PBM Economics

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PBM Economics

• What is the role of PBMs in the pharmaceutical supply chain?
• How well is the PBM market functioning?
• Potential policy solutions
Flow of prescription drugs

PBMs are true middle men, they play no role in the physical distribution of prescription drugs to consumers
Flow of services

R&D, marketing, manufacturing

Manufacturer

Wholesale distribution

Wholesaler

Retail distribution

Pharmacy

Beneficiary

Plan sponsor

Employer

PBM

Manage drug benefits

Rx drug coverage

Health Plan

Manage drug benefits

Rx drug coverage

PBM

Manage drug benefits

Rx drug coverage

Health Plan

Manage drug benefits

Rx drug coverage

PBM

Manage drug benefits

Rx drug coverage

Health Plan
PBM relationship with other supply chain participants

- **Manufacturer**
  - Provide market access
  - Receive rebates & adm. fees

- **Distributor**
  - Provide market access

- **Pharmacy**
  - Pay pharmacies on behalf of health plans

- **Health Plan**
  - Pay pharmacies on behalf of health plans

- **Employer**
  - Provide market access

- **Beneficiary**
  - Manage drug benefit
How do PBMs make money?

**Manufacturer**
- Provide market access
- Receive rebates & adm. fees

**Distributor**
- Provide market access

**Pharmacy**
- Pay pharmacies on behalf of health plans

**Beneficiary**

**Employer**
- Provide market access

**PBM**
- Receive negotiated payment for reimbursing pharmacies & admin fee
- Pass through some rebates to health plans
- Manage drug benefit

**Health Plan**
- Spread Pricing: Difference between negotiated payment from health plan and what is paid to pharmacies
- Retained Rebate: Difference between rebate received from the manufacturer and amount passed through to plans
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Buying a house:

- Sally is considering buying a house.
- Her real estate agent is John.
- John negotiates with the seller a $10,000 reduction in the price of the house.
- Sally pays $10,000 less for the house.

Scenario:

- She now has two agents: John & Joe
- John negotiates a $10,000 discount from the seller. The amount is **secret and not disclosed**. He keeps some of the money and passes the rest to Joe.
- Joe keeps some of the **undisclosed** money received from John and passes the rest to Sally.
- How much of the $10,000 did Sally receive?
Lack of transparency means consumers might not benefit from higher rebates

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Rebates misalign incentives: Not choosing cheaper drugs

Drug A
Retail Price: $200
• rebate of $50

PBM keeps
$5

Cost to health plans
$155

Cost to consumers?

Drug B
Retail Price: $100
• rebate of $30

PBM keeps
$3

Cost to health plans
$73

Cost to consumers?

Assume retail and wholesale mark-up is 10%; PBM keeps 10% of rebate
Lack of competition in the supply chain

- Highly concentrated supply chain with few key players controlling large market shares
  
  - Top 3 PBMs account for roughly 75% of covered lives
  
  - Wholesale, pharmacy and insurer markets are also highly concentrated
  
  - Of $100 spent on drugs, $42 goes to PBMs, wholesalers, pharmacies, and insurers.
Consolidated PBM markets means higher costs for consumers

- Dominant PBMs might negotiate higher rebates but not pass rebates to health plans
- Dominant PBMs might engage in excessive “spread pricing”
New wave of vertical consolidation in pharma supply chain might further curtail competition

• Misaligned incentives
  – A PBM that owns a pharmacy might favor its own pharmacy even if rival pharmacies have lower costs
  – A PBM that owns a health plan might try to increase drug costs of rival health plans

• Barriers to entry
  – Need to entry several distinct supply chain markets to effectively compete in the market
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Recommendation one: Improve drug price transparency throughout the supply chain

• Improve drug price transparency throughout the supply chain by following the flow of money for “tracer” drugs.
• Tracer drugs are:
  – Those that account for significant fraction of state/federal spending on drugs
  – Those that have experienced significant increase in list price
• Any firm (manufacturer, wholesaler, PBM, pharmacy etc) that does not participate cannot get state/federal funding
Recommendation two: Move from a rebate system to a discounts model

- Discount model ensures that price reductions are passed to health plans and consumers
- Discount model better aligns incentives of PBMs with incentives of payers and consumers

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Recommendation three: Mandate pass-through of rebate to consumers

- Ensures that consumers get the benefits of rebates
- More equitable as sick consumers using drugs are not subsidizing healthy consumers not using drugs
Recommendation four: Outlaw unfair business practices of PBMs

- Limits to spread pricing
- Minimum rebate pass through
- Limits to favorable pricing for affiliated business units such as health plans and pharmacies
Recommendation five: Reduce barriers to entry in the PBM market

- I do not know how to do this, but it is a good idea!