In recent months the pharmacy world has been buzzing about new generic discount programs. These programs range from $4 generic programs like those offered by Wal-Mart and Target, to free antibiotic programs at Meijer and H-E-B, to 90-day supplies for reduced prices at Wegmans and Kmart. Now that the dust has started to settle, many of us in the pharmacy industry are thinking: How does this really impact me? What should I be doing? When is the last time I evaluated my cash pricing strategy?

Evolution of U&C Pricing

Traditional usual and customary (U&C) pricing for many retail pharmacies is established based on maximizing reimbursement from third-party payers, since they typically account for over 90% of a pharmacy’s prescription business.

- For most brand drugs, U&C is set equal to or comfortably above the most profitable pharmacy network rate. Cash prices are set in this manner to avoid the “lower than U&C” clauses in PBM contracts, which dictate that a PBM will not reimburse more than the cash price for any drug.
- U&Cs for generics are typically set as a percentage discount from the brand U&C. Often, this percentage discount strategy creates a cash price that is significantly higher than the acquisition cost. The goal is to have the patient recognize that the generic price is a fraction of the price of the brand and so choose the generic, while the pharmacy is still able to capture a healthy profit margin.
- The third element to most U&C strategies is to manually set prices for a small subset of drugs based on the competition in your geographic area. These competitively priced drugs typically include both brand and generic fast movers, especially those that are commonly not covered under insurance.

Recently many pharmacies have shifted to a discounted cash prescription strategy designed to offer value that will attract or retain customers. These strategies take the approach of setting the U&C as a markup from the pharmacy’s acquisition cost of the drug. Costco has most notably adopted this strategy. The new flat-price generic programs are a variation of this approach. These programs have selected a group of relatively low-cost drugs and set a standard U&C that is generally just above the acquisition cost of the product.

Whether we are considering the cost-plus markup strategy or a flat-price program, these strategies all reduce gross margin on a group of generic drugs that were highly profitable. Pharmacies use these discounted prices to attract new customers and to drive both prescription and front-end sales.

U&C Analysis

Use the following series of questions, along with your pharmacy software’s reporting tools...
or data warehouse, to determine if it’s time to update your U&C pricing strategy.

**Understand Your Business**

How many prescriptions are dispensed as cash, and what is the total dollar value of this business? You may find a significant amount of revenue associated with cash prescriptions. On the other hand, you may realize that your cash business is minimal and that it’s not worth competing in this space. The important part of this knock-out question is to actually check the numbers. Since perceptions can be deceiving, determine which drugs are most frequently dispensed as cash rather than third-party covered claims. Consider the following questions:

- Are the drugs that comprise the highest percentage of your cash business competitively priced?
- What is your profit margin per prescription on your cash business, calculated both as a percentage and as dollars profit?
- Within this subset of “cash” drugs, what is the percentage of cash versus third party for each drug? What is the average “total amount due to the pharmacy” (PBM payment plus patient co-pay) for these cash drugs when they are submitted to a third party? You must review these numbers before making any U&C changes, since third parties generally pay the lower of the U&C or “total amount due.”

Once you understand your current U&C strategy, begin to consider your competition.

**How Competitors Are Affecting Your Business**

Here are some questions to help evaluate your competition. Have pharmacies in your area adopted an aggressively discounted U&C approach without launching a specific program? You can survey competitors to verify their cash prices, particularly on your high-volume cash drugs. Are there new or existing generic discount programs in your region? If there is a specific program that you feel you will be competing against, you will need to continue to drill down further. Do you fill a significant number of prescriptions for the drugs in the competing program? Are these cash or third-party prescriptions? It is important to consider third-party prescriptions because if the U&C is low enough, such as a $4 generic program, then third-party patients will experience savings on their co-pay. If the program has already been launched, you may want to try to identify patients on these prescriptions and determine if they have recently stopped getting refills at your pharmacy. This may indicate that you are losing prescriptions to this competitive program. Are you losing prescription sales and/or front-end business?

To help answer these questions, you may want to regularly monitor several business metrics. These metrics should be calculated for all prescriptions, but they can also be broken down by third party and cash business and brands versus generics. These metrics could include:

- Sales volume in dollars and prescriptions.
- Gross margins.
- Average ingredient cost per prescription and co-pay for third-party drugs.
- Generic substitution rate.

These metrics will be even more important if you decide to launch a pilot program of your own. Always create measurable goals of success and monitor them over time.

**The Impact of Matching a Program**

If you determine that a competing program is placing you at a disadvantage, one course of action would be to consider matching this program. To evaluate the situation, you must compare the upside benefits to the opportunity cost. Calculate the patient savings if you were to match this program and determine if the savings is large enough to affect patient behavior. What are your current U&Cs for the targeted drugs, compared to the new, discounted U&Cs? Will the lower U&Cs decrease patient co-pays? Are these savings significant enough for cash or third-party patients to switch pharmacies? If so, consider how you will benefit. Can you forecast a gain in nondiscounted prescription products or front-end sales? It is also important to consider if this is an internal strategy intended to prevent the loss of existing customers, or if it is an external strategy designed to bring in new customers. This determines how you measure success and also impacts the marketing dollars that must be spent on this program.

The downside of matching a program

*continued on next page*
generic discount program is the financial opportunity cost. What is the difference between your current cash prices and the new discounted prices? This will be the same as the number you calculated for the cash patients’ savings. You must also consider if the new U&Cs are lower than the total amount you would have received for third-party prescriptions. In this case, the lost revenue due to lower third-party payments is a direct cost to the pharmacy. Carefully calculate this number. Often the third-party dollars lost due to “lower than U&C” are much greater than the savings shared with the patient.

Evaluate Alternatives

Instead of matching a competitor’s program, consider alternate ways of increasing your cash pricing competitiveness. You may want to lower prices on a different group of drugs. You may find that one of the other generic discount programs would better fit your business model and have less of a financial impact while still generating promotional buzz. For example, if a neighboring store is adding a $4 generic program, you may want to evaluate a discounted antibiotic program. Another simple strategy would be to lower your minimum prescription price. You may also consider only matching prices for patients who request it. I would caution that price-matching strategies can be problematic. They are historically poorly controlled and inconsistent. Additionally, if you are overriding a majority of U&C prices, you will no longer be accurately reflecting your true U&C to PBMs on covered claims.

Alternatively, consider a focused approach to market the value of your current services without changing your U&C strategy. You may not need to compete on price if patients recognize superior service or increased convenience. Do not assume that patients automatically will recognize these advantages. Consider how to communicate your pharmacy’s value to your customers. This may be the best use of your time and money.

Regular Checkups

In these changing times you must always be analyzing and evaluating new strategies and tactics. Setting U&C pricing is no different from creating any other business strategy. It is critical to evaluate your alternatives regularly, create a written game plan, understand the implications and assumptions, and measure your results. By following these steps you can make informed decisions and know their financial impact rather than just follow the trend.

Michael Bunn, Pharm.D., M.S., is a consultant with Pharmacy Healthcare Solutions in Pittsburgh, Pa. He can be reached by email at bunn@phsirx.com.