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# The Push for Transparency

Pharmaceutical Strategies Group  
*Maximizing Value in Pharmaceuticals*



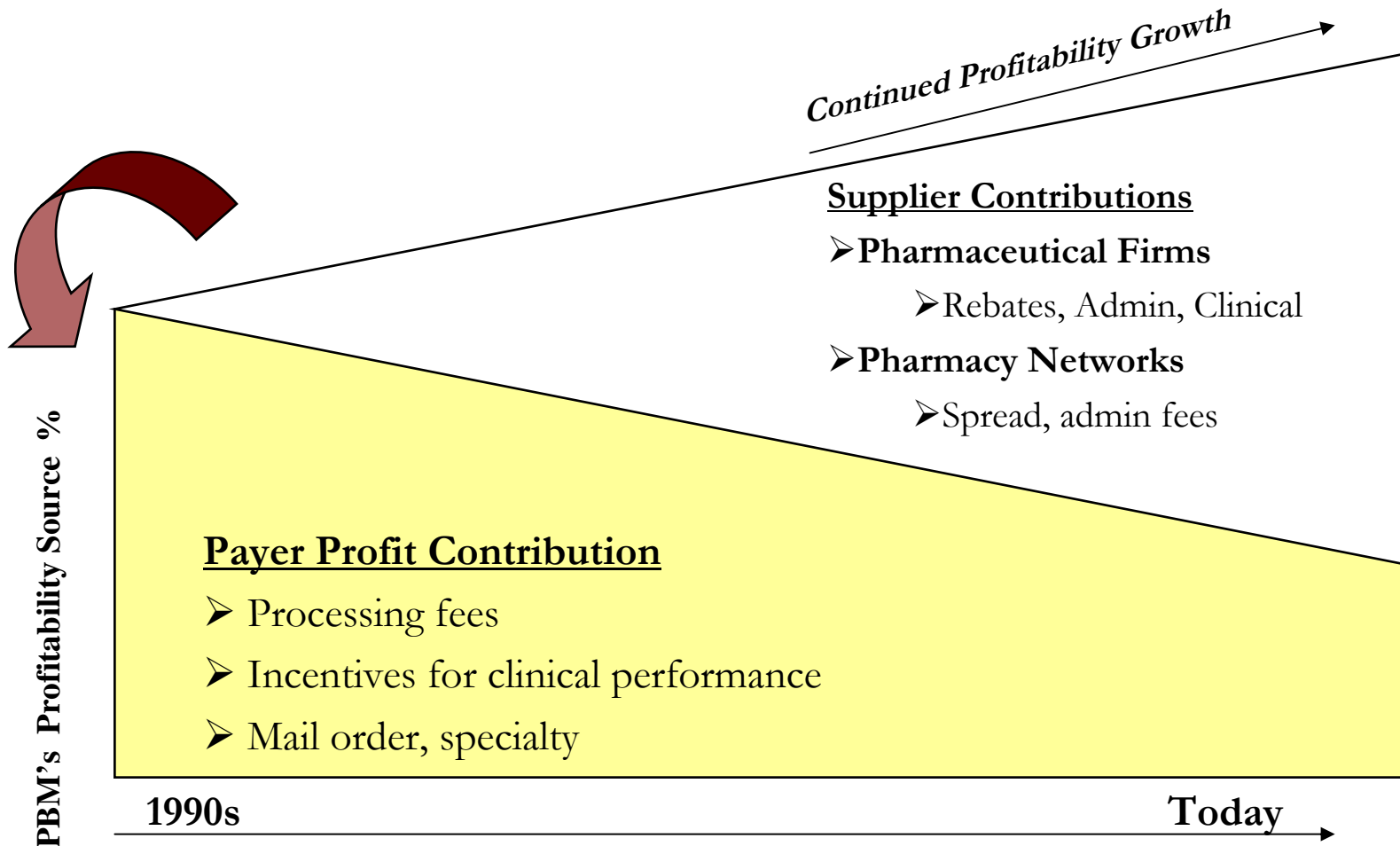
# Transparency

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- The Changing Financial Dynamic
- Transparency Defined
- The Appeal
- The Challenge
- The Competitive Landscape
- Comparing Financial Offers
- Contracting



# The Changing Financial Dynamic



# The Changing Financial Dynamic

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"There is nothing more complex than the negotiation to try to figure out what you're purchasing," says Keith Bruhnsen, assistant director of benefits at the University of Michigan and who manages the university's pharmacy plan. "It's the most ambiguous and convoluted part of my job."

Comments in Managed Care Magazine, September 2002



# A New Model is Being Considered

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## Key Elements of the New Model

- Demonstrate transparency in supplier pricing arrangements
  - Network pharmacies
  - Pharmaceutical firms
- Implement effective strategies to improve clinical outcomes
  - Compliance, adherence to guidelines, etc.
- Recapture the role of educating providers and consumers on the relative value of medications
  - Become a key participant in evaluating the outcomes & costs of medications when used by patients in real world settings



# Transparency Defined

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- Market Definition
  - PBM discloses and provides the full extent of pre-negotiated supplier discounts, in exchange for a flat billing mechanism (per claim, PEPM, PMPM, etc)
    - Retail network pricing
    - Manufacturer discounts
- Vendor Definitions
  - Disclosure only?
  - Disclosure + pass along some pricing?
  - Disclosure + pass along all pricing?



# The Appeal of Transparency

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- Simplify the PBM Procurement Process
- Leverage more value from the PBM supplier relationship
- Reduce or eliminate the potential for perverse incentives to increase costs
  - e.g. pushing higher cost brand drugs to obtain rebates
- Obtain better information to facilitate better plan coverage and management decisions
  - Net cost of drugs
- Reduce overall cost of PBM relationship



# The Challenge of Transparency

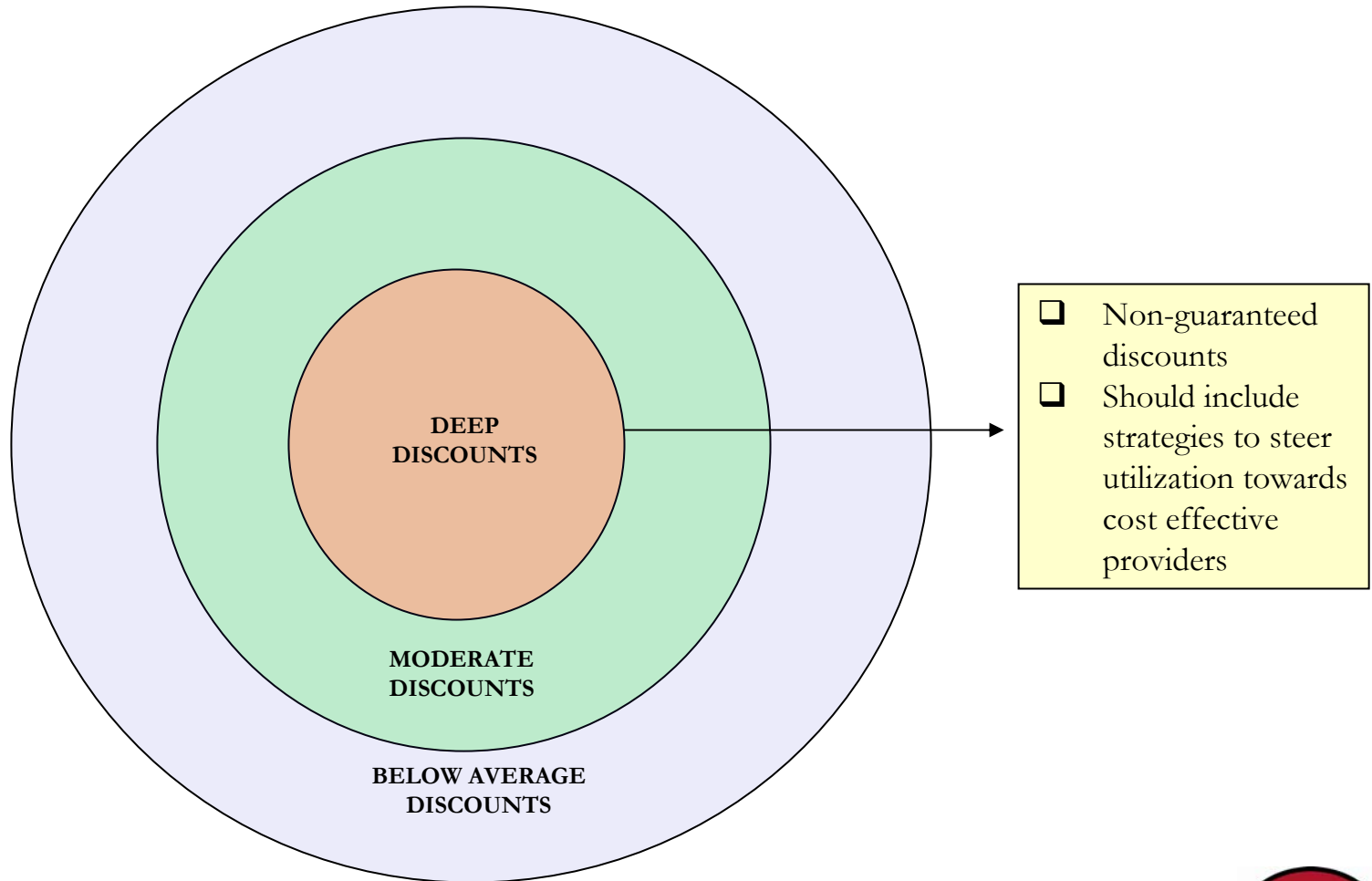
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- Could create a negative financial position for employers and other payers
  - Upfront cash for admin fees that may not be offset by incremental supplier discounts
  - Supplier contracting risk shifts to the employer or payer to manage
    - Steerage management programs must be in place to obtain maximum value from the transparent contracting approach
- Audits may be required to ensure transparency
  - More comprehensive than past audits
  - Different audit skill set / industry expertise required
- Inexperience of new market entrants
  - Service guarantees are important
  - Service bundle expectations are important
- Will PBMs lose their interest in negotiating aggressive supplier contracts?

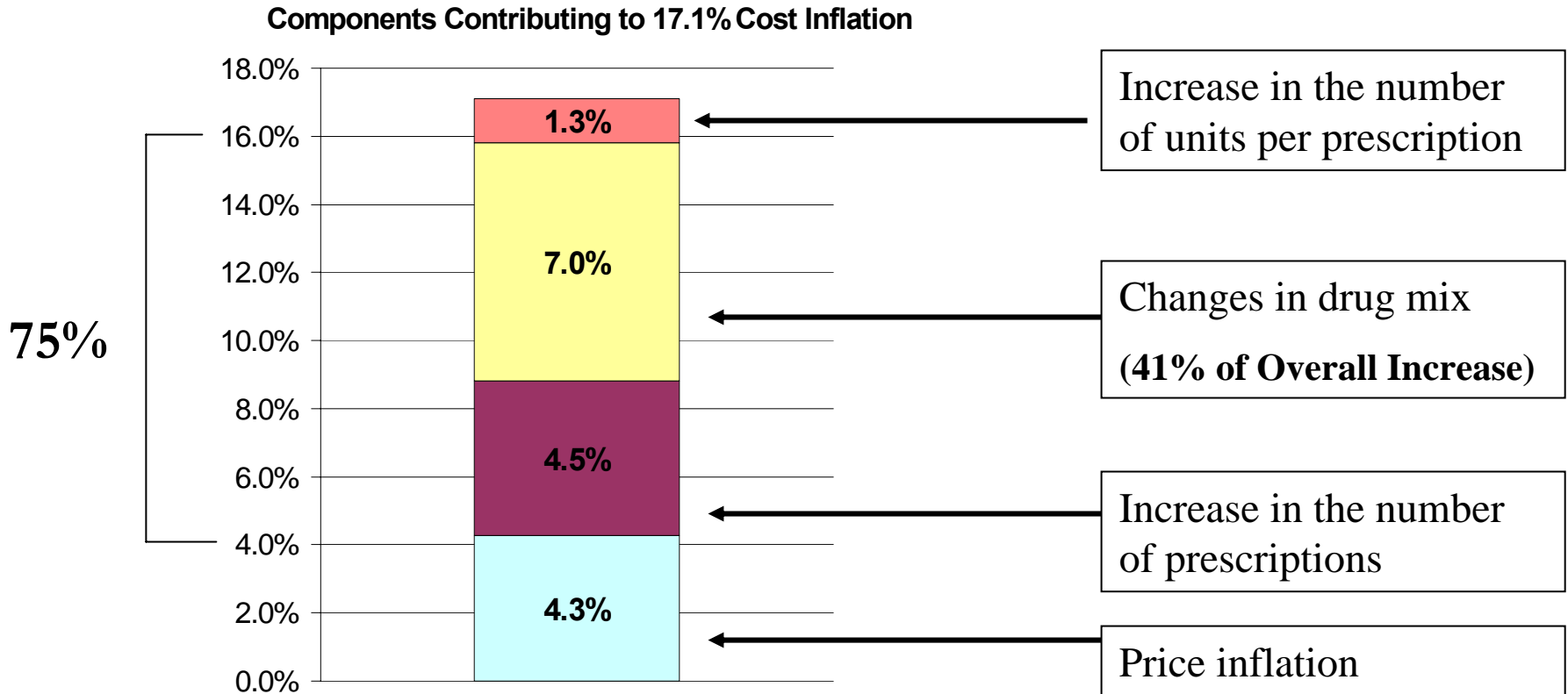


# The Challenge of Transparency

Network  
Steerage



# The Challenge of Transparency



Source: Mercer Human Resources Consulting Report to CalPERS, 2003



# The Competitive Landscape

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- **New Market Entrants**
  - EBR<sub>x</sub>
  - Envision Pharmaceutical Services
  - Innoviant
  - Navitus
  - RxEDO
  - Others?



# The Competitive Landscape

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- **Established Firms**

- Several firms offering a version of transparent pricing
- May be expected to continue to provide traditional levels of service for much reduced fees
- Cost structure may not allow traditional firms to compete under this model
  - Shareholder expectations may prevent these firms from changing quickly enough



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# Evaluating Alternative Sourcing Strategies



# Evaluating Alternative Sourcing Strategies

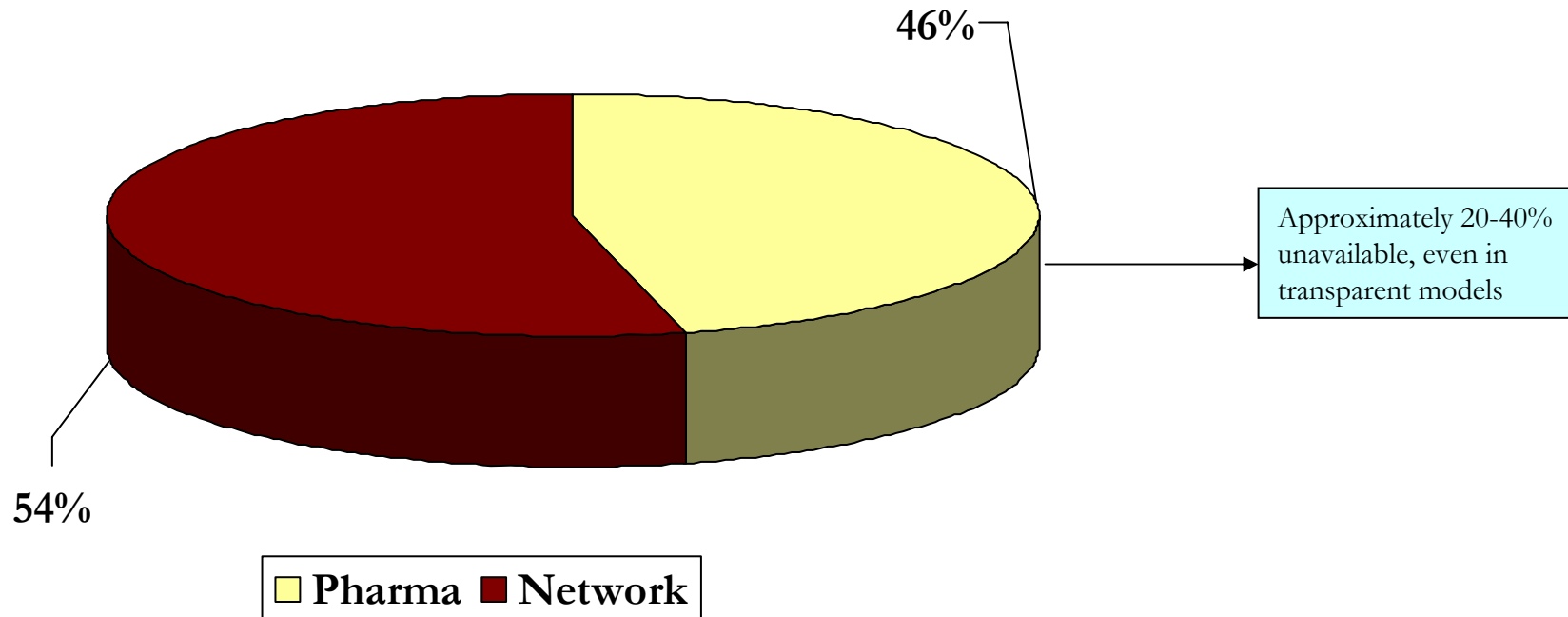
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- **Sample client**
  - Midsized employer or small MCO
  - New PBM contract within the past 18 months, with competitive rates
  - 3 tier copay



# Evaluating Alternative Sourcing Strategies

Where the Money Is..\$3-5 “net revenue”  
Approximately \$4.10 / Rx



# Evaluating Alternative Sourcing Strategies

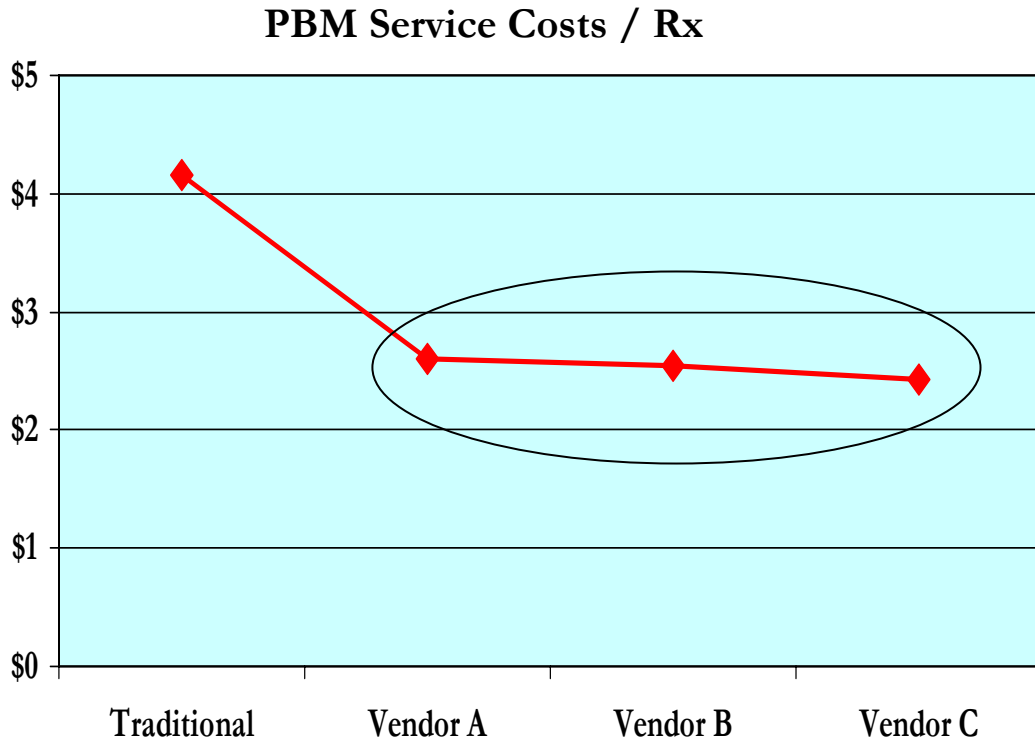
## PBM Service Costs / Rx

Traditional Revenue Model		Transparent Revenue Model	
Admin Fees	\$xx	<u>Flat fee / Rx, PEPM, or PMPM</u>	\$xx
Network Spread	\$xx		
Rebates	\$xx		
Pharma Admin Fees	\$xx		
<u>Other Misc Fees</u>	<u>\$xx</u>		
<b>Subtotal</b>	<b>\$3-\$5/Rx</b>	<b>Subtotal</b>	<b>\$3-\$5/Rx</b>

Traditional PBMs that are willing to offer clients a transparent pricing model may seek to obtain the same level of revenue, all derived from the client in the form of higher administrative fees. The market may be unable or unwilling to bear the pricing that will be required for traditional PBMs to succeed under this type of model.



# Evaluating Alternative Sourcing Strategies



Transparent pricing has the potential to strip 30-50% of cost from the current PBM / employer relationship

“Transparent” PBMs will most likely compete on service bundle, experience, difference of model, ability to influence utilization, etc.

Pricing points will be fairly similar in the next 12-18 months



# Review of Financial Model

## Sample Net Cost Analysis

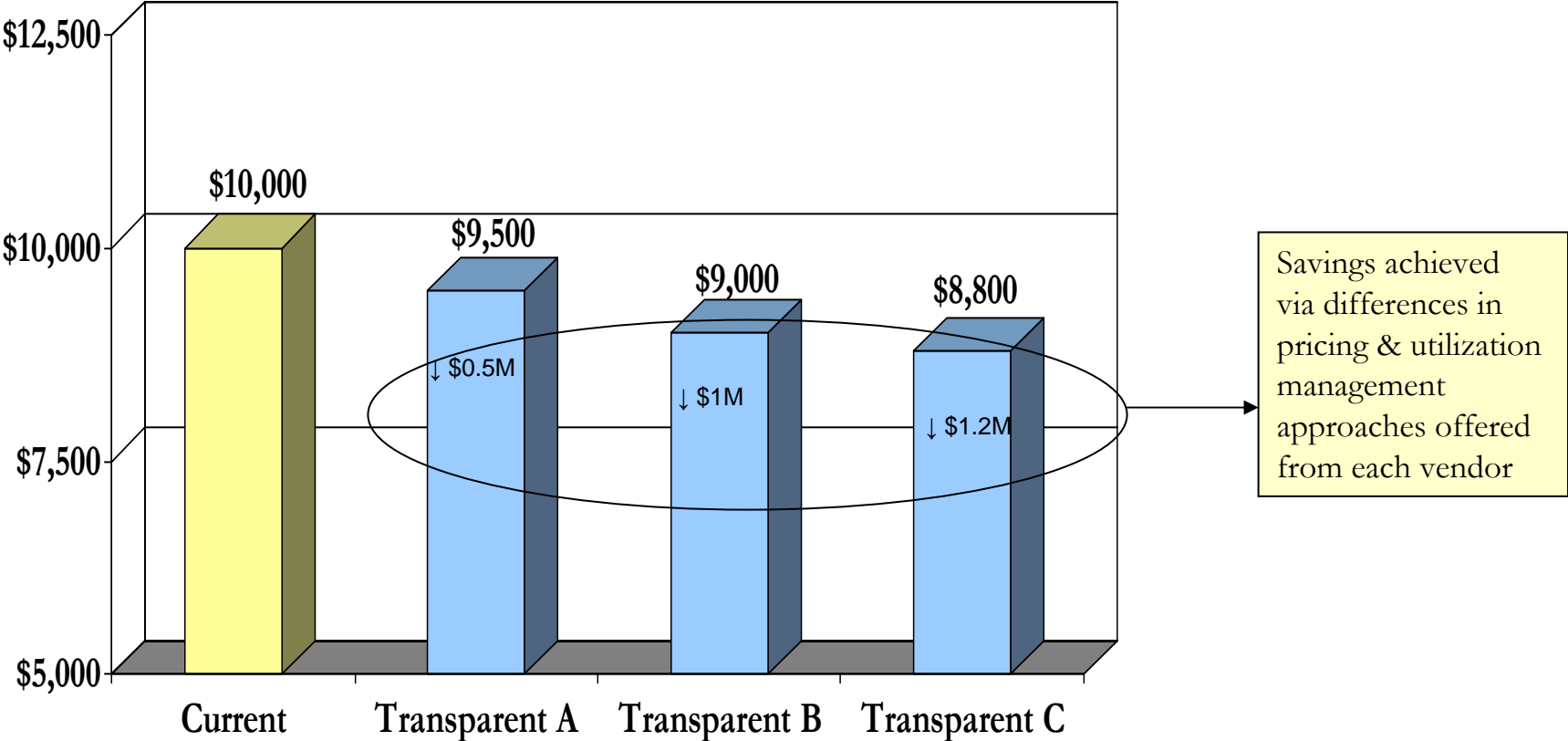
Cost Element	Traditional Pricing Model	Transparent Pricing Model		
		Vendor A	Vendor B	Vendor C
Gross AWP				
- Network Discounts				
- Rebates				
- Network Fees				
- Cost Share				
+ Administrative Fees				
+ Dispensing fees				
<b>Est. Net Cost</b>				

This traditional pricing analysis should be supplemented by an evaluation of how drug mix could change under each management model based on each vendor's formulary, clinical program strategy, financial incentives etc.



# Evaluating Alternative Sourcing Strategies

Sample Financial Comparison  
Annual Pharmacy Spend (000's)



# Evaluating Alternative Sourcing Strategies

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- **Financial comparisons**
  - How does Vendor A's transparent pricing compare to Vendor B's?
  - Which vendors will offer a guaranteed effective rate as part of their overall proposal?
  - What services will be included in the flat pricing offered?
  - How will differences in clinical program strategies influence net costs?
- **Operational / service comparisons**
  - What service bundle will you require the vendor to manage?
  - How effective will each vendor be in executing on the basics...claims admin, member education, reporting, network management, etc?
  - What experience does each firm have serving customers of similar size and scope?
- **Clinical Comparisons**
  - What resources does the company have to help drive utilization of cost-effective medications?
  - How effective have the firm's clinical programs been historically?
  - Are the firms willing to guarantee the effectiveness of their programs?



# Evaluating Alternative Sourcing Strategies

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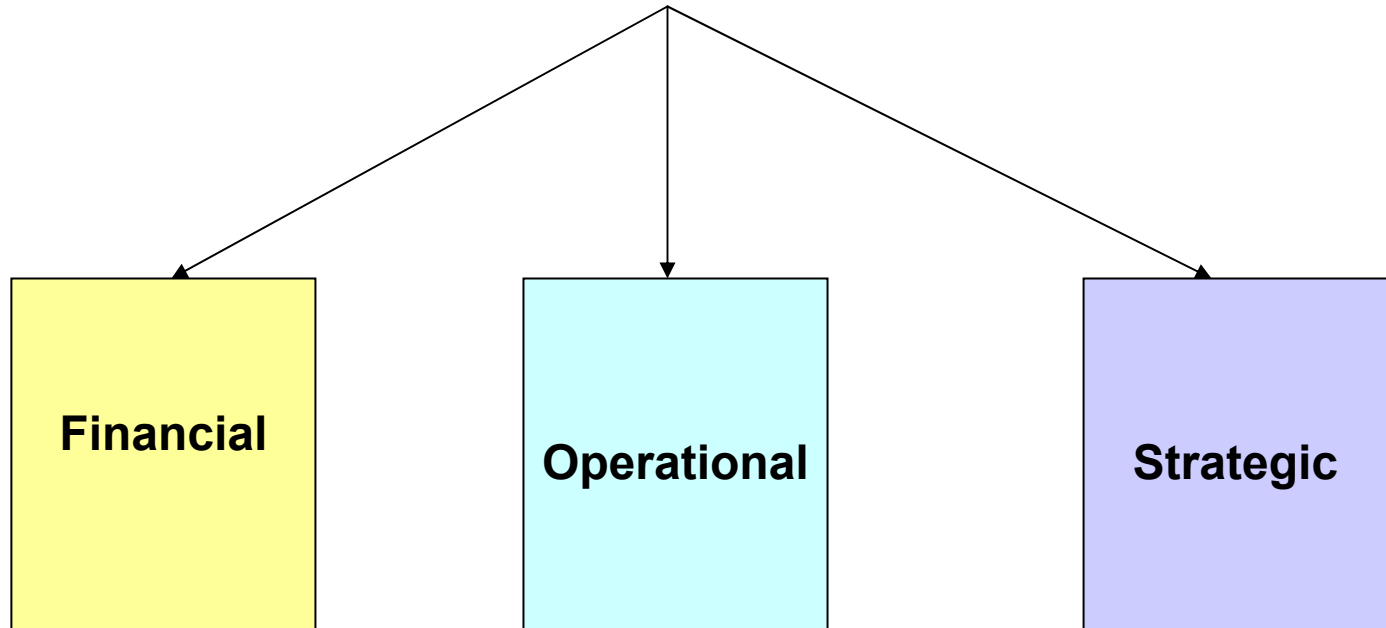
- Service guarantees
- Financial improvement guarantees or corridors
  - Pricing
  - Clinical programs, including utilization management
- Audit rights
  - Network agreements
  - MAC pricing tables
- Manufacturer audit rights
  - Access to top 15 agreements annually
  - Contracts, invoices submitted to manufacturers, and reconciliations



# Evaluating Alternative Sourcing Strategies

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## Decision Criteria



# Summary Points

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- **The Appeal...**
  - Know what you're paying
  - Get appropriate value for those fees
  - Chance to strip significant cost from the system
- **The Challenge...**
  - Difficult to know if you're really getting the full value of supplier discounts
  - Fees paid by employers and payers could go UP, not down (if pricing discounts are not supplied)
  - Basic service levels could drop if firms choose inexperienced partners solely for their interest and ability to adopt this pricing mechanism

