



Revenue Leakage: Pharma's \$11 Billion Dollar Problem

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Revenue Leakage in the Life Sciences

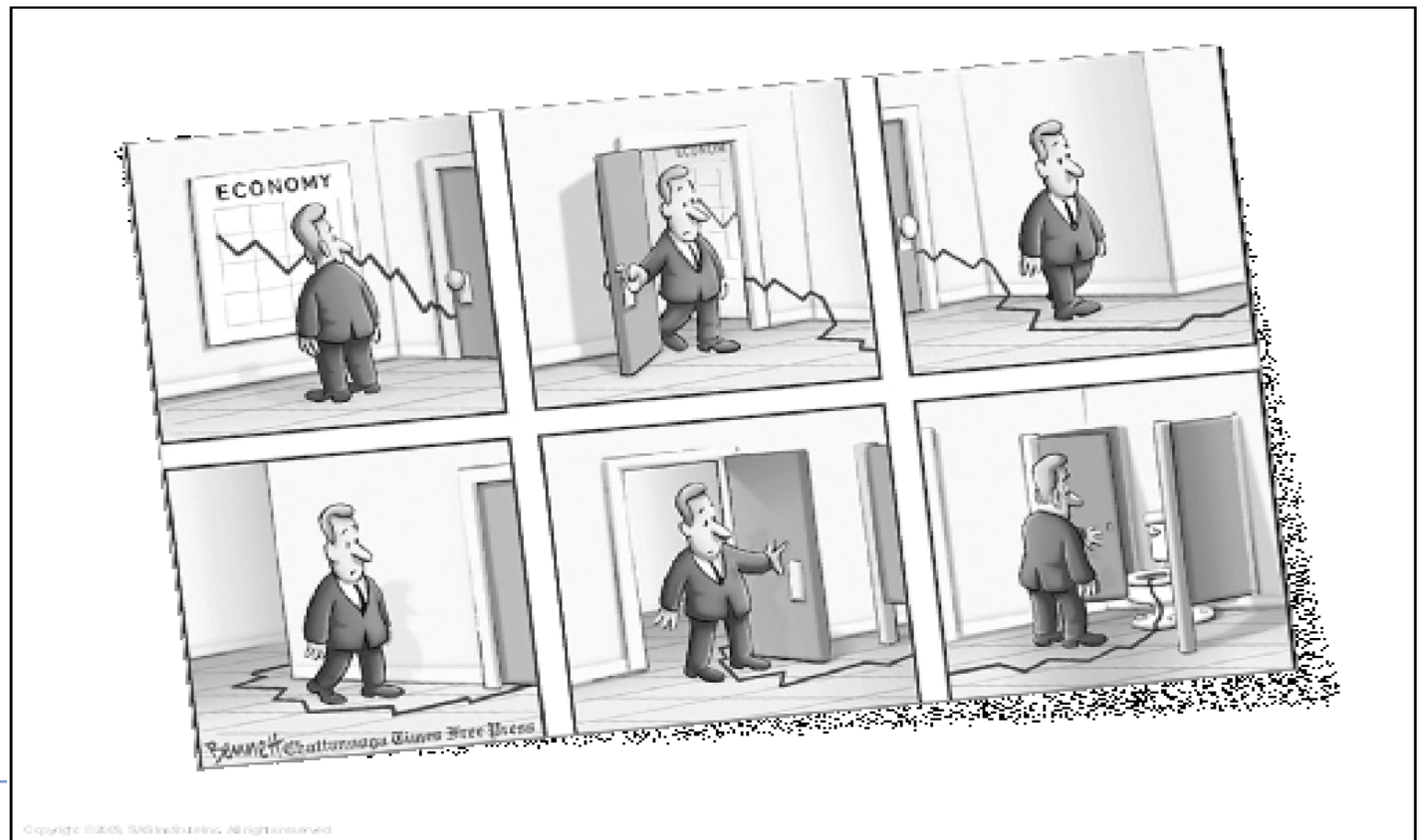
Ranks among top 10 life science issues for 2010

Today's discussion points:

- What is causing revenue leakage? What are the leakage points?
- What are companies doing to reduce leakage exposure?
- How large is the problem?

Market Forces

- Fewer “blockbuster” drugs, shrinking product pipelines, expiring patents
 - 10.5% in 2006-2007, 9% in 2008-2011
 - 80% avg. decline
- Increased compliance spending
- Increasing threat of generics
- The economy



Channel Transformation

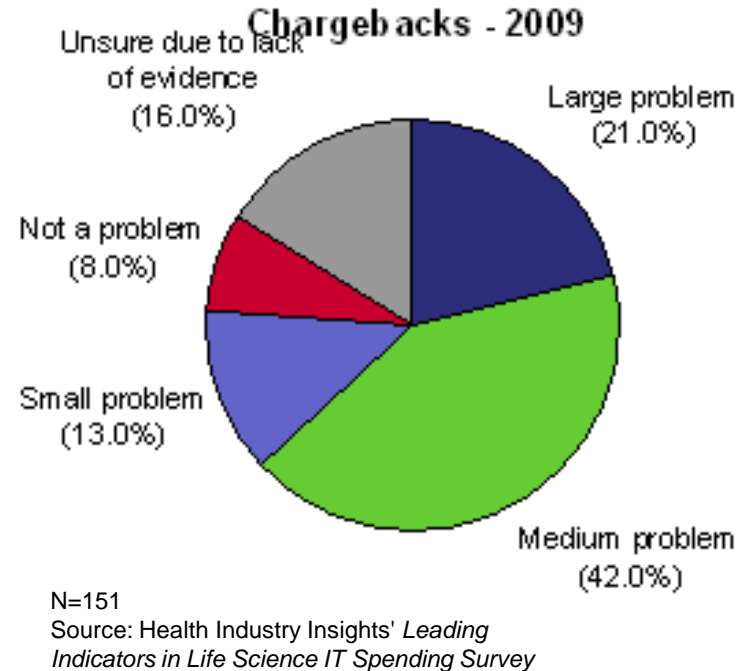
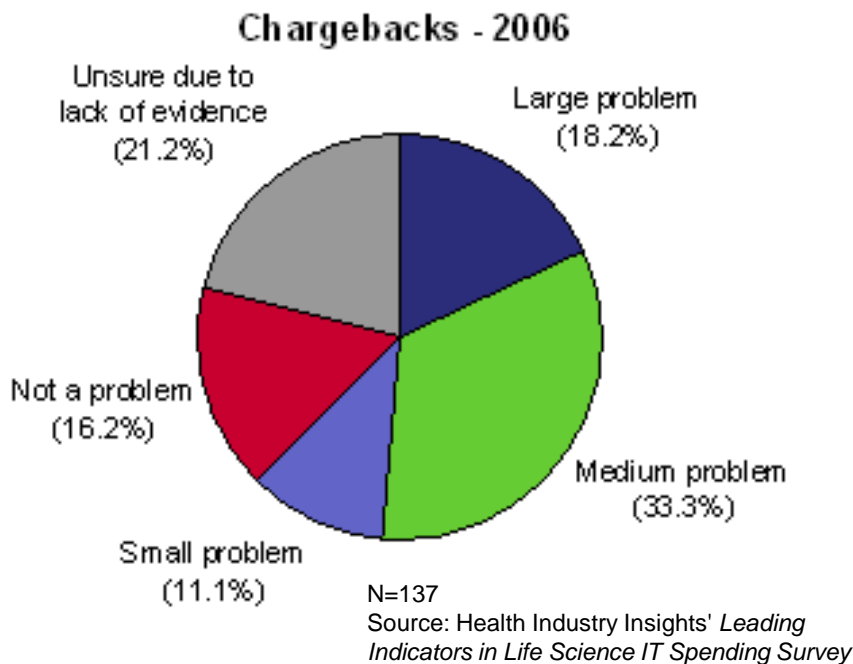
- Drug Safety
 - FDA investigations have skyrocketed
 - Counterfeit drug sales to exceed \$75B by 2010 (CMPI)
 - 6-10% of global drug supply is counterfeit (World Health Organization)
 - US vs. emerging markets
 - Supply Chain Security
 - Drug pedigrees
 - Item level serialization
 - PDMA
 - Pilots underway
 - RFID / 2D Bar Codes
- Moving toward increased item-level visibility
- Late-stage PLM: 4% of COGS
- Additional revenue leakage
 - Gray area of inefficiency

Methodology

- Purpose: Identify reconciliation process pain points and quantify sources of revenue leakage
- HII conducted in-depth interviews with 23 pharmaceutical manufacturers and 4 wholesale distributors
- HII survey data: 151 industry leaders, more than 117 pharmaceutical companies
 - VP level: 19%
 - Director level: 62%
 - Manager level: 19%
- Companies of all sizes included:
 - \$10B+ : 27%
 - \$1B - \$9.9B : 21%
 - \$500M - \$999M : 19%
 - \$100M – \$499M : 22%
 - Less than \$100M : 11%

Industry Sentiment: Significance of Revenue Loss

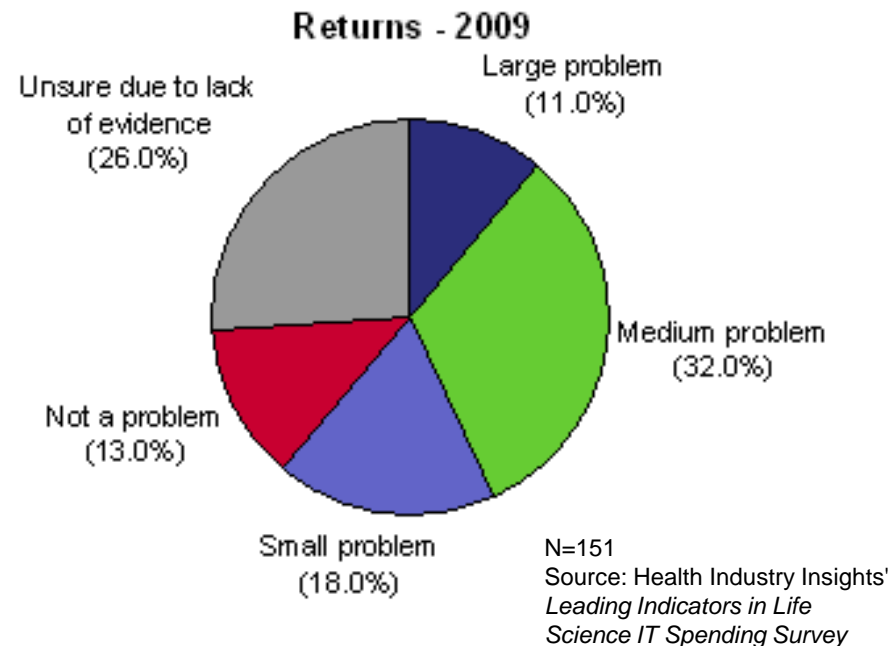
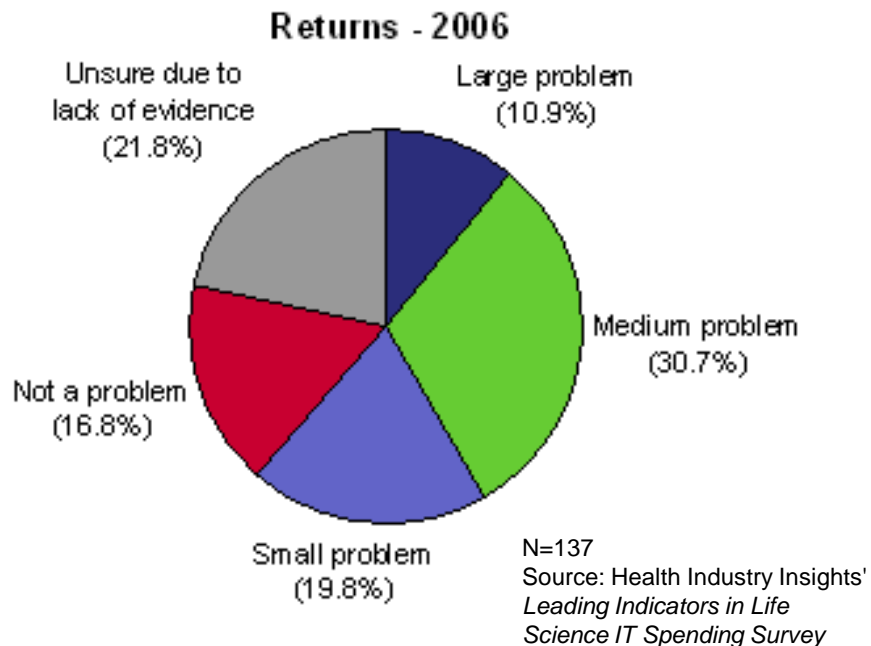
Q. Is revenue leakage through the **chargeback** process a significant problem for your company?



- Increased awareness
- 63% believe its a medium or large size problem for their company
- up 12 percentage points from 2006, nearly a 25% increase

Industry Sentiment – cont.

Q. Is revenue leakage through pharmaceutical **returns** a significant problem for your company?



- 42% believe its a medium or large size problem for their company

Industry Sentiment: Percentage of Revenue at Risk

TABLE [1]

Revenue Leakage

Q. What percentage of revenue do you believe your company loses through inefficient chargeback, rebate, and return related processes?

	2009	2006
Overall Average	4.4%	4.53%
Less than 1%	7.28%	9.82%
1%	6.62%	4.30%
2%	8.60%	7.29%
3%	9.27%	4.93%
4%	11.25%	5.21%
5%	13.24%	9.20%
6%	4.63%	4.41%
7%	1.32%	1.51%
8%	1.32%	1.26%
9%	2.64%	2.70%
10 - 14%	3.97%	4.15%
15 - 19%	0.62%	0.68%
20% or more	0.62%	0.83%

n = 151

Responses of "don't know" are not included.

Source: Health Industry Leading Indicators in Life Science IT Spending Survey

The Holes: Key Areas of Revenue Loss

- Chargebacks
 - Chargeback discrepancies
 - 2.2% of chargeback dollars are lost completely
 - Missing reverse chargebacks
 - 15% of reverse chargebacks are never captured
 - Duplicate chargebacks
 - An estimated 3% of chargebacks are duplicate
- Rebates
 - Managed care rebates
 - Overpaid by 5.5%
 - Medicaid rebates
 - Overpaid by 4.5%
- Returns
 - 0.4% of returns are written off due to errors
- Concealed shortages
 - 4% of shipments result in concealed shortage claims
 - 7% average discrepancies size

Chargebacks

Some discrepancy causes:

- GPO's slow to update price changes, GPO membership roster constantly changing (1000's of changes on a regular basis)
 - 1 change could affect several contracts, Manufacturers often the last notified about membership changes (causing eligibility discrepancies)
- Chargeback errors caused by price change delays due to contractual agreements
 - Lowest price guarantees vs. wholesaler price change window guarantee, huge administrative burden
- Chargebacks in excess of purchases (1M sold, 1.2M chargebacks come back)
 - Difficult to disprove - no starting inventory visibility or item level visibility, use prior sales to guesstimate a probable max
- Tolerance ranges: 25% formally set tolerance ranges (Avg: 8.3%, Range: 5% - 10%), but are followed loosely
- Most companies are checking 852 data as a forecasting method / Most companies not yet checking 867 data against chargebacks, but are working towards that goal / Some companies still working to resolve chargebacks from up to 3 years ago
- Case: \$500M pharma records sales of \$10M for a particular product during 2008.
 - Current Reconciliation Procedures:
 - Company simply checks chargeback correctness
 - 27 data checks (correct price, GPO member, contract #, etc...)
 - 8% Tolerance Range (to allow for seasonal deviations)
 - They review actual vs. predicted chargeback levels quarterly.
 - Q1 results = 6% over YTD
 - Q2 results = 7% over YTD
 - EOY results = 9.5% over YTD
 - Director of Chargebacks commented:
 - "In past years we had been so bogged down with chargeback disputes, that we implemented a somewhat large tolerance range in 2007 to keep things more in motion. Our resources have definitely been freed up as a result, but its also clearly just masking an underlying problem that exists."
 - For 2008, they estimate they overpaid chargebacks by nearly \$700k. Opened a dialog in 2009 with distributor to dig deeper.

Chargebacks - cont.

The Bottom Line:

- 12% of chargebacks flagged with errors
 - 33% of flagged errors fixed without resubmission by identifying/correcting small errors, (outdated prices, old contract #'s, etc...)
- 8% of chargebacks resubmitted to wholesalers, half typically get resolved.
- 4% of all chargebacks remain unresolved.
 - Out of that 4%, 10% get written off and 90% are eventually split 50:50 between manufacturer and wholesaler.
- At the end of the day:
 - 2.2% of all chargeback dollars are completely lost by the manufacturer.

Reverse Chargebacks

- 2% of all pharmaceuticals are returned
 - Damaged packaging, expired goods, incorrect product shipped, etc...
- Large portion of reverse chargebacks never occur
 - This problem increases nearly 50% in smaller companies
- 40% of reverse chargebacks are initially missing (up to 90% in small-caps)
 - 25% of reverse chargebacks are resolved
 - 15% of reverse chargebacks are never captured
- The onus falls on manufacturers
 - Must send quarterly report to wholesaler of missing items
- Example:
 - Mid-size pharma distributes one of its products entirely through 2 distributors
 - During 2008, sales were \$95M with \$2.9M in returns
 - 38% sold on contract ($\$2.9 \times .38$) = \$1.1M expected in reverse chargebacks
 - EOY review uncovered only \$350K in reverse chargebacks received (barely 1/3rd of amount owed)
 - Company has now moved to quarterly reviews of reverse chargebacks to improve visibility

Duplicate Chargebacks

- Example: Product sold, chargeback occurs, returned unused & unopened to wholesaler, resold, second chargeback occurs
- No hard data due to lot level tracking (lack of item level serialization)
- Anecdotes:
 - Prior study: One interviewee used to work at a major wholesaler and claimed he's seen situations where companies have got charged up to 3 times for the same item
 - Current study: Manager-level employee at major distributor said he had “frequently witnessed the generation of duplicate chargebacks and saw situations where companies were charged several times for the same item.”
 - He explained since there is no visibility into these occurrences, little incentive exists to correct them, and its administratively easier to treat all sales in the same fashion.
- Double chargeback estimation: 2% – 3%

Rebates

- Causes:
 - Varying data formats received, difficult to reconcile
 - NCPDP format
 - CSV, Excel, text-based files
- Primary Error Types:
 - Error in quantity
 - Non-pill forms (i.e. liquids, injectables) cause conversion errors.
 - Example: milliliters to grams...frequent multiplication/division errors in magnitude of 10 or 100
 - Duplicate prescription records
 - PBM's may move/sell/subcontract business to each other, resulting in two different entities submitting rebate for same prescription
 - Validity of contract
 - Constantly changing membership rosters.
 - Must ensure product was on contract and member was valid on plan at time prescription was dispensed. Frequent cause of improper charges and pricing.
 - Formatting errors
 - Implied decimal points – no decimal included, implied 2 decimal padding?
 - Numbers saved out of Excel – No decimals? truncated?
 - Simple formatting errors lead to huge errors in multiples of 10, 100, 1000

The Bottom Line:

- Managed care rebates overpaid by 5.5%
- Medicaid rebates overpaid by 4.5%

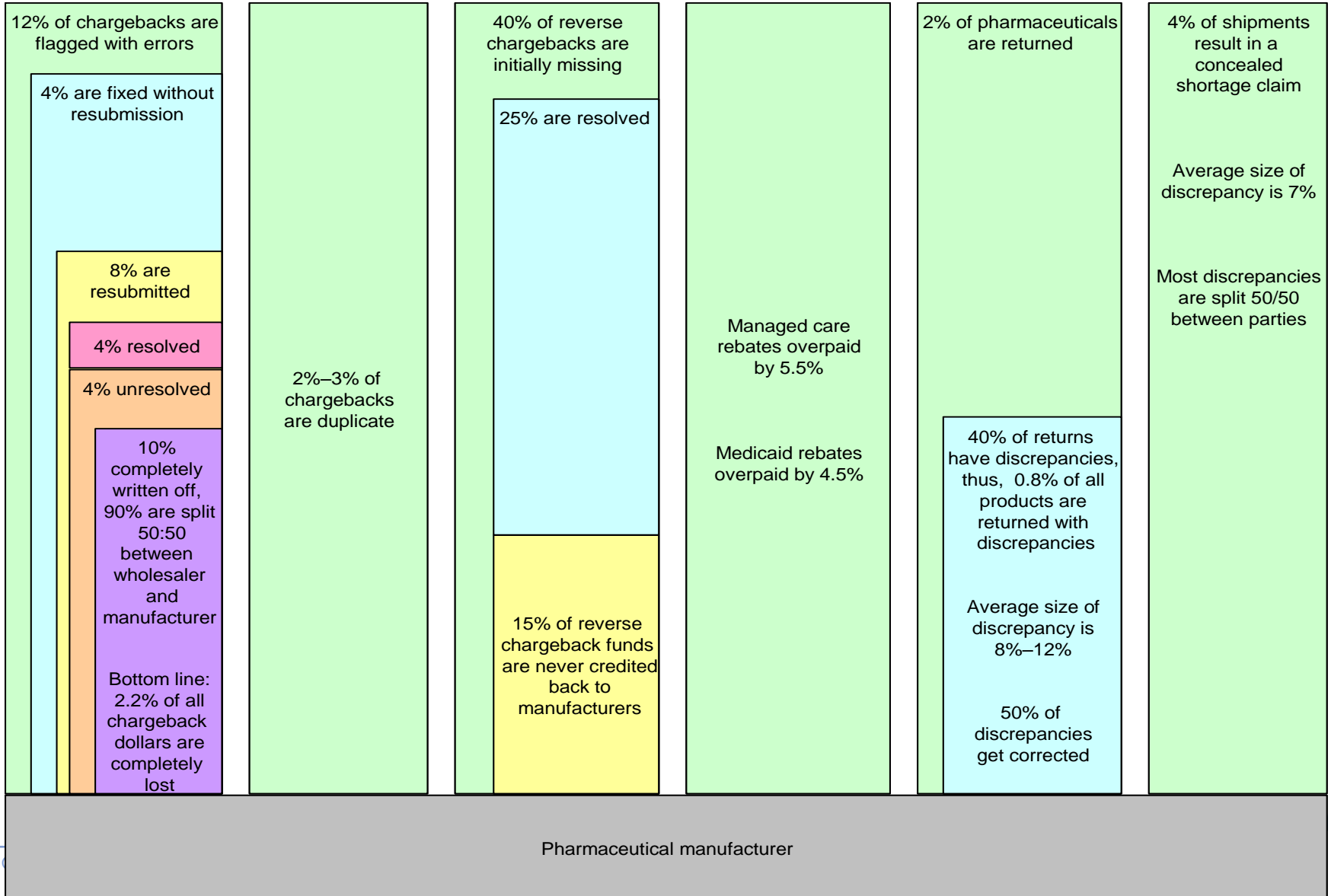
Returns

- Retailers throw in box, ship in bulk to returns processor to sort and ship
 - Inefficient piece counting
- Common discrepancies:
 - Incorrect quantity
 - Wrong product
 - Old price
 - Missing paperwork
- Returns are a game of debits vs. credits, real dollars are seldom exchanged
- Customers simply take credit on next invoice, making it administratively heavy to correct and recoup
- Problematic returns:
 - 2% of pharmaceutical products are returned
 - 40% of returns have discrepancies (average size of discrepancy is 8% - 12%)
 - Thus, 0.8% of all products are returned with discrepancies
 - 50% of discrepancies get corrected, 50% absorbed by manufacturers
- Bottom Line: 0.4% of sales dollars lost to return-related write offs

Concealed Shortages

- Quantity sent vs. quantity received
- Current safeguards are mildly effective
 - Weight
 - Claim window
- Policy enforcement is vital
- Example:
 - Case: \$600M company:
 - *All shipments sent through 3PL which includes weight measurement*
 - *Policy: 15 days for claims, but most debit claims occurred 1 month later*
 - *Afraid to enforce 15 days, didn't want to anger customers*
 - *13% of shipments resulted in claim, average discrepancy of 9%*
 - *Irresolvable disputes typically split 50 cents on the dollar*
 - Began enforcing 15 days, communicated enforcement necessity to customers
 - Citing economic times, gave 3 month notice of enforcement
 - Reduced claims 54% (to 6% claim rate), very minimal customer complaints
 - Reduced annual leakage by \$1.9M
- Shipments
 - On average, 4% of shipments result in concealed shortage claims
 - 40% of claims get resolved
 - Average discrepancy is 7%
 - Most discrepancies are split 50:50 between parties

Revenue Leakage: Summary Snapshot



Revenue Leakage: The Financial Reality

TABLE [2]

Revenue Leakage By Company Size

Company Size	Estimated Revenue Loss
\$40B – \$70B Top 5 Pharma	\$1.69B - \$2.96B
\$25B – \$40B Top 6-10 Pharma	\$848M - \$1.69B
\$8B – \$20B Top 11-20 Pharma	\$340M - \$848M
\$1B – \$8B Top 21-50 Pharma	\$42M - \$340M
\$250M – \$1B Mid Pharma	\$10.5M - \$42M
\$0 - \$250M Small Pharma	\$0 - \$10.5M

- For most top 50 pharmas, this is a several hundred million dollar problem
- Some top tier pharmas are likely leaking over \$1B annually
- Pharmaceutical manufacturers lose approximately \$11 Billion annually in the US as an industry due to revenue leakage
- Average system age: Over 6 years
- Reevaluations/system upgrades necessary

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Next up....

Panel Discussion

Ken Parmelee – Antenna

Joe Marttila – IMany

Fraser Edward – Research in Motion (RIM)

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