

The 2020 Economic Report on U.S. Pharmacies and Pharmacy Benefit Managers

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Drug Channels Institute

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Full report available at <https://drugch.nl/pharmacy>



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In 2020, Drug Channels Institute will launch a new series of online training videos. They will combine Dr. Fein's expertise and cutting-edge analysis—such as this *2020 Economic Report on U.S. Pharmacies and Pharmacy Benefit Managers*—into training videos that will offer your team a thorough grounding in crucial industry topics. These online tools will explain highly complex economic and business data and concepts so that you can:

- Make decisions that will best achieve your business goals
- Improve relationships with key accounts
- Understand your customers, channels, partners, and the economics of the U.S. pharmaceutical industry

Drug Channels Institute also hosts live webinars during which Dr. Fein discusses trends and policies that affect the pharmaceutical industry and its channels.

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INTRODUCTION AND GUIDE TO THE 2020 REPORT

U.S. drug channels experienced an eventful 2019. The industry is confronting a diverse set of business, political, and legal challenges, some of which have persisted for years:

- Total prescription dispensing revenues of retail, mail, long-term care, and specialty pharmacies reached a record \$446 billion in 2019. Specialty drugs accounted for 36% of these revenues—a new high for the industry.
- The largest insurers, PBMs, and specialty pharmacies have combined into vertically integrated organizations. They are poised to restructure U.S. drug channels by exerting greater control over patient access, sites of care, dispensing locations, and pricing.
- The specialty pharmacy industry continues to consolidate. UnitedHealth Group’s OptumRx business has acquired the two largest independent specialty pharmacies: Diplomat Pharmacy and Avella Specialty Pharmacy.
- Payers and PBMs are tightening their management of specialty drugs, which is pressuring independent specialty pharmacies, physician practices, and hospitals.
- Retail pharmacies have experienced slowing growth, lower profits, and mounting competitive pressures. The U.S. pharmacy industry has entered a shakeout process that will ultimately reduce the number of U.S. pharmacy locations.
- List prices for brand-name drugs are growing at rates that are slower than historical norms. Deflation in generic drug prices continues, though the rate of change has steadied. Politicians continue to condemn increasing drug prices, though brand-name drugs’ net prices (after rebates and discounts) are declining.
- The gross-to-net bubble, which measures rebates and discounts paid by manufacturers, reached \$175 billion in 2019. More people now face pharmacy benefit designs with coinsurance and deductibles. This development is raising awareness about the harm of basing patients’ out-of-pocket expenses on undiscounted list prices.
- Regulators, lawmakers, investors, and payers are publicly scrutinizing PBMs’ profit models. New disclosures about PBMs’ unexpectedly large profits in Managed Medicaid programs have triggered some states to reevaluate PBMs’ role and compensation.
- Outside investors have accelerated their pursuit of prescription dispensing. Amazon is still signaling that it wants to become a major participant in the pharmacy market, though its market share remains trivial. Venture capital firms are financing technology-enabled pharmacies that are attempting to alter traditional ways of doing business.

- The federal government and multiple states are pursuing new policies aimed at introducing the commercial importation of drugs intended for foreign markets.
- Regulatory efforts to remove the role of rebates in the drug channel system have failed. The prospects of federal legislative action regarding drug prices or the channel remain highly uncertain.

Understanding an Evolving Marketplace

The 2020 Economic Report on U.S. Pharmacies and Pharmacy Benefit Managers—our 11th edition—remains the most comprehensive, fact-based tool for understanding the entire U.S. drug pricing, reimbursement, and dispensing system. This unique resource is your ultimate guide to the complex web of interactions within U.S. prescription drug channels.

This definitive, nonpartisan resource includes the most current information about pharmacy dispensing channels, third-party payers, pharmacy benefit managers (PBMs), patients' financial contributions, government regulations, and more. The report synthesizes a wealth of statistical data, research studies, financial information, and my own unique business consulting experience. It will aid pharmaceutical manufacturers, wholesalers, pharmacists, pharmacy owners, hospital executives, pharmacy buyers, benefit managers, managed care executives, policy analysts, investors, consultants, and many others.

Thousands of companies operate within the U.S. system, enabling more than 6.2 billion equivalent prescriptions to be dispensed and paid. The table below highlights the largest public companies that operate in the drug channel. Many of these firms are among the largest businesses on the *Fortune 500* list.

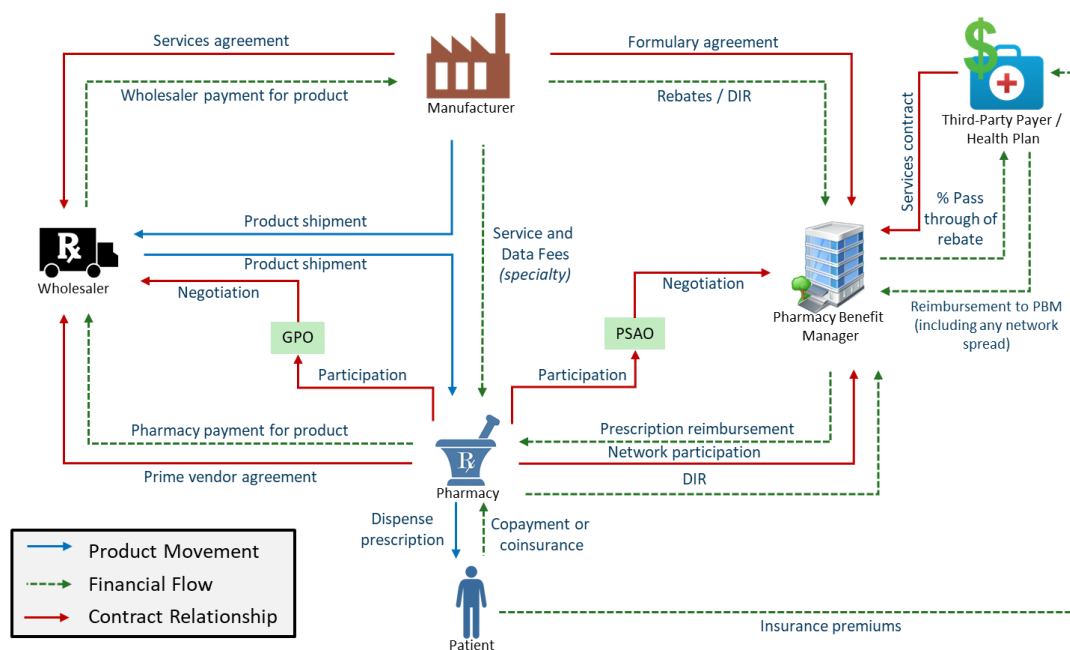
Major Public Companies Operating in U.S. Drug Channels

Company	Stock Ticker	Primary U.S. Channel Role(s)
CVS Health	CVS	Chain drugstore/PBM/Mail & specialty pharmacy/Insurer
Kroger	KR	Supermarket with pharmacy/Specialty pharmacy
Rite Aid Corporation	RAD	Chain drugstore/PBM
Walgreens Boots Alliance	WBA	Chain drugstore/Mail & specialty pharmacy
Walmart Stores, Inc.	WMT	Mass merchant with pharmacy/Specialty pharmacy
AmerisourceBergen Corp.	ABC	Pharmaceutical wholesaler/Specialty pharmacy
Cardinal Health, Inc.	CAH	Pharmaceutical wholesaler
McKesson Corporation	MCK	Pharmaceutical wholesaler/Specialty pharmacy
Express Scripts, Inc. (Cigna)	CI	PBM/Mail & specialty pharmacy/Insurer
Humana Pharmacy Solutions	HUM	PBM/Mail & specialty pharmacy/Insurer
OptumRx (UnitedHealth Group)	UNH	PBM/Mail & specialty pharmacy/Insurer

PBM = pharmacy benefit manager
Source: Drug Channels Institute research

These and other companies discussed in this report operate within a complex distribution, payment, and reimbursement system, illustrated on the next page.

The U.S. Pharmacy Distribution and Reimbursement System for Patient-Administered, Outpatient Brand-Name Drugs



GPO = Group Purchasing Organization; PSAO = Pharmacy Services Administrative Organization; DIR = Direct and Indirect Remuneration
 Source: Drug Channels Institute. Chart illustrates flows for Patient-Administered, Outpatient Drugs. Please note that this chart is illustrative. It is not intended to be a complete representation of every type of product movement, financial flow, or contractual relationship in the marketplace.

The 2020 Economic Report on U.S. Pharmacies and Pharmacy Benefit Managers discusses the three key channel flows illustrated above:

- **Product movement**, which traces shipments from pharmaceutical manufacturers to the drug wholesalers that supply pharmacies. Retail, mail, long-term care, and specialty pharmacies mark the final step in which a prescription is dispensed to a patient.
- **Financial flows**, which transfer money from third-party payers to pharmacy benefit managers (PBMs), which in turn reimburse pharmacies. Funds flow to manufacturers via pharmacies, which purchase drugs from wholesalers. Funds flow from manufacturers to PBMs in the form of rebates. The PBMs share most of these rebate payments with plan sponsors, reducing plans' net prescription costs. Manufacturers' rebates to PBMs and other third-party payers do not flow through wholesale or retail channels.
- **Contractual relationships**, which govern the relationships between: 1) payers and PBMs; 2) PBMs and pharmacies; 3) pharmacies and wholesalers; 4) wholesalers and manufacturers; and 5) manufacturers and PBMs.

In Sections II and III of the report, we revisit this chart to associate each flow with the corresponding report chapters that explain and analyze it. To further explain these flows and their corresponding report chapters, the chart appears as [Exhibit 64](#) (page 100).

What's New in the 2020 Report

The 2020 Economic Report on U.S. Pharmacies and Pharmacy Benefit Managers retains the overall structure that we introduced in last year's edition. However, some sections and chapters have been expanded and/or reorganized to better cover the latest industry developments. As always, we have updated all market and industry data with the most current information available, including our annual analyses of the market positions of the largest pharmacies, specialty pharmacies, and PBMs. The many significant changes and updates in this 2020 edition include:

- [Chapter 2](#) incorporates significant revisions to certain prescription data based on IQVIA's revised methodologies for measuring demand.
- We have expanded the [Chapter 3](#) analysis of the specialty market, including new data and additional information about industry participants.
- In [Chapter 6](#), the data on patient out-of-pocket expenses include new information on cost sharing and average out-of-pocket spending.
- [Chapter 9](#) contains a new section with information on third-party payers, rebates, and benefit designs. We have also expanded our discussion of PBMs' evolving profit sources.
- We have further streamlined the material on wholesalers in [Chapter 10](#). Our companion [*Economic Report on Pharmaceutical Wholesalers and Specialty Distributors*](#) contains a detailed analysis of this sector.
- [Chapter 11](#) includes significant new information based on our analyses of newly disclosed data on the following topics:
 - PBMs' profit from spread pricing in Managed Medicaid programs
 - Direct and indirect remuneration (DIR) fees paid by pharmacies
 - Pharmacies' profits from the 340B Drug Pricing Program
- [Chapter 12](#), which was introduced last year and covers the industry outlook and emerging trends, has been expanded. Notable additions include new material on:
 - Consequences of vertical integration among insurers, PBMs, specialty pharmacies, and providers
 - Commercial importation of drugs intended for foreign markets
 - State legislation of the drug channel
 - Specialty pharmacies' role in cell and gene therapy channels
- Throughout the report, we have added new industry data sources, deepened our coverage of many topics, and added more trending information. There are 203 exhibits in the 2020 edition, compared with 180 in the 2019 edition.

Structure of the 2020 Report

This report analyzes the industry in 3 major sections, comprising 12 total chapters.

SECTION I: THE U.S. PHARMACY INDUSTRY

- [Chapter 1: Industry Overview](#) (page 9) defines the industry and its regulatory framework, describes the different products and prescriptions that a pharmacy dispenses, provides data on traditional and specialty prescription costs, delineates among different pharmacy industry participants, and quantifies differences among dispensing formats. This chapter includes our analysis of retail clinics and pharmacist-provided clinical services, including medication therapy management services.
- [Chapter 2: Pharmacy Industry Market Structure](#) (page 39) analyzes the industry's prescription and revenue growth trends. It identifies the largest pharmacies based on prescription revenues. It then analyzes recent market share trends for each dispensing format and for the major national companies.
- [Chapter 3: Specialty Drugs and Specialty Pharmacies](#) (page 60) provides a comprehensive overview of the pharmacies dispensing specialty medications. It includes our exclusive analyses of national market share for pharmacy-dispensed specialty drugs and accreditation trends among pharmacies. It also provides a competitive analysis of the various organizations that compete to dispense specialty medications. The chapter reviews the channel strategies that pharmaceutical manufacturers use for specialty drugs, explains the role of service fees, and reviews the specialty hub services market.

SECTION II: THIRD-PARTY PAYMENT AND PHARMACY BENEFITS

- [Chapter 4: Payment and Spending for Prescription Drugs](#) (page 101) examines the primary payers for prescription drugs at retail, mail, long-term care, and specialty pharmacies. It analyzes recent changes in the payer mix and spending on traditional vs. specialty drugs. Chapter 4 also reviews the cash-pay prescription market and the use of discount card programs.
- [Chapter 5: Pharmacy Benefit Management](#) (page 119) identifies the services and roles of pharmacy benefit managers (PBMs). Chapter 5 also analyzes the structure of the PBM industry and reviews the business strategies of the largest PBMs. It describes the relationship between PBMs and the pharmacies that participate in a PBM's network, reviews how pharmacy services administrative organizations (PSAOs) intermediate between retail pharmacies and PBMs, and explains how plan sponsors compensate PBMs for benefit management services.
- [Chapter 6: Consumer Copayments and Coinsurance](#) (page 146) analyzes the benefit designs and plan structures that determine patients' out-of-pocket spending for the

major third-party payers: employer-sponsored health plans, Health Insurance Marketplace (HIM) plans, Medicare Part D, and Medicaid. We explore manufacturers' out-of-pocket payment support programs, explain the emergence and use of copay accumulators, and provide data on patient out-of-pocket expenses. We also explore how benefit design affect patients' costs.

- [**Chapter 7: Narrow Pharmacy Networks**](#) (page 176) analyzes the structure, utilization, and economics of narrow network models. We explain the use and economics of narrow networks for pharmacies in commercial health plans and Medicare Part D. We review the use of mail and retail pharmacies as narrow network options for maintenance prescriptions. This chapter also evaluates the latest data on payer-defined networks for specialty drug dispensing in commercial health plans and for buy-and-bill channels.

SECTION III: DRUG CHANNEL ECONOMICS AND OUTLOOK

- [**Chapter 8: Prescription Reimbursement by Third-Party Payers**](#) (page 201) explains the formulas and methodologies for computing a pharmacy's revenue from brand-name, generic, and specialty prescriptions. This chapter compares traditional list price methods with acquisition-cost reimbursement approaches. We also review the economics of mail vs. retail pharmacies for payers and consumers.
- [**Chapter 9: Drug Pricing, Rebates, and Payer Costs**](#) (page 215) explores rebates in commercial health plans, Medicare Part D, and Medicaid. It explains how PBMs negotiate with manufacturers, analyzes trends in list and net drug prices, and describes the gross-to-net bubble phenomenon. The chapter includes a new section that explains how plan sponsors use rebates, the role of point-of-sale rebates, and controversies over rebates. The chapter concludes by illustrating how prescription reimbursement, formulary rebates, and consumer copayments affect a plan sponsor's net costs for a typical traditional and specialty prescription.
- [**Chapter 10: Relationships With Pharmaceutical Wholesalers**](#) (page 244) explores pharmacies' interactions with their primary wholesale suppliers of drugs. It explains wholesalers' channel roles and services, identifies the largest wholesale suppliers, and analyzes how wholesalers affect pharmacies' acquisition costs for drugs. We present our latest data on pharmacy group purchasing organizations and the generic sourcing relationships between wholesalers and large pharmacies.
- [**Chapter 11: Pharmacy and Prescription Profitability**](#) (page 256) unites the reimbursement and cost discussion from Chapter 8 and Chapter 10 by presenting the latest available data on pharmacy and prescription profitability. This chapter documents overall drugstore profitability, pharmacy margins for prescriptions from different dispensing formats, profit differences between brand and generic prescriptions, PBMs' per-prescription profits from network and mail pharmacies, and a detailed review of

PBMs' spread pricing profits from Managed Medicaid programs. Chapter 11 also includes material on the direct and indirect remuneration (DIR) fee payments that pharmacies make to PBMs and health plans. Finally, we consider pharmacies' role and profits in the 340B Drug Pricing Program.

- [Chapter 12: Outlook and Emerging Trends](#) (page 288) presents the outlook for net prescription drug spending, the future payer mix, and our updated projections for the pharmacy industry's product mix and revenues in 2024. This chapter also considers future trends, including pharmacy-dispensed biosimilars, importation, state and federal legislation, cell and gene therapies, and such new entrants as Amazon and venture-backed startup pharmacies.

How to Use the 2020 Report

The chapters are self-contained and do not need to be read in order. We include extensive internal clickable hyperlinks to help you navigate the entire document and customize it to your specific needs. After clicking a link, use the following shortcuts to return to your previous location in the document:

- Windows: **ALT+Left Arrow**
- Mac: **Command+Left Arrow**

There are more than 600 [endnotes](#), most of which have hyperlinks to original source materials. The report also includes a list of the [Acronyms and Abbreviations](#) used within it. To search the entire PDF document for every occurrence of a word or phrase, use the following keyboard shortcuts:

- Windows: **Shift+CTRL+F**
- Mac: **Shift+Command+F**

As always, I welcome your feedback. Please contact me if you have any questions or comments about *The 2020 Economic Report on U.S. Pharmacies and Pharmacy Benefit Managers*.

Adam J. Fein
March 2020

P.S. [Click here for post-publication errata.](#)

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