

# **Follow the Pill**

## **U.S. Commercial Pharmaceutical Supply Chain**

Summary prepared by WCD August 2006

### **Flow of product**

#### **Manufacturers**

- Produce brand and generic drugs
- Manage the actual distribution of drugs from manufacturing facilities to drug wholesalers, and in some cases, directly to retail pharmacy chains, mail-order and specialty pharmacies, hospital chains, and some health plans
- Underwrite clinical studies designed to demonstrate the value of the drug
- Engage in promotion and marketing of products to health care providers as well as direct consumer advertising
- Administer patient assistance programs that provide the firm's products at nominal cost to low-income consumers
- Ensure safety by producing informational labeling for both prescribers and consumers
- Use electronic bar coding on packaging that may be used to track individual product lots in order to prevent prescribing errors

#### **Wholesale Distributors**

- Purchase pharmaceutical products from manufacturers and distribute them to a variety of customers, including pharmacies, hospitals, long-term care, and other medical facilities
- Operate product warehousing and inventory management
- Provide drug repackaging, electronic order services, reimbursement support, and drug buy-back programs

#### **Pharmacies**

- Purchase drugs from wholesalers and take physical possession of the drug products
- Assume responsibility for safe storage and dispensing to consumers
- Maintain an adequate stock of drug products
- Provide information to consumers about safe and effective use of prescription drugs
- Facilitate billing and payment for consumers participating in group health benefit plans
- Provide information link among pharmacy benefit managers (PBMs), drug manufacturers, and wholesale distributors

#### **Pharmacy Benefit Managers (PBMs)**

- Currently manage prescription drug benefits for 57 percent of U.S. population
- Coordinate with insurers to manage drug purchases by establishing which drugs will be paid for, the amounts that the pharmacy will receive, and the amount the consumer must pay when the prescription is filled

- Provide basic services including claims processing, record keeping, reporting programs, drug utilization review, disease management, and consultative services; develop and maintain prescription drug formulary; develop network pharmacy providers; administer mail-order services

## **Flow of Money**

**Manufacturers** have the most influence over pharmaceutical prices. They develop the Wholesale Acquisition Cost (WAC), which is the baseline price at which wholesale distributors purchase products.

*Brand manufacturers* offer discounts based on a percentage of AWP or WAC. Purchasers can acquire brand drug products for a price in a range of AWP minus 5 percent to 40 percent, depending on their purchasing power or that of their designated agent, such as a PBM.

*Generic manufacturers* operate in a more aggressive and dynamic negotiation environment and thus the prices for generic drugs change frequently in response to market forces. The most common discounts and rebates include:

- Retroactive rebates — based on market share — paid by manufacturer to pharmacy or PBM based on its ability to direct consumers to certain products
- Volume discounts triggered by meeting predetermined sales volume targets
- Prompt-pay discounts triggered when the purchaser reimburses the manufacturer in an expedited fashion

## **Wholesale distributors**

For branded products, purchase price is fairly uniform with little negotiation. The distributor typically purchases branded products for a discounted rate off the WAC.

For generic products, the purchase price is highly variable, largely depending upon competition in the class and the ability of the wholesale distributor to drive market share or increase the volume sold. Wholesalers play a larger role in the negotiation of the price of the product.

## **Pharmacies**

Retail pharmacies negotiate with manufacturers for discounts and rebates based on the pharmacy's ability to sell specific volumes of certain drugs or achieve a certain share of a specified market. They may be able to negotiate discounts with manufacturers that are more substantial than the wholesale distributor's cost. In these instances, the wholesale distributor facilitates the discount and "charges back" the manufacturer for any difference between the negotiated prices paid by the customer and the wholesaler's cost of the goods (WAC).

Pharmacies contract with PBMs to join the network. This structure provides pharmacies with guaranteed, stable reimbursement from private payers and access to a greater number of customers. The network consists of a group of retail and independent pharmacies and serves to offer plan members with lower prescription drug costs. As

part of the pharmacy network contract, retail pharmacies must agree to a guaranteed reimbursement formula for prescription drugs. Smaller retail stores either purchase directly from wholesalers — at a price significantly higher than retail pharmacies — or join group purchasing organizations.

### **PBMs**

Contract with health plans to manage their prescription drug costs. Although contracts may vary among health plans and PBMs, there are generally three basic components of the payment negotiated between PBMs and their sponsors:

1. PBMs receive payment for the services they provide, which may include claims adjudication processing and disease management services.
2. PBMs assume some type of performance risk in the contracts. Performance risks may include customer service, clinical quality measures, and cost-management techniques.
3. PBMs retain a portion of rebates they secure from manufacturers.

### **Conclusions**

Understanding current pharmaceutical issues (including the sources of prescription drugs, pricing and discounts, cost-containment methods, and brand/generic questions) requires knowledge about the various actors in the supply chain.

The pricing of prescription drugs and the flow of money among the various links in the pharmaceutical supply chain is more complex than the physical distribution of drugs through the chain.

The price differences highlighted by these and other analyses lead to questions about the basis for these pricing differentials. Public policy discussions regarding transparency and price disclosure are thus likely to continue during the coming years.