Germany, for instance. In the US, value-based pricing was first introduced with the adoption of the Affordable Care Act. The intention was to set prices based on a common understanding of the cost and performance balance between buyers and sellers to better serve each party's interests.

Acknowledging customer needs in pharma

That need to understand cost and performance on both sides — that is, the need to acknowledge the needs and perspectives of customers as the starting point for any pricing/strategy development discussion — is the key to successful value-based pricing and is very different from the traditional cost-plus pricing approach. In the pharmaceutical industry, rather than ask: "What do I need to charge to cover my costs and make a decent return?" the question to answer is: "Given the market's perception of my product portfolio's value, which of those products can we profitably produce?"

A switch to value-based pricing won't make the pricing of pharmaceuticals any easier. The complexities of establishing value can be daunting and costly. Efforts must start with data from the earliest development phases through clinical trial results and also include post-approval studies. Value-based pricing as a strategy is particularly difficult to implement for first-in-class therapies and products that intend to establish a new standard of care. For these drugs, there are no existing products to act as comparators. In these cases, ethical considerations become important. For instance, pricing a drug at the level the market can bear may prevent lower-income patients from gaining access to life-saving medicines.

Value-based pricing as a strategy is particularly difficult to implement for first-in-class therapies and products that intend to establish a new standard of care

Increasing pricing efficiencies

In addition to implementing novel manufacturing strategies designed to increase efficiency and productivity, thereby bringing down the cost and time needed to develop and commercialise new drugs, the pharmaceutical industry is also looking to other avenues that provide efficiency gains. Generic drugs and biosimilars are one such avenue. Indeed, generic drugs account for a significant portion of small-molecule drug sales today, and as increasing numbers of biosimilars receive approvals, they too will have an impact on pricing in the biopharmaceutical segment of the market.

Generics are in fact a great example of efficient drug pricing in close-competition environments. When patent exclusivity is lost and generics are introduced to the market, innovator companies refocus their business models on efficient pricing. To that end, they manage production and supply chain costs more diligently. Outsourcing to contract development and manufacturing organisations (CDMOs) with lower cost structures is common at this stage, allowing for increased supply chain flexibility combined with reduced costs.

The importance of optimised pricing

In the end, pricing optimisation is needed to ensure healthy bottom lines, regardless of the industry sector. In general, pricing optimisation can lead to improvements of 1–2% and can also be achieved quickly compared with other corporate-wide improvements, such as training and internal process development efforts. It can also be done without the disruptions or heavy capital expenditures associated with cost and productivity investments. In addition, pricing optimisation often carries a greater return on investment.

In the pharmaceutical industry, pricing optimisation has the potential to benefit all members of the value chain, including suppliers, manufacturers and patients. The focus of pharmaceutical companies is on the discovery, development and commercialisation of medicines that can improve quality of life and extend lifetimes. Drug pricing policies should reflect, demonstrate and communicate the value of those therapies and their performance to all stakeholders.

REFERENCES

1. www.forbes.com/sites/brucebooth/2016/08/29/innovators-vs-exploiters-drug-pricing-and-the-future-of-pharma/#25f35a5664fc.
2. http://money.cnn.com/2016/08/25/news/economy/daraprim-aids-drug-high-price/index.html.
3. www.nytimes.com/2015/09/21/business/a-huge-overnight-increase-in-a-drugs-price-raises-protests.html.
4. www.fiercebiotech.com/biotech/fda-commish-we-need-to-talk-about-drug-development-costs.
5. www.quora.com/Does-the-pharmaceutical-industry-follow-a-cost-plus-pricing-strategy-What-are-the-advantages-and-disadvantages-of-cost-plus-pricing.

FOR MORE INFORMATION

Haig Armaghanian
President and CEO
Haig Barrett Management Consultants
haigbarrett.com