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# PBM Economics

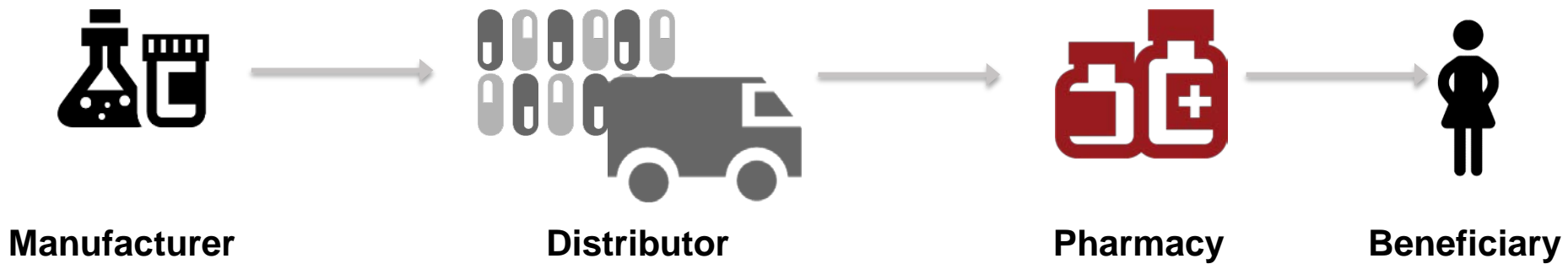
**Neeraj Sood, PhD**

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USC Price School of Public Policy & USC Schaeffer Center*

## **PBM Economics**

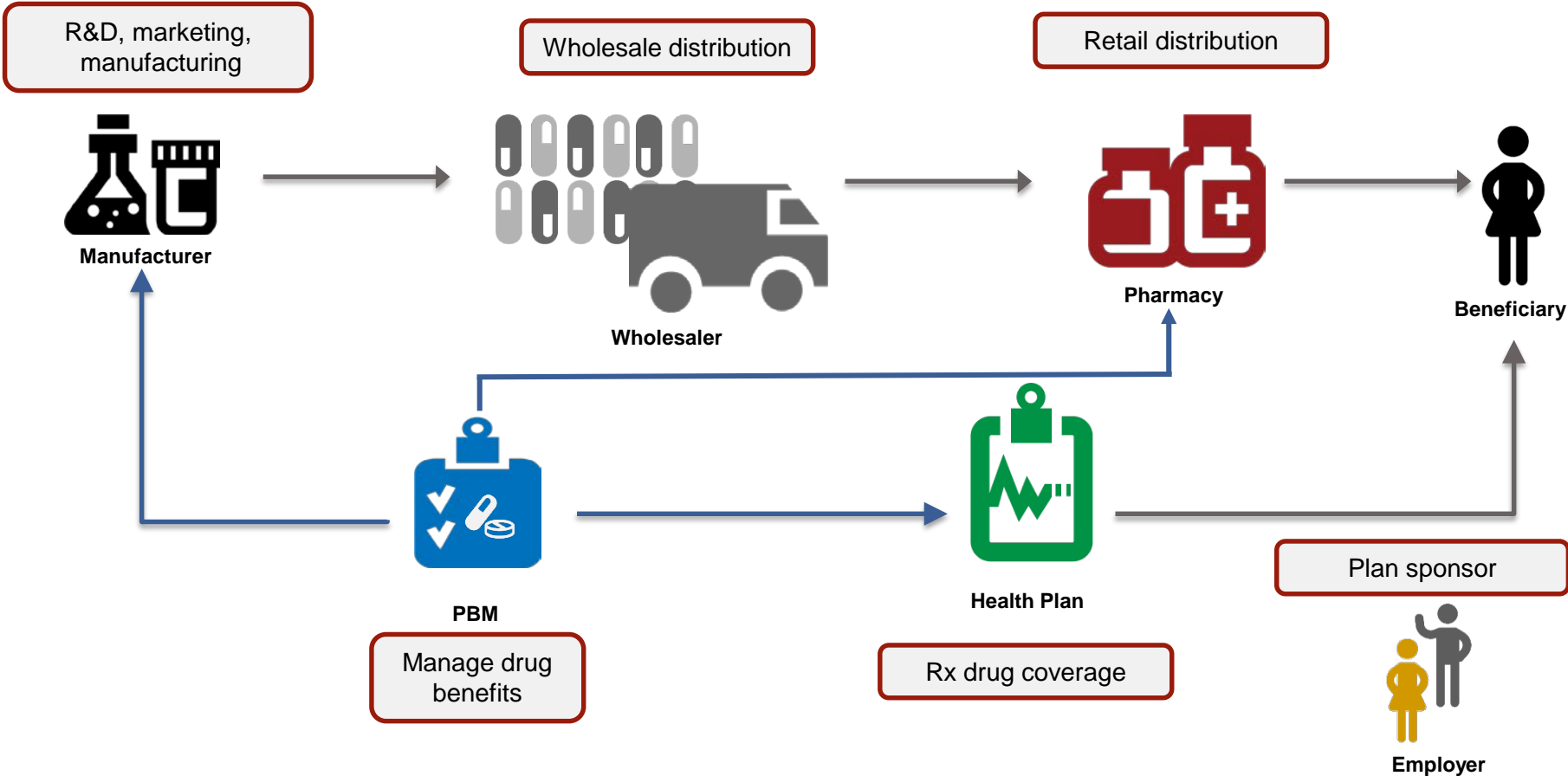
- **What is the role of PBMs in the pharmaceutical supply chain?**
- **How well is the PBM market functioning?**
- **Potential policy solutions**

# Flow of prescription drugs

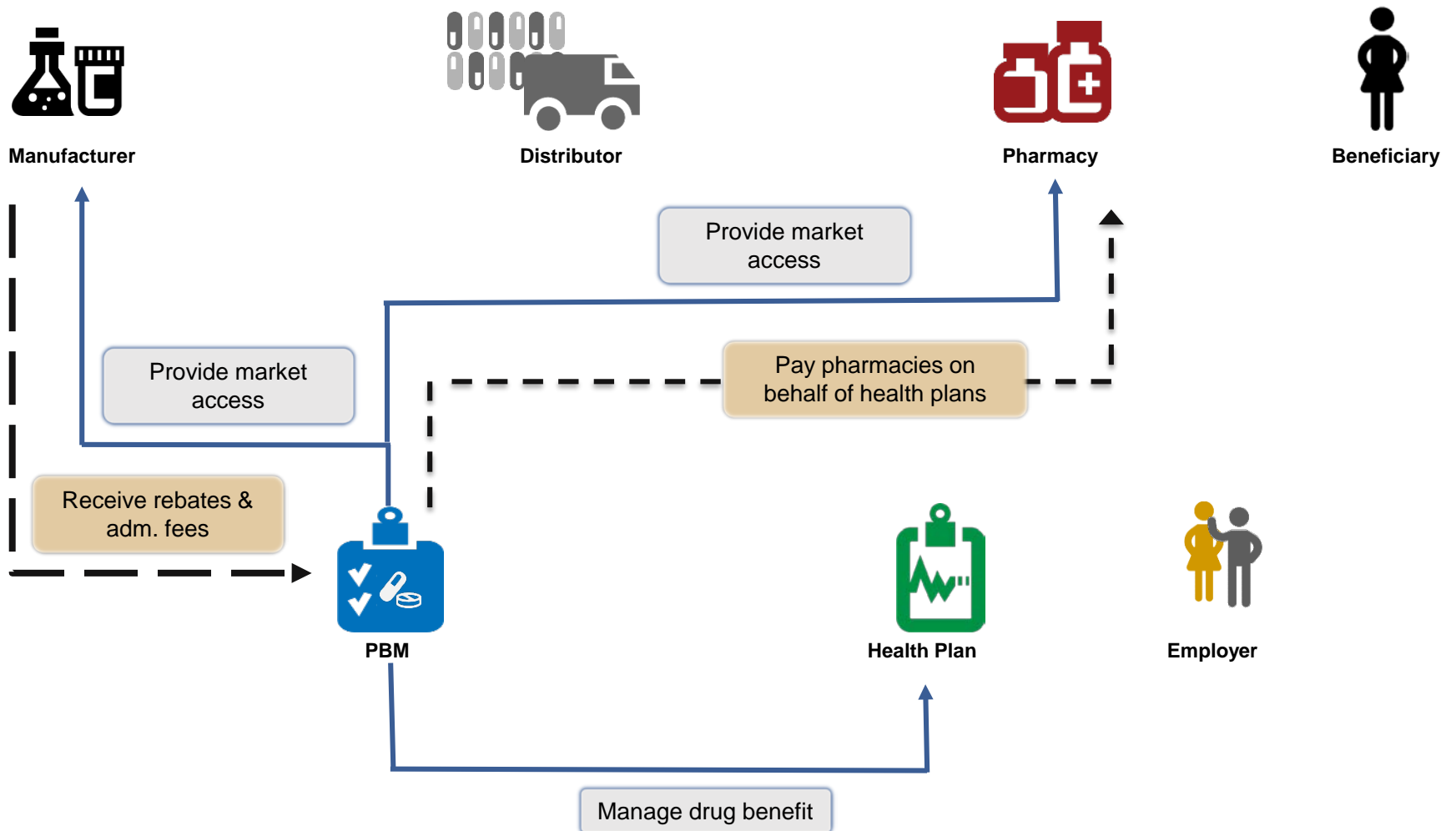


PBMs are true middle men, they play no role in the physical distribution of prescription drugs to consumers

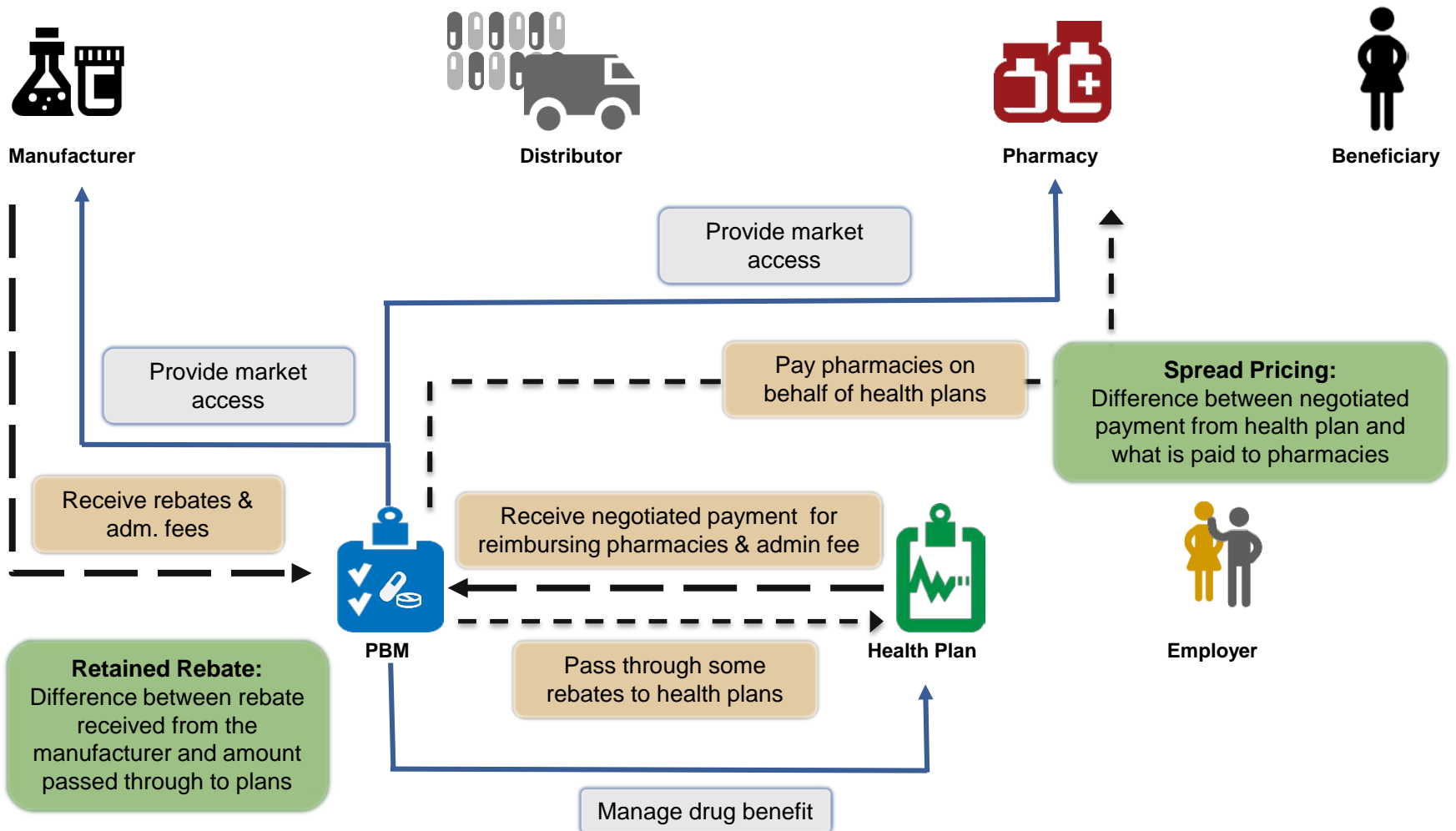
# Flow of services



# PBM relationship with other supply chain participants



# How do PBMs make money?



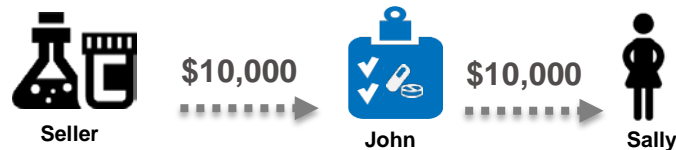
## PBM Economics

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# Trickle down rebates ...

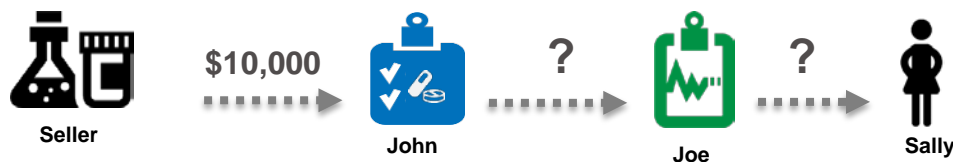
## Buying a house:

- 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?

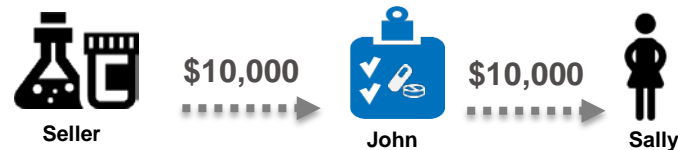




# Lack of transparency means consumers might not benefit from higher rebates

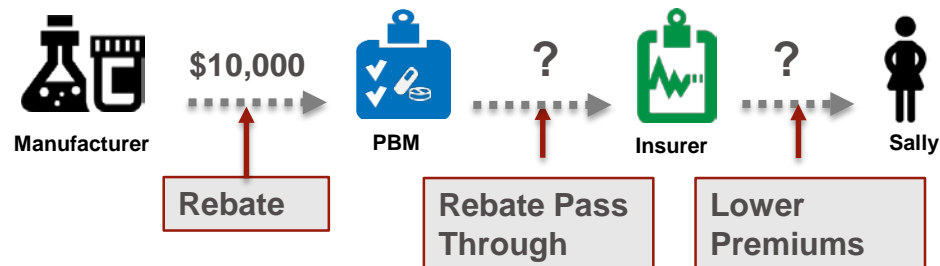
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# Rebates misalign incentives: Not choosing cheaper drugs

	 PBMs keeps	 Cost to health plans	 Cost to consumers?
 <b>Drug A</b> Retail Price: \$200 • rebate of \$50	\$5 <input checked="" type="checkbox"/>	\$155	
 <b>Drug B</b> Retail Price: \$100 • rebate of \$30	\$3	\$73 <input checked="" type="checkbox"/>	<input checked="" type="checkbox"/> <b>Uninsured</b> might pay list price <input checked="" type="checkbox"/> <b>Insured consumers below deductible</b> might pay list price <input checked="" type="checkbox"/> <b>Insured</b> may pay higher premiums

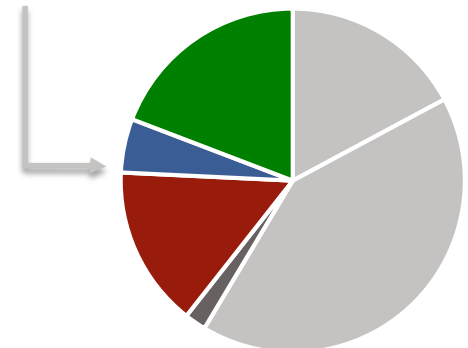
*Assume retail and wholesale mark-up is 10%; PBM keeps 10% of rebate*

## Lack of competition in the supply chain

- Highly concentrated supply chain with few key players controlling large market shares

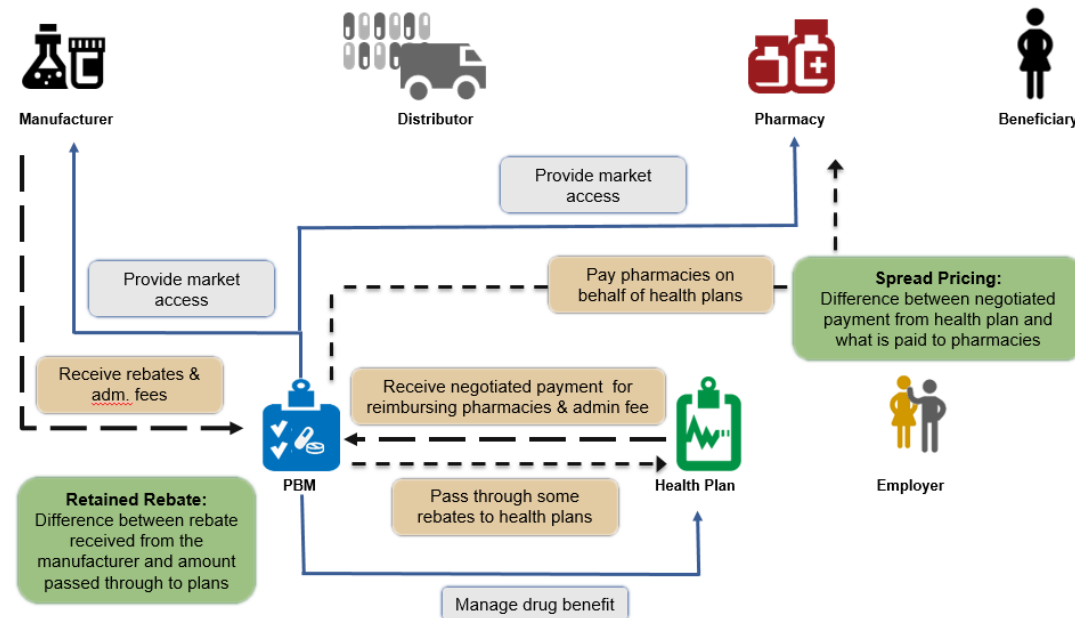


- Top 3 PBMs account for roughly 75% of covered lives
- Wholesale, pharmacy and insurer markets are also highly concentrated
- Of \$100 spent on drugs, \$42 goes to PBMs, wholesalers, pharmacies, and insurers.



# 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



## PBM Economics

- What is the role of PBMs in the pharmaceutical supply chain
- How well is the PBM market functioning?
- **Potential policy solutions**

## **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

### Buying a house:

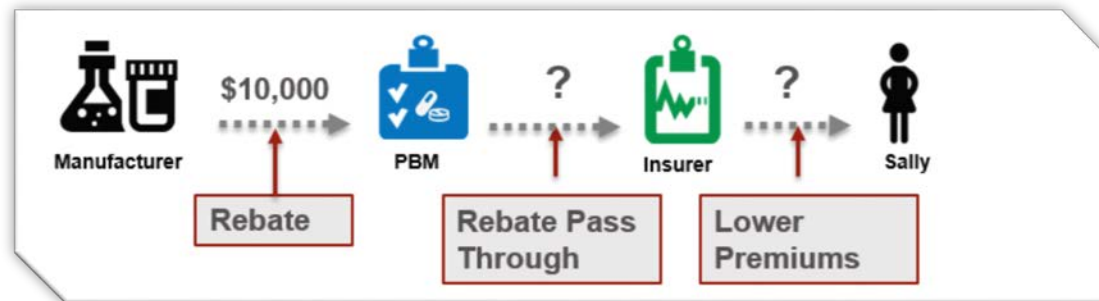
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## Recommendation three: Mandate pass-through of rebate to consumers

- 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!