Health Capital Topics
Volume 11
Issue 3
March 2018
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Hospitals Form Pharmaceutical Company to Combat Rising Drug Prices

On January 18, 2018, four health systems – *Intermountain Healthcare*, *Ascension*, *SSM Health*, and *Trinity Health*, along with the *U.S. Veterans Affairs Department* (VA) – announced their intention to establish a non-profit, generic pharmaceutical company, with the goal of developing cheaper, more accessible drugs.[1] In the years preceding this announcement, hospitals experienced artificially-induced drug shortages, which led to exceedingly high drug prices.[2] In fact, between the years of 2006 and 2016, total prescription drug expenditures increased by nearly 50 percent.[3] Further, drugs such as morphine and *Nitropress*, an essential heart medication, have encountered persistent shortages and abrupt price increases in the recent past.[4] Over time, these price increases have created enough of a financial burden on health systems so as to prompt them to finally take action against the pharmaceutical industry.[5] The creation of a new drug manufacturing company may pose a direct threat to the pharmaceutical industry, which has ignored repeated requests from hospitals to lower their prices.[6] The partner health systems consist of at least 450 hospitals, and more than 100 hospitals joined the initiative within a few weeks of the announcement, with an expectation of over 1,000 hospital participants in the future.[7] It is believed that up to a third of all U.S. hospital operators may become members of the new nonprofit venture, which is expected to become operational later this year.[8]

The announced plans highlight an emerging healthcare industry trend in which buyers are consolidating with their suppliers, otherwise known as *vertical integration*.[9] This trend toward vertical integration includes hospitals as well as other sectors within the healthcare industry, such as health insurance companies and *pharmaceutical benefit management* (PBM) companies.[10] For example, on December 3, 2017, *CVS Health* announced that it will acquire *Aetna* for $69 billion in order to combine CVS's PBM division with Aetna's insurance division.[11] Additionally, in 2017, *Optum*, a subsidiary of health insurer *United Health Group*, announced that it would consolidate with both *Surgical Care Affiliates*, a walk-in surgical practice chain,[12] and *DaVita Medical Group*, one of the largest independent medical groups in the U.S.[13] Most recently, in March 2018, *Cigna* announced acquisition of *Express Scripts* (the last major independent PBM) for $52 billion.[14] These transactions are a departure from past instances of *horizontal integration*, or a type of integration in which two similar types of entities consolidate.[15] In recent years, several horizontal mergers have been blocked by antitrust authorities, such as the case with the failed *Humana-Aetna* merger, as well as the failed *Cigna-Anthem* merger.[16] Whether future instances of vertically integrated transactions will experience this level of regulatory scrutiny still remains in question.

News of consolidation within other sectors of the healthcare industry, e.g., health insurance and PBMs, comes in the wake of the financial hardship experienced by many hospitals struggling to navigate declining growth in Medicare reimbursement rates.[17] Therefore, hospitals have taken it upon themselves to vertically integrate with other healthcare organizations along the supply chain.[18] However, this current plan to create a hospital-based drug manufacturing company is not without its challenges, as taking on such a project requires significant financial capital, as well as a considerable amount of time for FDA drug approvals and facility inspections.[19] There is still discussion among the health systems as to whether they will manufacture the drugs themselves, or if the drugs will be developed by subcontracted companies.[20] Acquiring or contracting with a drug manufacturer may be a more efficient way to carry out the initiative, and building a new infrastructure may trigger regulatory and financial concerns.[21] Uncertainty remains as to whether this proposal will be effective at alleviating drug shortages and lowering drug prices, as previous attempts to form a specialty-pharmacy network among hospitals failed.[22] Nonetheless, some industry leaders are still optimistic, such as Michael Rea, CEO of *Rx Savings Solutions*, a company that sells software to help health insurers lower drug costs, who stated:

> "*There are no new entrants to the [pharmaceutical] market because it is so difficult to get into…But having the capital source of hospitals is a great start—now they need to execute on the plan.*"[23]

With drug spending expected to increase by 8 percent in 2018, health systems are proactively seeking solutions to combat rising drug costs, such as the proposal to establish a hospital-based drug manufacturing company.[24] According to Laura Kaiser, President and CEO of SSM Health,

> "*The best way to control the rising cost of healthcare in the U.S. is for payers, providers*

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and pharmaceutical companies to work together and share responsibility in making care affordable…Until that time, initiatives such as this will foster our ability to protect patients from drug shortages and price increases that limit their ability to access the care they need."[25]

Although this initiative attempts to confront the problem of rising drug prices directly, the health systems involved may still face many challenges, including issues of limited capital funding as well as regulatory scrutiny from the FDA, *Federal Trade Commission* (FTC), and *Department of Justice* (DOJ). Further, previous instances of blocked horizontal mergers may foreshadow potential regulatory scrutiny toward vertical mergers. Whether the health systems are successful in their attempts to implement this solution depends on their ability to overcome these forces.

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