The Pharma Letter
Keywords: Japan, Generic drug marketing, Reimbursement prices, Insurance

Japan generics market: Boom or Bust? by P Reed Maurer

Article | 17 November 2011

Japan has the lowest generic utilization rate of developed markets. Thus, as you might expect, Japan has the highest market share from off patent brands. Is this unique position a kind of "generic drug lag" or does it reflect fundamental market dynamics?

To answer this question we need to first understand what players drive generic utilization in the health care system. This analysis I call "Follow The Money." Second, what changes in the system will alter the dynamics of the generic market? Will these changes lead to a generic boom or bust?

Players in the system

Patients

• Universal health care was enacted in Japan in 1961 so there is a 50 year history of 100% insurance coverage of the population, and open access for health care in any medical facility in the country. The pressure on health care costs is primarily attributed to the aging of the patient population, or a shift from providing acute care to chronic care.

Health Care Providers

• Patients receive care in either clinics or hospitals. In terms of drug utilization there are two types of clinics, ie, those that dispense drugs, and those that provide prescriptions to be filled at independent pharmacies. The former have declined in number as various incentives encouraged separation of dispensing and prescribing.

• There are 8,730 hospitals in Japan. In terms of reimbursement for their services hospitals are either paid on a fee for service basis, or a method of flat sum reimbursement called Diagnosis Procedure Combination or DPC, a system akin to the DRG system in the USA.

Payers

There are three kinds of payers, ie:

1 National and local government insurance which covers 37% of total health care costs.

2 About 1,500 insurance societies who cover employees in companies.

3 Individual out of pocket payments covering 13 of total health care costs.

Reimbursements for both medical care and drugs are the same for all payers.

Follow the money – patients

Turning now to the cost of drugs for patients, reimbursement prices are initially set at relatively high levels but are reduced every other year. Generics are the priced at 70% of the brand drug price. Assume a branded drug at 100, the generic price will be 70. The patient out of pocket cost is 30% of the price so 30 for the branded drug and 21 for the generic drug, or a difference to the patient of 9. These two factors, the downward price spiral and the small difference in out of pocket costs for generics do not give patients an economic incentive to demand generics.

Follow the money – wholesalers and pharmacies

Pharmacy income from drugs is the difference between the reimbursement price and purchase price. Wholesaler income is the difference between the selling price to a pharmacy and the purchase price from a manufacturer. This can be depicted as follows by using 100 for the brand drug reimbursement price and 70 for the generic drug.

Pharmacy Brand Generic
Reimbursement Price 100 70
Purchase Price (at 10% margin) 90 63
Gross Profit 10 7
Wholesaler Brand Generic
Selling Price 90 63
10% Margin 9 6.3

Wholesalers and pharmacies make less income selling and dispensing generics given similar margins. To compete, generics must offer higher discounts, but this leads to larger price reductions in the reimbursement tariff. Thus, a short term gain will lead to longer term pain for generic discounters.

Follow the money – doctor and hospitals

• Most doctors work in hospitals as salaried employees or in clinics that do not dispense drugs, therefore they are insensitive to the cost of drugs.
• Hospitals and doctors who dispense drugs consider their pharmacies as profit centers, therefore, given a similar margin percentage a high priced drug is more attractive than a low priced drug. However, in the DPC hospitals mentioned earlier, their pharmacies are cost centers so a low price drug is better than a high price drug. Not surprising that generic drug penetration is high in DPC hospitals.

Follow the money – payers

Payers prefer a low price drug but the challenge is how to influence buying and dispensing decisions. To date the following measure were taken.
1 Higher fees for pharmacists who dispense generics.
2 Give pharmacists the right to substitute a brand drug with a generic unless the doctor specifically forbids it.
3 Promotion campaigns directed to patients to ask the pharmacy for generics.

Each of these actions has had a positive but limited impact on generic usage. Thus there are calls for further incentives to be enacted in the 2012 revision of prices and fees. Examples include higher dispensing fees for pharmacies, mandatory generic name prescribing, and generic prices set at 60% of the brand drugs rather than 70%.

Some of these actions cost money, so the question arises, "How much money can we spend to save money?"

Key near term issue

As noted earlier, off patent drugs have a large market share in Japan because they provide a greater economic reward to players in the system. Lowering the reimbursement prices of these drugs would

result in significant cost savings, much greater than promoting generics because of the market share difference. However this action is objected to by manufacturers with a high percentage of these drugs in their product portfolio.

If enacted, generics will be negatively affected (a bust) given consumers familiarity and preference for branded drugs. But the payers would be winners.

In short, the Japanese generic market is a work in progress. How it will evolve is not completely known but the economics of the system preclude the assumption it will evolve to be like the USA. But the current upward momentum will certainly propel the generic market share in terms of value past the 10% threshold. And because this is such a large market, generics will be a serious business. Thus, neither a boom nor a bust.

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