



Creating Competitive Advantage Through Contract Analysis

INDUSTRY WHITE PAPER
From HighPoint Solutions

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INTRODUCTION

Pharmaceutical contracting has transitioned over the past 20 years from being a small, incremental part of pharmaceutical manufacturers' business to one that is integral to almost every market segment. Contract strategy and effectiveness is now a key differentiator in the Managed Markets space to increase profitability.

In many cases, the sale of an individual unit to the end patient results in the need for manufacturers to honor multiple contractual agreements. For instance, sales within the institutional segment of the business often require a manufacturer to honor its fee-for-service contracts with wholesalers, the payment of administration fees to Group Purchasing Organizations (GPOs), and submission of performance based rebates to individual hospitals. For retail managed care sales, manufacturers will still need to honor those same wholesaler fee-for-service agreements and likely pay rebates to Pharmacy Benefit Managers (PBMs) or other managed care plans. Government funded programs, such as the Federal Supply Schedule (FSS) program, Medicare Part D, and State Medicaid, have further complicated the contracting landscape. Given the amount of discounts currently being paid, which can be as high as 90% of a product's Wholesale Acquisition Cost (WAC) pricing, there are significant challenges within the industry to better manage contract pricing from both a strategic and operational perspective.

This white paper will examine the challenges companies often face due to the lack of analytics insight, as well as, the framework for how to think through them. By integrating the analytics framework with a closed loop process model, companies will gain competitive edge through more effective pricing and contracting.

CONTRACT ANALYTICS MARKET SEGMENTS AND NEEDS

A simple, yet effective way to conceptualize contract analytic needs within your company is to think about them along two broad dimensions: 1) the business situation you are attempting to address and 2) the market for which you are addressing them.

Situational Analysis:

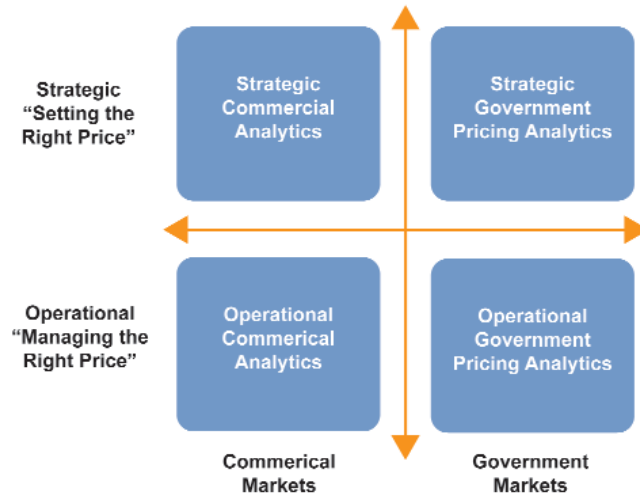
Broadly defined, the business purpose of the analytics can be focused on either a strategic issue or an operational issue. Analytics addressing strategic issues are defined as those that help companies determine the optimal price or discount. Analytics that address operational issues are defined as those that help companies manage the right price.

Market Analysis:

From a market perspective, analytics are described as either focused on commercial or government segments. Depending on a company's product portfolio, specific sub-segments can be more relevant than others. For

example, a company with a branded, retail based product line should focus more on the PBM's, Health Plans, and Medicare Part D from a commercial perspective, as opposed to institutional sub-segments. The graphic below depicts this framework:

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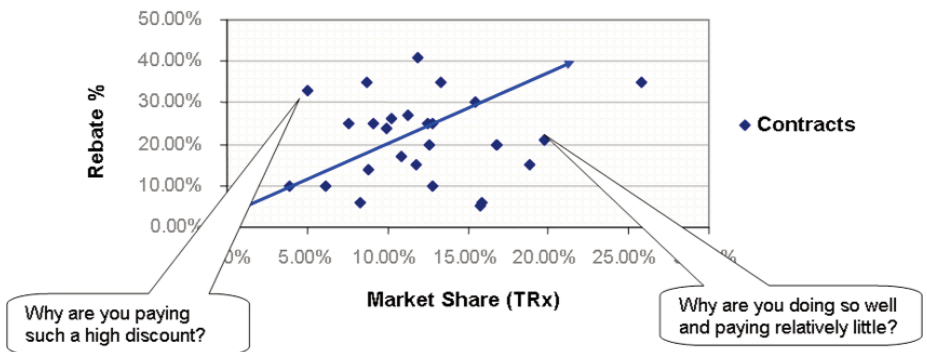


STRATEGIC ANALYTICS – “SETTING THE RIGHT PRICE”

From a strategic perspective, pharmaceutical manufacturers sometimes rely on judgmental methods to reach discount decisions that can impact a company’s bottom line by hundreds of millions of dollars. Vague arguments such as, “It’s an important customer” are still used to justify disproportionately high discounts to certain contracted customers, resulting in a company’s product being well under national market share or expected sales volumes.

Alternatively, other customers “judged” not to be as important are not aggressively pursued for contracting purposes, resulting in dramatically decreased market share or sales volume. To highlight these points, let’s take a look at a sample analysis that correlates level of discount offered to the relative market share for its commercial customers:

“Company X Product” Discount Percentage vs. Market Share



The CEI uses statistical techniques drawn from past performance to objectively predict steady state market share and volume for the product in question.

As you can see from the graphic on the previous page, market shares varied widely with little correlation to the discounts that the manufacturer paid. Sometimes there are rationale explanations to these variances. For instance, it would be expected that a newly signed contract would take time for adoption and the initial market share would be lower than national market share. Nevertheless, many times it is a lack of understanding of a customer's ability to influence business results that drives these inefficiencies.

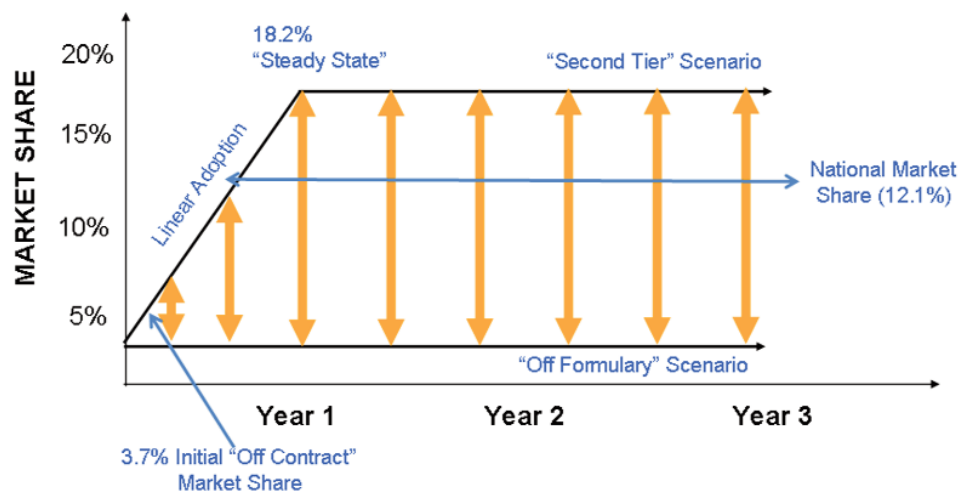
Situations can be greatly improved through more sophisticated quantitative modeling that enables better forecasting. In fact, one model leverages past performance within a given therapeutic class. HighPoint Solutions has defined two key performance indicators within this model, a Conversion Effectiveness Index (CEI) and a Conversion Adoption Index (CAI), to help manufacturers more accurately model the expected performance of their contracts over their lifecycle.

The CEI uses statistical techniques drawn from past performance to objectively predict steady state market share and volume for the product in question. The information is based on existing national market shares and number of products on formulary.

The CAI uses statistical techniques to forecast the rate of adoption and the type of adoption curve that it will have as it gets to steady state.

Taken together, these two models can greatly improve the accuracy of contract forecasting as well as rebate accruals. It is also helpful to use the outputs of this model to forecast positive or negative variances to expectations, allowing a company to adapt to them more quickly.

The example below shows a product that will have a linear adoption curve and achieve a market share that is 6.1 share points above national once it reaches steady state.



OPERATIONAL ANALYTICS - "MANAGING THE RIGHT PRICE"

Once a contract is in place, there are a number of operational analytics that should be in place to ensure that the business is paying its contractual liabilities promptly and accurately. These include;

1. **Payment Trending Reports:** Provides longitudinal views by customer to identify outliers in rebate liabilities compared to historical norms.
2. **Chargeback Rejection Reports:** Provides metrics regarding % of line items that are processed without error, number of line items outstanding segmented by appropriate timeliness (e.g. 7 days vs. 30+ days outstanding).
3. **Cycle Time Reports:** Provides the average total time it takes from the submission of a claim (e.g. rebate, chargeback)

Operationally, companies still struggle with managing the vast array of contract related payment requests including, to name a few, chargebacks, GPO administration fees, Medicaid rebates, Managed Care rebates, and Medicare Part D rebates. While there are a multitude of reasons why companies struggle with these payments, we can group them into three overlapping areas:

1. **Contract Complexity:** The greater the complexity of a contract, the greater the effort to accurately pay on a timely basis. For example, contracts with multiple market share tiers, changing prices based on CPI-U (Consumer Price Index - Urban), and changing competitor products for market baskets will obviously be much more difficult to manage than an upfront discount.
2. **Eligibility:** By definition, a contract creates some sort of special set of pricing for certain customers versus others and therefore "eligible" customers must be accurately maintained. Some of the more common challenges today within the industry include PHS -340B eligibility, GPO Membership eligibility, Managed Care plan eligibility, and prescription eligibility within an eligible managed care plan based on a host of criteria, including other coverage, outlier quantities, and duplicate prescriptions.
3. **Data Quality:** Data quality can be driven by customers' or a company's own internal systems and includes both timeliness and accuracy. Poor accuracy is often times the result of master data management challenges. It may also be reflective of a complex information technology architecture with many custom applications, and the need to manage a

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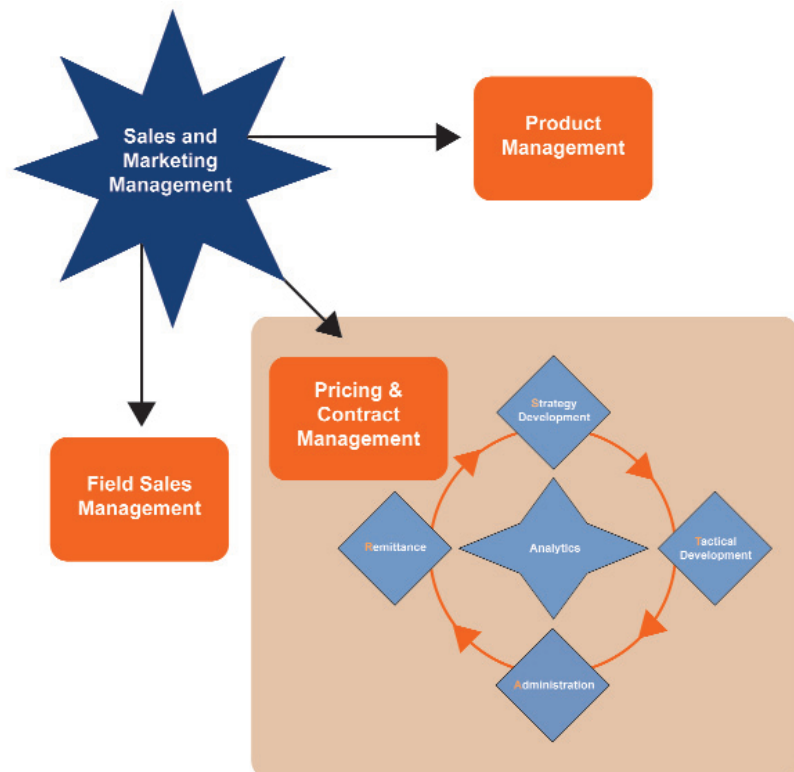
CREATING CONTRACT ANALYTICS EXCELLENCE WITHIN THESE MARKETS

Whether strategic or operational analytics are the focus, there are certain steps a company must take to improve its analytics capabilities for both commercial and government markets. We recommend three specific steps beginning with understanding contract management as a closed loop process prior to thinking through specific analytics. The implementation of either a small, inexpensive tool or a more robust analytics technology solution would follow.

Step 1: Create a comprehensive process framework for understanding analytic needs within the context of contract lifecycle management.

At Highpoint Solutions, our team has developed its own STAR™ process framework to address industry issues that are most common within pharmaceutical companies for Pricing and Contracting. Our STAR™ Framework process model logically maps analytics needs to each step of the

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contract lifecycle to facilitate both strategic and operational decision making. The graphic below highlights our framework within the overall context of sales and marketing management:

As you can see from the graphic above, the “STAR” in the middle of the

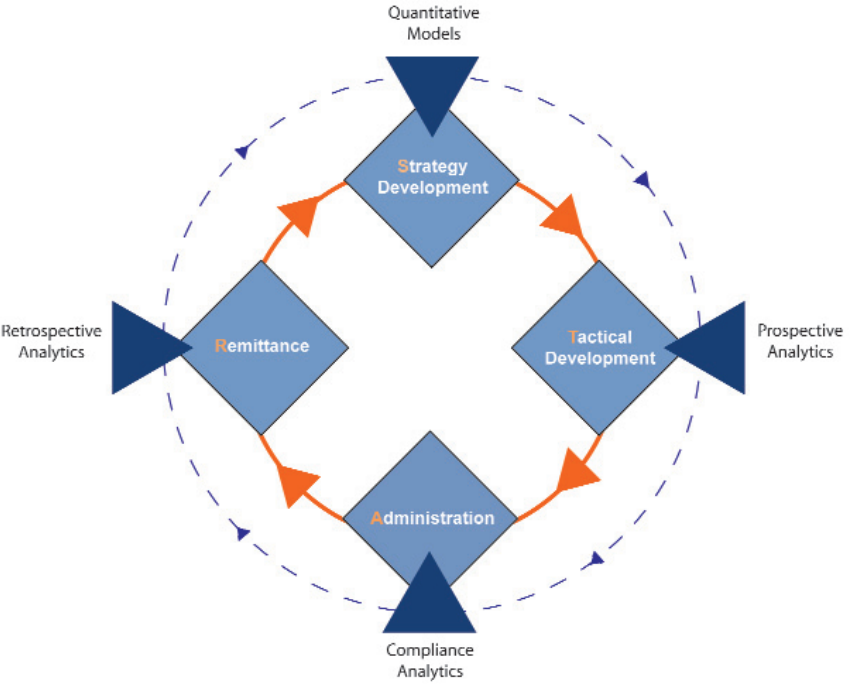
While each company's needs are unique based on its specific product portfolio, we have identified the categories of analytics that will be needed at each step of the process.

Strategic Development	The contracting strategies and policies for the organization and/or product line.
Tactical Development	The development of contracts from initial customer negotiations to final signature and loading into relevant systems.
Administration	The initial set-up, ongoing maintenance, and compliance monitoring of contracts, including the addition/deletion of key contract components such as pricing information and membership.
Remittance	Processing and validation of contract payments including chargebacks, rebates and administrative fees.
Analytics	Within the STAR™ framework, analytics supports all four areas above with prospective and retrospective analysis of contracting efforts regarding strategies, operations, and regulatory compliance.

process model is intended to represent the importance of analytics at each step of the process model. Each of the areas of the STAR™ framework are explained in more detail on the following page.

Step 2: Identify and understand analytic needs within each of the process areas.

What are the analytic needs of a company at each step of the process? While each company's needs are unique based on its specific product portfolio, we have identified the categories of analytics that will be needed at each step of



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the process. Similar to the closed loop process model we just highlighted, analytics should logically link to each other as well. The four categories of analytics are depicted below based on the STAR™ framework:

Quantitative models are the analytics that form the predictive basis of the dynamics within a therapeutic class and a company’s product(s). By leveraging statistical techniques and financial analysis, a company can better understand contract performance.

The key differentiator in the market place is the integration of quantitative models that provide better understanding. Quantitative models make companies more knowledgeable their contract, rebate and ROI metrics by suggesting optimal deal prices based on historical data. They can also help explain how a proposed contract measures up against historical contracts. A win/loss analysis can determine outliers and trends. It can also identify which accounts are paying lower prices and predict probabilities of winning versus

Pre-Deal Analytics	Analytics that are “prospective” and used for forecasting key performance indicators on both an individual and aggregate basis.
Post-Deal Analytics	Analytics that are “retrospective” and compare. Pre-Deal Analytic forecasts to actuals with the goal of indentifying reasons for both postive and negative variance.
Compliance Analytics	Analytics that provide insights into how well a contract is performing in comparison to contract terms & conditions. Ideally this activity is proactive to facilitate corrective actions when a customer is identified as “out of compliance”.

losing for given contract offers.

Quantitative models can leveraged throughout the contract lifecycle to support the other types of analytics described below:

As one can see, the STAR™ Solution Framework links “pre-deal” analytics, compliance analytics, and “post-deal” analytics, allowing companies to investigate real expectations associated with contract and proposal performance. By bringing the appropriate information together, companies will be able to ask and answer questions such as:

- What should the steady-state market be for particular contracts?
- What is the maximum discount before a contract is not profitable?
- What is the performance of my contracts and proposals over the last year?

Step 3: Create an analytics solution based on a well defined and documented approach

Working within multiple functional areas, including executive management,

A best-in-class analytics solution applies business intelligence to Managed Markets and then leverages statistical methodologies to enable analytic excellence for pharmaceutical companies.

finance, legal, managed care, marketing, and contract operations is critical to identifying the comprehensive analytic needs of any organization. With so many needs, how can does a company prioritize which analytics to implement and in what order?

One potential way is to utilize a prioritization matrix integrating business value with the ability to implement. Alternatively, a balanced scorecard approach can be used to more formally considers these things, as well as, availability/accuracy of data, cost of development, and time to implement. As with any roadmap, things may change. However, formally creating and periodically reviewing the analytics roadmap creates focus and momentum to improve.

As an organization continues to need more and more analytics, it must repeatedly ask the question, “What business decisions are being made based on this analytic?”. An analytic can help determine a more optimal contract discount. For example, a 1% percent change in price can often have a 5-10% impact on profit. A compliance analytic can help to better understand payment or non-payment to customers. Industry studies have regularly found revenue leakage can be 4% of total revenues. Well defined and implemented analytics can help make these opportunities much more visible and addressable to organizations.

Finally, a flexible and scalable solution to address the analytic needs from a technology perspective needs to be implemented. Solutions can be as simple as excel based charts and graphs supported by an Access data base or as complex as business intelligence tools with data warehouses integrating internal and external data sources. Solution Architects at HighPoint Solutions have extensive experience in developing roadmaps and implementing customized solutions to support a company’s specific analytics needs.

SUMMARY

Contracting continues to be a significant differentiator in the Managed Markets space for pharmaceutical companies as they look to increase profitability. The need for effective quantitative models, prospective analytics, compliance analytics, and retrospective analytics is stronger than ever. A best-in-class analytics solution applies business intelligence to Managed Markets and then leverages statistical methodologies to enable analytic excellence for pharmaceutical companies.

Analytics allow manufacturers to stay one step ahead of the competition. While companies use analytics in a variety of ways, what sets the leaders apart is their strategic use of analytics across the entire organization. For these companies, analytics is the essential component of their unique business strategy and ability to execute.

HighPoint Solutions has a dedicated Pricing & Contracting Management practice with extensive industry and technology expertise that brings a proven framework around Contract Analytics. Our Pricing & Contracting practice and Business Intelligence practice has the experts who have leveraged many of the frameworks presented in this white paper to create more effective and efficient contracting

Contact HighPoint Solutions today to start the conversation about your contracting and pricing needs and how our frameworks can navigate your organization through this complex environment. We have the right combination of strategy, operations, and systems integration experience to ensure your success.



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