The price is right?

For pharmaceuticals, it's not just the costs, it's the market.

For all of the excited talk about pharmaceutical pricing and whether people in the United States are being overcharged for drugs in comparison to their North American and European neighbors, there has been little rational discussion of the factors that affect the corporate decision-making process on drug pricing.

"Contrary to the widely held opinion that pricing is simply a matter of adding up costs and establishing a markup, pricing experts agree that costs may help to establish a price floor but the market provides most of the information for the pricing decision," says Mick Kolassa (*1*), associate director of the Center for Pharmaceutical Marketing and Management at the University of Mississippi (*www.rx.olemiss.edu/cpmm2000*).

As in any industry, it is critical for a pharmaceutical firm to understand how its product compares with that of the competition. While a company does not want to charge a premium for its product and thereby potentially limit its market penetration, it is equally important not to charge too little for the product because prescribers often believe that the better product is the one that costs more. If the current market leader is the one that costs the most, this might indicate that there is little or no price sensitivity for this market. If, however, the market leader is the least expensive option, you might want to price your new product accordingly.

Patient and disease characteristics also play a critical role in the pricing function. If a drug is targeted at senior citizens, it will be important not to overprice the drug because they are less likely to fill their prescriptions. Likewise, studies have shown that people are much more likely to pay a premium for drugs that treat acute disorders associated with pain and balk at those drugs that treat chronic diseases, such as hypertension, that might be asymptomatic.

"Having a realistic concept of what price your drug will command is important, even at the preclinical stage of development," says Peter Kolchinsky (*2*), a public-equity analyst with RA Capital Associates (*www.racap.com*). "A drug's revenue-generating potential, and therefore its appeal to prospective partners, depends on its price and the number of patients who will use it."

The value of the treatment should also be considered in making pricing decisions. At a rudimentary level, if a new drug saves a patient from undergoing $5000 worth of other treatments, then its value is $5000. Admittedly, these numbers are not always easy to obtain, but they do provide an estimate that can be used as a starting point.

Traditionally, physicians prescribed medicines with little thought to or knowledge of the cost to their patients. More recently, with increased pressure to cut costs, physicians affiliated with HMOs (health maintenance organizations) and PPOs (preferred provider organizations) are limited in their ability to prescribe drugs that have not been preapproved by the insurer. This has led some pharmaceutical firms to alter their pricing strategies to ensure that their drugs get listed.

Recently, Nina Pavcnik, a researcher at Dartmouth College (*www.dartmouth.edu*), studied the situation in Germany, where patients bear some of the costs associated with drug treatments (*3*). In 1989, the German government established a maximum reimbursement policy, whereby drugs for a given ailment were set at a specific reference price (RP). If the retail price of a particular treatment was higher than its designated RP, the patient had to bear the extra cost. Pavcnik found that almost immediately after this legislation began, the price of drugs dropped, and this decrease was greatest in brand-name products with generic competition.

The goals and abilities of the pharmaceutical producer should also be considered in the pricing equation. Will the price and expected market provide enough income to continue other research endeavors? Pricing a product too high or low is likely to affect the balance of this equation. Similarly, price will also be affected by the ability of the company to promote its product. For this reason alone, many small biopharmaceutical companies that do not have the appropriate marketing expertise or clout have entered into licensing agreements with larger pharma partners.

Finally, no matter what price a company decides to set for its product, it will come under scrutiny from public policy officials, who are being inundated with conflicting calls for price regulations and maintaining the liberty of a free market. And of course, the argument continues to be made that companies that cannot make money will be less likely to engage in basic research. To bring this discussion full circle, Nina Pavcnik concludes, "Clearly, future research should identify this trade-off between lower pharmaceutical prices and R&D investment."

References

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