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Impact of Japanese drug price reductions, by P Reed Maurer

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Outside observers have long predicted the mandated price reductions of drugs will kill the Japanese pharmaceutical industry, reduce the motivation to introduce new drugs, and stifle innovation, says P Reed Maurer, president of International Alliances Limited, and a pharma industry watchers who has lived and worked in Japan since 1970.

In reality, top tier companies have ample cash to acquire product assets from outside Japan, the pace of new drug introductions is increasing, and there are more new drug ideas in Japan than there is funding to develop these "seeds" into proven drugs.

Why are prices reduced?

To be clear, the price reductions we are talking about are reductions in the prices at which drugs are reimbursed within the National Health Insurance (NHI) system. Manufacturers' selling prices to wholesalers are less than the NHI prices, as are wholesaler prices to dispensers which include doctors, hospitals, and pharmacies, Mr Maurer notes.

The insurers reimburse dispensers at NHI prices but obviously prefer to reimburse at actual purchase prices, thus they insist NHI prices should be reduced to the purchase price level. If manufacturers and wholesalers did not discount their prices vis a vis the NHI prices there would be no price reductions.

But this is a competitive market with free market pricing, ie, there are no fixed margins. So companies consider demand is elastic and discount to increase sales even though this will lead to price reductions. Easy to note in certain therapeutic categories with many equivalent drugs, the discounts and price reductions are higher than those in "niche" markets.

Are there any benefits?

It is difficult for an individual company to see the benefits of operating in a deflationary environment, says Mr Maurer. Sales revenue cannot be increased by raising prices, and volume will decrease if discounts are reduced. So the only way up the price curve is to come out with a new drug because new drug prices are invariably higher than old drug prices. This dynamic forces the industry to innovate. Rewards are given for something new, anything new.

Patients on long term therapy see their out of pocket costs, usually 30% of the NHI price, go down over time as prices are reduced. It is not surprising the public image of drug companies in Japan is quite favorable.

Companies benefit because it is typical for products to have a "long tail." A disciplined approach to discounts will reduce the magnitude of price reductions so revenue does not precipitously decline. These so called long listed drugs provide more than 50 percent of revenue for many, indeed a majority of Japanese pharma companies.

What is the downside?

Like practically every other developed country health care system, Japan needs to cut costs to fund natural increases in health costs because of an aging population. But Japan is getting hit with a double punch in that its population is also declining. The population of healthy young people is declining relative to chronically ill older people.

Cutting drug expenditures is a favorite way to reallocate funds. Another option is to reduce demand for health care but this is political suicide for its advocates. One way to save money is to promote generics whose NHI prices are initially 70% of branded drug prices. But for a variety of reasons generic drug consumption in Japan is relatively low compared to the USA and Europe.

A substantial cost reduction could be achieved by cutting the prices of long listed drugs down to the generic level. This action was strongly proposed by the Finance Ministry (MOF) leading up to the 2012 price reductions implemented in April. The MOF wanted to implement a double-digit price reduction on top of the price reductions derived from actual market prices.

Because the MOF wields more power than other ministries, many believed they would have their way in negotiating with the Ministry of Health Labor and Welfare (MHLW). In reality the actual additional price reduction on long listed drugs turned out to be 0.9 percent. This result has been a blessing for companies that do not innovate and survive on long listed drugs, says Mr Maurer, noting that maintaining the status quo for these companies is bound to put pressure on new drug pricing because costs must be reduced.

A persistent status quo

Protecting companies that do not innovate may save jobs and avoid the disruption of harmony so prized in Japan, but [it] avoids the creative destruction necessary for rebirth and the creation of a dynamic bioventure industry. Risk is avoided in favor of stability.

On the other hand, larger companies took the risks inherent in consolidation. Examples include Dainippon Sumitomo, Tanabe Mitsubishi, Yamanouchi and Fujisawa into Astellas, and Kyowa Hakko Kirin. Or they shed non-core assets to concentrate on the pharma business. Examples include Takeda and Eisai. Both strategies led to a sharper focus of internal resources and expansion outside Japan.

These are the companies that need to benefit from a home market that rewards innovation and avoids arbitrary price reductions such as price cuts because of higher than forecasted demand.

Japan's MHLW is quite unique in that one of its missions is to promulgate policies that insure a viable, dynamic, and growing pharmaceutical industry. This is certainly not the mission of the US Food and Drug Administration. However, by maintaining the status quo of mid- and small-sized companies, the innovative, expansion minded, and acquisitive larger companies are forced to comply with growth limitations in their home market.

The next price reductions are scheduled for 2014, says Mr Maurer, adding: "I suspect the MOF will not quietly back off its demands for long listed drug price cuts the second time around. If so, the status quo will be shattered."