Pricing Society

Pricing Advisor

Despite the importance contracting may play for many products in managed markets, it is commonly overlooked as a viable strategy by manufacturers seeking to enhance the financial performance of their products. This article, although focused on the healthcare and pharmaceutical industries, will illustrate how, by avoiding seven common pitfalls, price-setters in these and other industries can immediately contribute to manufacturers’ bottom line. Author Nicholas Keppeler, Director at Simon-Kucher and Partners LLC can be reached at nicholas.keppeler@simon-kucher.com. This article originally appeared in the Summer 2009 issue of Healthcare Insights, Simon-Kucher & Partners’ life sciences newsletter.

F or many drugs covered under the pharmacy benefit, contracting is a critical component of a manufacturer’s managed markets strategy.

Consider, for example, a product with US sales exceeding $500 million: a 1 to 2 percent improvement in net prices at just a few managed care plans can translate into millions of dollars in incremental revenue and profit. Effective contracting strategies can also boost patient access to your products. However, despite the importance contracting may play for many products, it is commonly overlooked by manufacturers seeking to enhance the financial performance of their products. As a result, there is often significant room for improvement in the contracting strategies of many manufacturers.

This article will illustrate how avoiding seven common pitfalls can immediately contribute to a manufacturer’s bottom line.

Pitfall #1: Forgetting that the goal of contracting is financial

For many drugs covered under the pharmacy benefit, contracting is a critical component of a manufacturer’s managed markets strategy. First and foremost, the goal of any solid contracting strategy should be to improve financial returns (e.g., net revenues or profits). However, we routinely see managed markets teams pursue access as their end goal.

This “access first” mentality permeates much of their thinking. For example, contracting success is often based on the idea that “2nd tier is a win; 3rd tier is not.” Accordingly, many managed market teams set their target to be “2nd-tier, unrestricted coverage at 80 percent of plans.” This mentality even extends to how account manager incentives are designed: “I get my bonus for securing 2nd-tier access at my accounts.”

Once the goal of contracting becomes access for the sake of access, it leads to a variety of bad habits. Manufacturers can become too willing to offer large discounts and unwilling to walk away from contracts that may potentially result in large financial losses. Therefore, the first step in improving your contracting strategy is to focus your attention back on the goal of maximizing the financial performance of your products.

Pitfall #2: Assuming that a product needs high 2nd-tier penetration (unrestricted) for commercial success

Many manufacturers assume that a product that is primarily on Tier 3 (or heavily restricted) cannot be a commercial success. This common misconception causes managed markets teams to be overly aggressive in their contracting and/or pricing strategy.

In reality, there are many products that are considered blockbusters despite primarily having 3rd-tier coverage at the largest managed care plans. Two excellent examples are Abilify (aripiprazole) and Lyrica (pregabalin) which respectively had US sales of $1.67 billion and $1.45 billion in 2008, but are often covered on Tier 3.

If a manufacturer is open to the possibility of 3rd-tier strategies, it may find that 3rd-tier coverage provides greater financial opportunities for some products than a strategy that solely pursues 2nd-tier (or unrestricted) access. Indeed, in certain therapeutic areas, there is only a minimal difference in utilization from being on 2nd tier vs. 3rd tier.

Furthermore, the impact of tier status can often vary across plans depending on aspects like the plan’s coverage of other treatments, the relative difference in patient co-pay levels across tiers, and the plan’s ability to influence physician utilization. Due to such factors, the difference between 2nd-tier and 3rd-tier coverage is often not as clear-cut as many
managed care teams may believe. Therefore, it is imperative that managed markets teams understand the implications of how 2nd- vs. 3rd-tier coverage will influence their product specifically and that they take all of these factors into account when formulating their contracting strategies.

**Pitfall #3: Gravitating toward the largest possible discount rather than the highest possible net price**

Most manufacturers pursue a value-based, revenue-optimizing approach for their pricing strategies. This approach, however, often does not extend down to the contracting level.

A case in point is that when implementing contracting strategies, managed markets teams often rely on a break-even or target margin discount level. While these can be helpful in setting discount floors, they are not effective for establishing target levels. This is because when combined with the “access first” mentality (i.e. Pitfall #1), the “discount floor” often becomes the de facto target discount level.

A better approach to contracting would be for managed markets teams to assess the key factors that drive contract acceptance and use them to predict the probability of success (at the plan or segment level) of different contract offers. Armed with this information, managed markets teams can confidently create initial, target, and floor contract offers.

In addition, this analysis can provide guidance on when a shift in discount levels is needed. Since a discount reduction of only a few percentage points can translate into millions of dollars in extra revenue, this approach can substantially improve your bottom line and help bring contracts towards the highest possible net price.

**Pitfall #4: Believing that contracting for access is only about net price, discount level, or contract terms**

Many managed markets teams rely too heavily on discount levels and contract terms to obtain their desired access levels. In reality, the most effective tool in a manufacturer’s contracting arsenal is a well-developed value story, as evidenced by two key observations.

First, payers consistently state that the most important aspects driving their coverage decisions are, in order of importance, efficacy, safety, and then net price.

Second, contracting is rarely required (or recommended) for innovative products or for those that address major unmet needs. Thus, developing and communicating a compelling value story can often be the most effective way to attain favorable coverage for a product.

**Pitfall #5: Relying only on a general segmentation approach**

Most manufacturers segment their managed markets customers into low, moderate, and high control plans. Unfortunately, we rarely find that such a general segmentation approach can lead to a profit-optimal contracting strategy for a specific product.

Consideration of additional segmentation criteria related to the product itself usually allows for more accurate predictions of how plans will respond to potential contract offers. For example, inevitably question the value story, and it is always tempting for managed markets teams to respond by falling back on discounting concessions. Resisting the temptation to offer too much discount too early is key in ensuring that you capture the full financial potential of your products.
manufacturers can also consider the therapeutic area and the actions of other manufacturers within that therapeutic area.

An even more sophisticated approach would be to incorporate consideration of the effects of additional plan-specific characteristics such as the coverage philosophies of certain plans in different geographical areas and the manufacturer’s existing relationships with a particular plan.

Accounting for such additional factors can help a manufacturer make more informed and more precise decisions about which plans to contract with and what discounts / contracts to offer. Developing this knowledge is an essential step in maximizing your financial returns from contracting.

Pitfall #6: Forgetting managed care’s perspective

There are many situations in which payers reject contracts that offer a lower net price than that of another product of similar clinical value. When this occurs, it is often beneficial for a manufacturer to look at the potential offer from the managed care plan’s perspective — in other words, a manufacturer should examine how the contract being offered will influence the plan’s spending in the relevant therapeutic area.

For example, a new product with limited market share entering into competition against two dominant players may have trouble obtaining 2nd-tier access even at net prices well below those of the other competitors. This can be especially true if either of the dominant players has contract terms in place that are tied to performance (e.g. a certain level of utilization within the plan).

In this case, the plan may not accept a contract for the new product if it has the potential to jeopardize the discounts already in place for the dominant product. The plan may perceive the risk of increased spending in that particular therapeutic class to outweigh any potential gain to come from accepting a contract for the new product.

In fact, in some cases, this barrier can make it almost impossible for a new product to enter the class on Tier 2. When faced with this type of situation, a manufacturer may find more success by further developing the value story for the product or by pursuing a 3rd-tier strategy.

Pitfall #7: Thinking of contracts in isolation

The managed markets customer base is highly consolidated. According to data from the 2009 AIS Directory of Health Plans, the 20 largest plans cover 80 percent of the commercial lives in the US. Furthermore, your managed markets team probably interacts with these plans on a regular and recurring basis, meaning that you and your customers are well-acquainted.

Anecdotally, we often hear from managed care plans which manufacturers are known to offer aggressive discounts and which are highly disciplined with their discounting. It is important to remember that each contract is not offered in isolation, but rather, is part of an ongoing series of contracts and negotiations you have with your small customer base. Manufacturers often forget this when they look to deviate from their typical contracting policies to support a product that is underperforming.

Deviating from typical contracting policies (by offering an increased discount, for example) can be risky, as it can set undesired expectations for future contracts. Therefore, it is important to be both disciplined and consistent across all contracting efforts.

Conclusion

Overall, managed markets teams are highly professional and knowledgeable about their customers, and there are numerous examples where contracting has helped secure additional revenue for many products. However, with their current contracting approaches, many manufacturers are leaving money on the table.

Avoiding the seven pitfalls described in this article will provide a good starting point for most manufacturers to begin the process of optimizing their contracting strategies. Improvements to just one or two of these areas can potentially lead to substantial financial improvements for your core products.

With the pending loss of exclusivity on numerous blockbusters and pipelines that are struggling to produce new products, manufacturers can no longer afford to ignore the extra revenue that may be realized through optimal contracting strategies.