

## Gauging the Impact of CDHPs on Pharmaceutical Companies

**IN THE FACE OF CONTINUALLY RISING HEALTH CARE COSTS**, consumer-driven health plans (CDHPs) are gaining in popularity as a cost-effective alternative to traditional health plans. Increased awareness of health care and pharmaceutical prices on the part of those who participate in CDHPs, which couple lower monthly premiums with higher deductibles, has the potential to change consumer purchasing patterns for many types of health care goods and services, including brand-name drugs.

The model for CDHPs is significantly different from that for traditional health plans because consumers, by paying for a larger portion of their expenses, play a more central role. By making the consumer of services more responsible for paying for them, these plans are intended to influence utilization toward lower-cost options and empower consumers, not the providers or payers, to be the primary decision makers. Because empowered consumers with a financial incentive will focus more on the cost of medical care, including the cost of pharmaceuticals, they are likely to change their medical usage behavior compared to what they would do under traditional health plans.

Unlike traditional health plans, CDHPs typically offer the ability to make tax-free payments into a vehicle for health savings, such as health

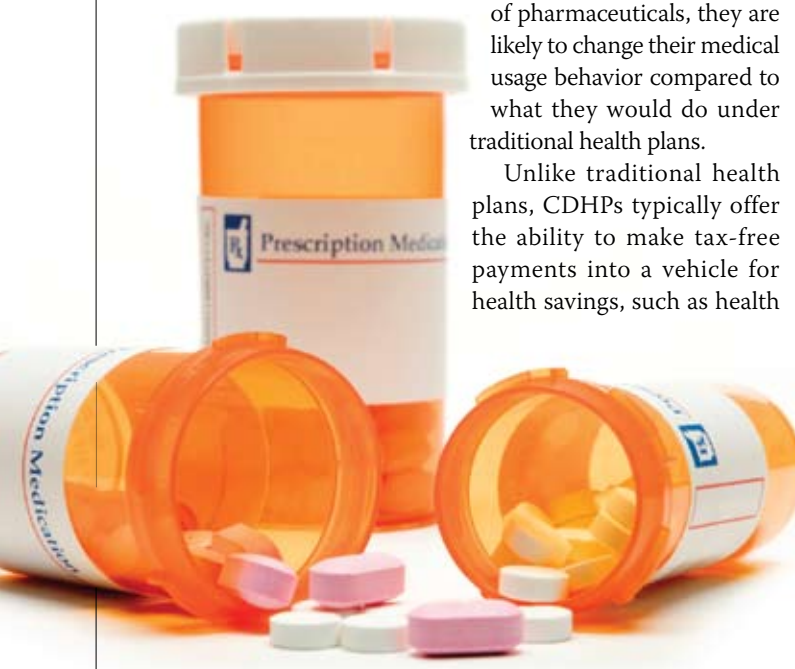
savings accounts (HSAs) or health reimbursement accounts (HRAs). HSAs, individually owned and tax-advantaged, allow consumers to save for future medical expenses by investing unspent annual health allocations. HSA funds can be invested in stocks and bonds, similar to 401(k) plans. Because funds may be withdrawn for nonmedical purposes once the account owner turns 65, HSAs serve partially as retirement accounts. In contrast, HRAs are solely owned and controlled by the employer or insurance carrier. All contributions to the funds come from the employer and are not portable when an employee changes jobs.

The high deductibles that characterize CDHPs lead to lower premiums. According to the *2007 Medical Cost Reference Guide* of the Blue Cross Blue Shield Association, the average premium for a single coverage CDHP in 2006 was \$3,405, approximately \$800 less than traditional health plans. The associated average annual deductible was \$1,715, approximately \$1,300 more than traditional health plans. A 2006 Kaiser Foundation survey found that lower premiums were the leading reason that consumers chose CDHPs. Like consumers, employers can also realize benefits by offering their employees lower-cost insurance plans while contributing to their HSAs.

The White House has predicted that CDHP enrollment will grow from 3 million accounts in 2006 to potentially 29 million accounts in 2010. However, high deductibles could negatively affect enrollment growth. Some fraction of consumers may prefer the relative certainty of traditional plans to the risk of increased out-of-pocket costs for prescription drugs and routine doctor visits. It's also unclear whether employers will support offering CDHPs to their employees, particularly if they suspect that the out-of-pocket costs could cause employees to defer necessary care or shirk complying with an established regimen of treatment. What is clear is that for CDHPs to work optimally, consumers must be well-informed on costs and therapeutic benefits to make the best health care decisions.

### Impact on Branded Pharmaceutical Companies

With the emergence of CDHPs, branded pharmaceutical companies have to consider the growing influence



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consumers now have on health care decisions. There are financial implications related to the prices consumers are willing to pay for pharmaceutical products and consumers' demand for information transparency. These can have a significant impact on profits. In order to assess the impact of CDHPs quantitatively, a proactive branded pharmaceutical company should consider building a model to aid in forecasting revenues and revisiting its brand strategy.

CDHP participants clearly have incentives to be more cost efficient with their health care decisions. For example, a consumer paying the entire cost for a pharmaceutical may opt for a cheaper drug if it's "almost as effective." A consumer using a traditional insurance plan who doesn't face a big co-pay cost difference for a more effective

(and more expensive) drug would be more likely to choose the best available product knowing that the insurance carrier will cover the bulk of the increased cost. Such considerations may lead to a change in product mix, market share, and pricing within the pharmaceutical industry. Marketers of expensive branded pharmaceuticals are expected to face increasing price pressure from generics and other less expensive branded alternatives in the same therapeutic class.

To counter the increased scrutiny on pricing, pharmaceutical companies will have to make additional efforts to demonstrate product quality and value to consumers. Historically, these companies have focused sales and marketing efforts primarily on doctors. As consumers become more central to the decision-making process, drug com-

panies will most likely need to refocus their sales and marketing programs and build stronger customer relationships. Consumers are likely to demonstrate more loyalty to those branded pharmaceutical companies that provide greater transparency when discussing the quality and value of their products.

**Developing a Model**

One way for a pharmaceutical company to assess the impact of CDHPs on future revenues and other metrics is by developing a multi-period, assumption-based model. By modeling various factors/assumptions and analyzing the output, a drug company with branded products will be better positioned to revisit business planning, pricing and rebate strategies, policy development, and other elements of strategic planning as they relate to its product portfolio.



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There are several factors that influence how CDHPs will affect a company, and some of the most significant are discussed below. Individual pharmaceutical companies are positioned differently in the market, so the following factors could vary in how they affect each company:

› **Individual Product Competitors**

The competitive position of a pharmaceutical product in its market is very important. A drug that is much more expensive (but not much more effective) than its nearest rival will face the greatest pricing pressure. A drug with good performance for its price will likely benefit.

› **Drug-Specific Exceptions** Certain products may qualify for condition-specific provisions (e.g., coverage regardless of whether the deductible has been met) under a CDHP, which could diffuse the negative impact of high deductibles to consumers.

› **Rebates** CDHPs can alter the rebate landscape. For example, when a consumer chooses a generic product over a branded product, the branded pharmaceutical company will not have to pay a rebate to the plan's benefits manager since its product was not utilized.

› **Consumer Response** Funds held in HSAs are not as available to consumers as funds in regular bank accounts; therefore, price sensitivity may be lessened compared to what it would be if consumers kept the money in a regular bank account. Consumers may be more likely to purchase a more expensive alternative when medical expenses are paid for with HSA funds rather than with regular funds, since use of HSA funds is limited to medical goods and services.

› **CDHP Benefit Design** CDHP benefit designs vary by deductible, premium, and drug benefits, and these differences may affect prescription drug demand and

compliance. Pharmaceutical companies must understand the specific designs of the various CDHP insurance products and their related effect on consumer drug spending.

A branded pharmaceutical company should incorporate these and other factors into its model, including quantitative inputs such as:

- › Overall CDHP growth
- › Percent of growth in HSAs and HRAs
- › Percent of plans with special prescription provisions
- › Percent paid by insurance companies by type of CDHP, by year
- › Average spending level of CDHP participants relative to the overall average by year
- › Prices, utilization, and effectiveness of drugs (including competitors)
- › Price elasticity of the demand for drugs by year
- › Average rebates per year.

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Branded pharmaceutical companies could use long-term revenue forecasts from their most recent

strategic plan as the baseline from which to model different CDHP scenarios and revenue impacts based on the above factors and inputs. By developing various scenarios, a company will better understand the sensitivity and interaction of these factors and can quantitatively assess their impact on important metrics, including:

- › Product utilization
- › Product revenues from private benefit plans (including CDHPs)
- › Changes in consumers' out-of-pocket costs.

The company could also use the scenarios to make informed decisions about how best to react to the changing competitive landscape.

CDHPs are a growing force in the health care market, and both consumers and pharmaceutical companies will play key roles in the transition. Consumers will most likely seek lower-cost alternatives and take additional responsibility for their health care decisions. Pharmaceutical companies need to proactively model various scenarios to assess their best strategy going forward.

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