



UNFAIR PRICING OR UNFIT PROCUREMENT? AVOIDING DISPUTES BETWEEN PAYERS AND SUPPLIERS OF PHARMACEUTICALS

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Procurement – the way in which a healthcare system chooses and compensates its suppliers – is one of the most important tools to ensure good patient outcomes at low costs.

Different countries have opted for markedly different approaches to procuring pharmaceuticals and medical devices. There have been long-standing debates on how suppliers should be remunerated to achieve value for money for payers (and ultimately, patients and taxpayers) while also preserving incentives to invest and innovate.

These conflicts have led to lengthy pricing and reimbursement negotiations, with some suppliers recently being accused of charging unfair or excessive prices for medicines. The debate about how suppliers should be compensated has therefore in some cases been escalated to competition authorities, resulting in complex, time-consuming investigations and even court proceedings.

Based on our experience of working across the healthcare supply chain, we believe that many of these disputes could be avoided simply by improving procurement practices. Here are four guiding principles that payers can follow to improve their procurement practices and achieve better outcomes by using a more efficient process:

1. Align procurement design with payers' objectives
2. Make the most of competition
3. Make the most of buyer power
4. Ensure that payers and suppliers get a fair share

ALIGN PROCUREMENT DESIGN WITH PAYERS' OBJECTIVES

Payers should ensure that their procurement design is aligned with their objectives: That the way in which they procure is actually geared towards achieving their objectives, such as lower costs across the entire healthcare system and/or better patient outcomes.

If payers do not include their objectives in the procurement model, they risk inadvertently procuring the wrong things, such as more expensive treatments.

The first step is to clearly define and understand the objectives. For some tried-and-tested 'simple' medical devices and medicines, payers may feel comfortable focusing on low prices. However, more often than not, the value of the purchased product or service spans across the patient pathway from direct impacts on a specific condition to indirect knock-on effects on, for example, avoiding costly hospitalisations¹.

Therefore, it is often important for payers to consider not only short-term costs, but also long-term benefits, including patient outcomes and healthcare system cost savings. Payers should rank their objectives and quantify the trade-offs, to understand matters such as how much more they would be willing to pay for an innovative treatment.

The second step is to structure the procurement process in such a way that it provides suppliers with an incentive to help the payer achieve their objectives. In other words, it should be financially beneficial for suppliers to provide offers aligned with the payer's objectives since it increases their chances of winning a contract.

For example, rewarding medicines that generate long-run cost savings directly in the evaluation mechanism, which determines the winning supplier. While this might enable some suppliers to charge higher prices, this need not be a concern if it allows a decrease in total expenditures (via cost savings elsewhere in the healthcare system) or an improvement in patient outcomes.

MAKE THE MOST OF COMPETITION

Payers should also ensure that their procurement approach maximises the competitive interplay between suppliers, which will incentivise suppliers to provide their best offer.

It is therefore advisable to pool several medicines together in a single tender competition, even when one or more of the suppliers provides a treatment that is superior along all dimensions (e.g. safety and efficiency) or even where one supplier is not large enough to fulfil the entire contract alone.

Knowing that they face competition, each supplier will have to provide a good offer in order to secure the contract or part of it. This does not preclude providing superior treatments with an advantage in the evaluation model (see point 1), reflecting differences in patient outcomes and total costs. However, the fact that a supplier could lose will force them to submit a favourable offer.

Other ways in which payers can stimulate competition include:

1. Minimising barriers to competition between suppliers (e.g. reducing barriers to parallel imports of pharmaceuticals)
2. Frequent tender interactions to keep suppliers 'on their toes' (such as in Denmark where contracts for hospital medicines are generally re-tendered every 1-2 years)
3. Mechanisms that seek to pre-empt any exploitation of market power in the aftermarkets of expensive devices (repairs, maintenance) already at the time of purchase²

There are opportunities for countries, health systems and individual payers to learn from each other.

MAKE THE MOST OF BUYER POWER

Payers can also ensure value for money by making the most of buyer power. While healthcare systems differ substantially between and within countries, they also exhibit some notable similarities. Most countries rely heavily on a strong public healthcare system, especially for hospital-based care, where the costs of pharmaceuticals and medical equipment are highest.

However, despite relying on public healthcare, there is not always a single, strong public buyer. Often, the procurement of medical supplies is carried out by regional or local-level public bodies or individual hospitals. Although this ensures that local-level needs are met, it does reduce buyer power. With more individual payers, there is less at stake in each interaction for the suppliers, and therefore less incentive for suppliers to provide their best offer.

By pooling the procurement of pharmaceuticals and medical devices across several regions or hospitals, payers can raise the stakes for suppliers. When it becomes costlier for suppliers to lose a contract (because there is a lot of revenue at stake, and because they have fewer back-ups), suppliers will have more of an incentive to provide their best offer.

In the UK, the National Health Service (an umbrella organisation covering hundreds of health providers and commissioners) increasingly uses collaborative procurement hubs and a national-level 'NHS Supply Chain' facilitates NHS-wide procurement from medical equipment to clinical consumables³.

In the Nordic countries, there is even international collaboration in procurement, where the healthcare procurement agencies of Denmark, Norway and Iceland work together to procure some medicines as a single entity. Similarly, in Finland, the health and social care reform package – agreed and announced by the government in October 2020 – envisages stronger payer collaboration as a key enabler of making the most of buyer power in pharma procurement⁴.

ENSURE THAT PAYERS AND SUPPLIERS GET A FAIR SHARE

It is a common misconception that effective procurement implies 'a race to the bottom' whereby payers seek to achieve the highest possible volume of a product, such as medicine, at the lowest possible cost. However, this need not be the case.

When optimising procurement processes, payers should remember that they are reliant on suppliers to ensure the long-term sustainability of the health system. Therefore, it is important to ensure that the system continues to incentivise investment and innovation by rewarding suppliers that provide high value products and services, not just high volumes of products and services. Payers should therefore be wary of designing their procurement in a way that undermines the ability of suppliers to generate a reasonable return on their investment, for example, by focusing exclusively on price in cases where other factors are also important, or by pitting superior medicines against inferior competitors without rewarding quantifiable advantages.

In a well-designed procurement system, the price and terms should be fair for all parties. This is because investments in innovative medicines or equipment will only be carried out if investors trust that they will be able to make a

reasonable return, given the risks associated with developing these products.

Examples of procurement mechanisms which ensure that the supplier can be fairly compensated include:

1. Outcomes based on 'no-cure, no-pay' payment models that split the risk between payer and supplier in a way that benefits both parties.
2. Procurement systems that offer some flexibility to doctors (e.g. to choose between several suppliers), so that there is some freedom to prescribe the right treatment in all cases.
3. Procurement systems that recognise broader social impacts, such as labour market participation or stress levels.

WHAT DOES THIS MEAN FOR SUPPLIERS?

This article focused on the considerations for payers, such as hospitals or public bodies. It goes without saying that suppliers will optimize their process within the procurement framework they find themselves in. They will set their prices and terms in order to maximise their profitability, subject to the constraints of competition and buyer power.

However, this optimisation is a careful balancing act between a) short-term profitability, b) long-term considerations, c) market share consideration, including the advantages of being the market leader, d) other pricing

constraints (brand-related and cross-country considerations (e.g. reference pricing or parallel importing)).

In our experience it can be challenging for suppliers to take these factors into account and navigate through innovative procurement models. We will discuss the implications of different procurement frameworks for suppliers in a subsequent article.

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FOOTNOTES

¹ Copenhagen Economics, (2020), The way forward: Value based healthcare in Partnerships. https://www.linkedin.com/posts/copenhagen-economics_copenhagen-economics-the-way-forward-activity-6721780205188329474-YG9c

² For example, in 2018, the Italian Competition Authority commenced an investigation concerning an alleged abuse of dominance in the aftermarket (e.g. maintenance) of diagnostic imaging equipment. [https://uk.practicallaw.thomsonreuters.com/w-013-6412?transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://uk.practicallaw.thomsonreuters.com/w-013-6412?transitionType=Default&contextData=(sc.Default)&firstPage=true)

³ For a description of the NHS procurement practices, see, for example: <http://knowledge.nic.nhs.uk/documentDetails.aspx?docId=10#section1>

⁴ The Finnish governments proposals are available at: https://api.hankeikkuna.fi/asikirjat/165db659-8cf1-49b4-b33d-c2cd7a4390bf/38b5aa55-7f81-4639-b836-4cdbc1858c45/MUISTIO_20200615062911.pdf