PIPELINE TO PROFITS: HOW DRUG MIDDLEMEN MAKE THEIR MONEY

The path of prescription drugs from the factory to the patient is complicated. Here, Julie Appleby of Kaiser Health News explains how money flows through the system and contributes to the cost of a 30-day supply of a hypothetical brand-name medicine.

KEY PRICES IN THE PROCESS

After a drugmaker develops a brand-name product and wins marketing approval, there are two key prices that it needs to begin selling:

LIST PRICE (WAC)

Set by drugmakers, this **wholesale acquisition cost** or **WAC** covers research, production and profits

WHOLESALE PRICE (AWP)

Called **average wholesale price** or **AWP**. It's the WAC multiplied by a set percentage.

Generally known as "ain't what's paid" — as you'll see in the chart below

$250 +20%= **$300**

THE PATIENT

Those with insurance pay an amount set by their benefit plan. Two common methods:

$25 CO-PAYMENT

INSURED

- A percentage of the cost of the drug.
- Flat-dollar co-payments, say **$10 to $50** per prescription.

$300 ◀ NET PAID OUT [1]

UNINSURED

Depending on the pharmacy, some might pay less, while others pay more.

1 — The price may be lowered by manufacturer or pharmacy discount programs.

INSURER OR EMPLOYER

Employers/insurers sign contracts with pharmacy benefit managers that include specific formulas for how much they reimburse PBMs for the cost of each prescription, generally an amount 15% to 22% below AWP. They sometimes also get rebates from drugmakers that are funneled through the PBM.

$232 ◀ REIMBURSEMENT TO PBM
- $50 ◀ REBATE FROM DRUGMAKER
$182 ◀ PAID BY INSURER/ EMPLOYER FOR THE DRUG

PHARMACY BENEFIT MANAGER (PBM)

A firm hired by insurers or employers to manage claims, set up networks of pharmacies, create drug formularies and negotiate discounts and rebates with drug makers.

PBMS are reimbursed by insurer/employers amounts that are generally above what the PBMs have paid pharmacies. They can also collect rebates from manufacturers.

$229 ◀ PAID TO PHARMACY
$232 ◀ REIMBURSEMENT FROM INSURER OR EMPLOYER
$3
+ $12.50 ◀ REBATE FROM DRUGMAKERS
$15.50 ◀ NET RECEIVED BY PBM

PBM payments to the pharmacy are based on a percentage of the AWP, which is higher than the list price, even though no one has actually paid that amount.

THE PHARMACY

The contract between the pharmacy and wholesaler for brand-name drugs generally sets a price below the WAC.

Note: Different payment arrangements are set for generics.

$250 ◀ WAC
- 4%
$240 ◀ PAYMENT TO WHOLESALER
+$229 ◀ REIMBURSEMENT FROM PBM
+$25 ◀ PATIENT CO-PAY
$14 ◀ NET RECEIVED BY PHARMACY

THE WHOLESALER

The contract between the drugmaker and the wholesaler discounts the WAC price by 2% to 5%.

$250 ◀ WAC
- 5%
$237.50 ◀ PAID TO DRUGMAKER
+$240 ◀ PRICE PAID BY PHARMACY
$2.50 ◀ NET RECEIVED BY WHOLESALER

REBATE TO INSURER AND BENEFIT MANAGER

$50 + $12.50 = **$62.50**

The PBM has negotiated a rebate on this particular drug. Drugmakers sometimes offer rebates in order to win favorable spots on an insurer's or PBM's formulary, so more patients take their drugs.

Rebates range widely, but can be 25% or more of the drug's WAC. In this case, let's assume the PBM gets back 25%, or $62.50.

THE DRUGMAKER

$237.50 ◀ FROM WHOLESALER
-$62.50 ◀ REBATE TO INSURERS AND PBMS
$175 ◀ NET RECEIVED BY DRUGMAKER

THE REBATES

SOURCES Pembroke Consulting, SSR Health, Kaiser Health News