The Academy
The Health Management Academy

QUICK-HITTING SURVEY
DRUG PRICING

Executive Summary

Methodology

In July 2017, The Health Management Academy conducted a quick hitting survey of 47 Leading Health Systems regarding drug pricing strategies. With a 40% response rate, the 19 responding Chief Financial Officers (CFOs) represent health systems with an average Net Patient Revenue of $3.7 billion that own or operate 213 hospitals with over 44,000 beds and approximately 2.1 million admissions annually.

Key Findings

- A majority of health systems utilize their group purchasing organization (GPO) cost file as a baseline for pricing inpatient (63%) and/or ambulatory (58%) drugs.
- In 2016, almost half (47%) of responding health systems used a percent of charge to set the markup on their inpatient drugs and 33% used a flat rate, while on the ambulatory side one-third (33%) of health systems used percent of charge and 40% used a flat rate.
- Less than one-third (31%) of responding health systems apply a consistent markup across all drugs; most differentiate the markup by drug or NDC (32%), service line (16%), or another method (21%).

Results

A majority of health systems utilize their group purchasing organization (GPO) cost file as a baseline for pricing inpatient (63%) and/or ambulatory (58%) drugs (Figure 1). Almost all (95%) responding health systems reported using the GPO cost file as either a baseline for both inpatient and ambulatory drugs, or neither inpatient nor ambulatory drugs. Only one health system reported using the GPO cost file as a baseline for impatient drugs, but not for ambulatory drugs.

FIGURE 1. DOES YOUR ORGANIZATION UTILIZE THE GROUP PURCHASING ORGANIZATION (GPO) COST FILE AS A BASELINE FOR DRUG PRICING?

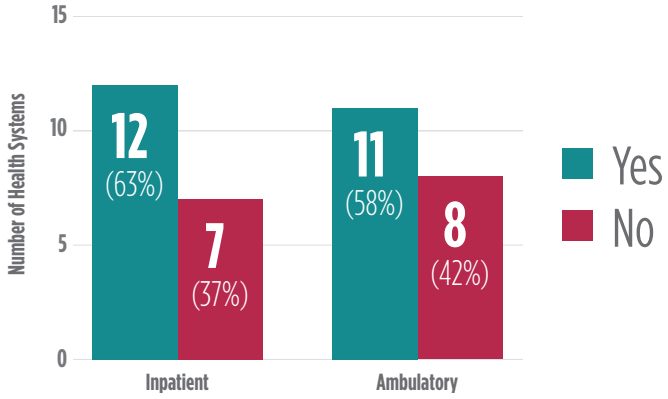
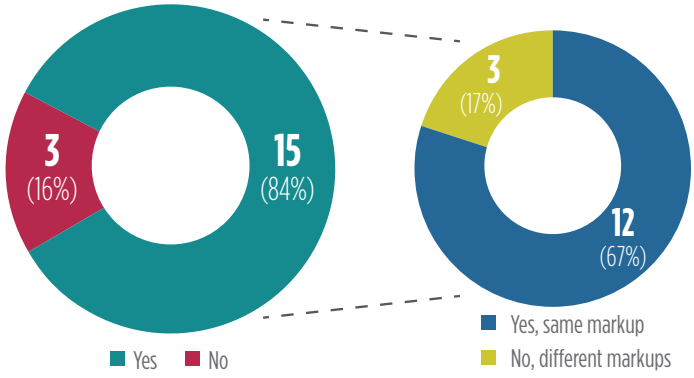


FIGURE 2. DOES YOUR ORGANIZATION APPLY A MARKUP TO THE GPO COST? IF YES, DOES YOUR ORGANIZATION UTILIZE THE SAME MARKUP CALCULATION FOR INPATIENT AND AMBULATORY DRUGS?



Most (84%) responding health systems apply a markup to the GPO cost when pricing drugs (Figure 2). Over two-thirds (67%) of those that apply a markup to the GPO cost utilize the same markup calculation for inpatient and ambulatory drugs. One health system that does not utilize the same markup calculation reported using percent of charge for some pharmaceuticals and a bundled flat rate for others. Another CFO commented, **"We interpret ambulatory to mean outpatient prescriptions filled in our retail pharmacy. They are a separate business than the inpatient pharmacy, using different computer applications, and billing under pharmacy benefit instead of medical benefit."**

In 2016, almost half (47%) of responding health systems used a percent of charge to set the markup on their inpatient drugs, while 33% used a flat rate (Figure 3). On the ambulatory side, one-third (33%) of health systems used percent of charge and 40% used a flat rate to set the markup in 2016. One health system reported setting the markup based on service location and type of medication, while another reported multiplying the average wholesale price. One health system reported their markup was partially based on volume and type of drug, and the calculation included factors such as acquisition cost and handling expenses, among others.

Those that used a percent of charge calculation to set the price markup reporting calculating the percent using historical trends, producer price index (PPI) projections, drug cost, and/or an analysis of managed care contracts. One CFO commented, **"It varies by the cost of the drug – the higher the cost, the lower the markup."** Two health systems reported using legacy percent calculations that were either put in place by previous ownership or have been applied at their health system for decades.

Health systems that use a flat rate to set the price markup report calculating the rate based on strategic pricing initiatives, the Medicaid rate, historical pricing, price bands between drugs, and/or handling costs. One CFO specified, **"Flat rate is determined by the cost of getting the drug dispensed, prepared and to the patient."**

Less than one-third (31%) of responding health systems apply a consistent markup across all drugs (Figure 4). Most health systems differentiate the markup by drug or NDC (32%), service line (16%), or another method (21%). Other differentiators reported include category (e.g., injectables, compounded, chemo, etc.), cost, service location, and type of medication.

Just over half (53%) of responding health systems take risk on ambulatory drug charge increases in their commercial contracts (Figure 5). Most (84%) health systems' ambulatory drugs are reimbursed at a percent of charge (Figure 6).

FIGURE 3. WHAT METHOD DID YOU USE IN 2016 TO SET THE MARKUP?

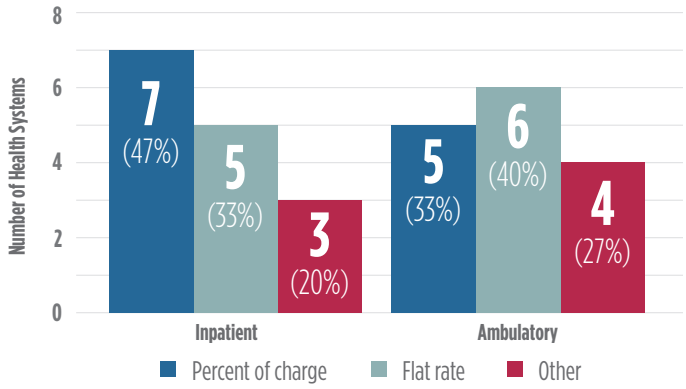


FIGURE 4. IS THE APPLIED MARKUP CONSISTENT ACROSS ALL DRUGS?

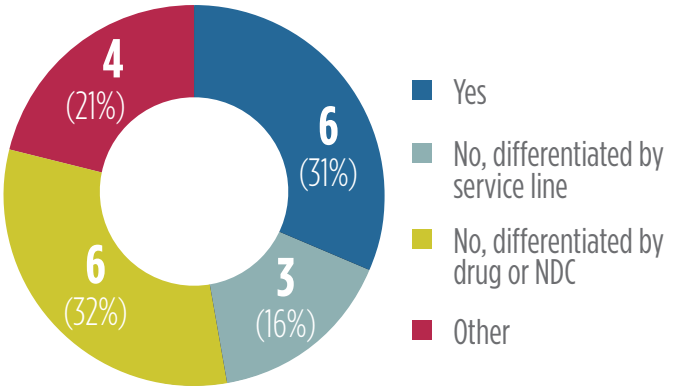
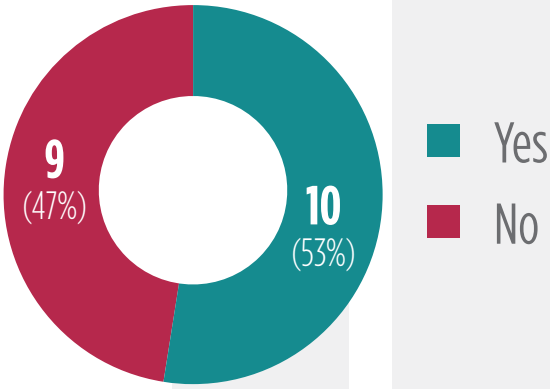


FIGURE 5. DOES YOUR ORGANIZATION TAKE THE RISK ON AMBULATORY DRUG CHARGE INCREASES IN YOUR COMMERCIAL CONTRACTS?



Over three-fourths (79%) of responding health systems report their commercial contracts do not reimburse drugs at cost plus a consistent markup (Figure 7).

Over one-third (37%) of health systems do not distinguish between branded drugs and generics when calculating pricing. Just under one-third (32%) of health systems report calculating their markup based on cost, and therefore branded and generic drugs have different markups.

"Our mark-up is based on the cost of the drug so the lower cost generics would have a less flat rate mark-up." (CFO)

One health system reported having a minimum charge for inpatient drugs in addition to using a percent markup, which more commonly affects generic drugs. Another CFO commented, **"Comprehensive pharmacy services include detailed pricing analysis of cost of both lines of drugs. Benefits are structured to incent use of generics."**

FIGURE 6. ARE ANY OF YOUR AMBULATORY DRUGS REIMBURSED AT A PERCENTAGE OF CHARGE?

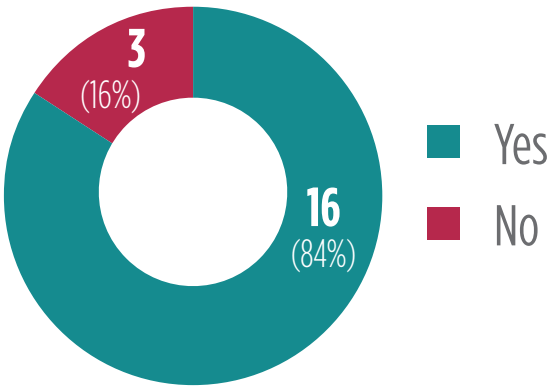


FIGURE 7. DO YOUR COMMERCIAL CONTRACTS REIMBURSE AMBULATORY DRUGS AT COST PLUS A CONSISTENT MARKUP?