to the same calculation from the previous quarter, determining the change in the average market price (delta) for every product.

DHSC then works out what the change in Target NIC should be, given the delta for any given product. To do this, DHSC multiplies the delta by the volume of that product dispensed by pharmacies in the latest 3 months' available data.

This process is conducted for every Category M product. The sum of all changes for every product then tells the DHSC what the total change in Target NIC due to underlying market movements needs to be, when setting the Category M price list for the upcoming quarter.

Margin related adjustments

Margin adjustments are determined by the findings from the ongoing Margins Survey that is conducted in collaboration between Community Pharmacy England, DHSC and NHSBSA. Every quarter the Margins Survey returns an estimate for the amount of margin that was earned by the community pharmacy sector. This is based on information gathered directly from independent community pharmacies.

The Margin Survey indicates how much margin was earned by the sector, and whether this represents an over or under delivery of margin compared to that quarter's targeted amount of margin. The quarterly margin target for 2025/26 would be £225m (i.e. £900m/4 quarters).

If the Margins Survey shows that there was an over or under delivery of margin in a quarter, this means a margin adjustment to correct this will follow. This margin adjustment has to achieve 2 aims:

a) Correct the margin run rate
b) Recoup / Repay the quantum of margin that was over or under delivered

So for example, if margin was over delivered by £10m in a quarter, subsequent Category M adjustments must reduce the run rate by £10m, **and** recover the £10m excess that was delivered. In theory this could mean a -£20m adjustment could be applied in the following quarter, followed by a +£10m the next quarter, once the £10m excess was recovered.

However, changes resulting from a Margin Survey result are not applied all in one go. They are smoothed over 4 quarters. This is in recognition that the results from any single quarter may not be robust, so it allows the results over 4 quarters to all be in play at the same time, evening out the potential error of survey results over time. Smoothing the application of margin adjustments over 4 quarters also means that potentially large hits to reimbursement get applied gradually rather than all at once.

An implication of this smoothing process is that the actual margin adjustment intended to be made in a given quarter is highly complex; it is the net sum of 8 different adjustments, with 2 new adjustments being added in and 2 dropping out each quarter.

Margin Adjustment Example

In the example where the results from the Margins Survey showed an over delivery of £10m, there would follow:

a) A downward adjustment of -£2.5m, left in place for 4 quarters, to recover the £10m; and
b) A downward adjustment of -£2.5m in the next quarter, which increases by -£2.5m for the next 3 quarters, so that by the 4th quarter after the margin result, a total run rate correction of -£10m has been applied. This is then left in place indefinitely.

If you have any queries or require more information, please contact: funding.team@cpe.org.uk