Is the CVS-Aetna Merger a Pharma Industry Transformative Event?

November 2018

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George A. Chressanthis, Ph.D., Principal Scientist, Axtria Inc.
Randy Risser, Principal, Axtria Inc.

> Our focus will be at the local and community level…to intervene with consumers to help predict and prevent potential health problems before they occur.[1]
>
> Larry Merlo
> *President and CEO of CVS Health*

> The AMA worked tirelessly to oppose this merger and presented a wealth of expert empirical evidence to convince regulators that the merger would harm patients.[1]
>
> Barbara McAneny
> *M.D., AMA President*

Remarks provided after US antitrust officials approved the CVS -Aetna merger

1. What does the CVS-Aetna merger and other recent activities mean for pharma?

US antitrust officials recently approved the proposed $69 billion CVS-Aetna merger, subject to some provisions requiring Aetna to sell off its Medicare Part D business.[1] This merger combines the third largest health insurance company (Aetna) with 22 million medical members, with a pharmacy business (CVS) having a reach to 5 million retail pharmacy customers per day, 9,800 retail outlets, 1,100 MinuteClinics, and its powerful pharmacy benefit manager (PBM) business.[1] This merger follows a similar action taken by the Justice Department to approve the Cigna-Express Scripts merger, and partnering activities by Amazon, Berkshire Hathaway, and J.P. Morgan to get into the healthcare industry.[1] These events taken together suggest what some have characterized as "the era of retail medicine is fast approaching."[2] What these changes also mean is an upcoming battle looming between big pharma, large retail, big health insurance companies, and large pharmacies with their influential PBM programs. Clearly, change is coming to the historically insular pharma industry, not from within, but rather from the outside and especially from business change-agents like Amazon and tech-giants.

The traditional establishments of pharma and physicians have never seen such developments. They may also see such consolidation as threats to their own respective places, exerting greater economic pressure to extract price and reimbursement concessions. The quote from the AMA president is fascinating. Why do physicians feel so threatened by this deal? Why do they feel patients will be harmed? It could be they see this merger as another big step in reducing their influence, caught between the mega-health systems and the mega-retail-insurance conglomerates, resulting in physicians having less and less say in the care of patients. The creation of monopolies or a small set of stronger oligopolies means cutting costs and higher profits by limiting access to patient care. While "better outcomes", "higher value", "improved prevention", etc. are all admirable goals that this and other similar mergers aspire to produce, the practical reality will be for CVS-Aetna playing hardball to exert their newly-created economic power in deals with pharma and

healthcare systems. There is a delicate balance between managing costs versus maintaining or increasing quality of care and outcomes. Mergers like CVS-Aetna may likely shift the balance to the former at the expense of the latter. For pharma, this then says a lot about who are the customers and what is the pathway to the patient. Both pharma and healthcare systems need to adapt to these changing dynamics.

There is no question significant cost cutting is warranted. The healthcare sector has significant cost-structure imbalances relative to outcomes generated that are causing people to question the status quo. Approximately 20% of US GDP is spent on healthcare where people question the outcomes they are receiving relative to the cost. Thus, external change-agents find such conditions ripe for opportunities, or, possibly as in mergers like between CVS and Aetna, may be motivated by these changes/conditions. CVS/Aetna may be seen less as change-agents and more as two healthcare industry insiders trying to adapt and position themselves in a changing landscape to protect their respective businesses.

Is the pharma industry prepared for such developments? Likely not. These mergers and collaborative efforts bring together companies that better understand how to serve the customer, know how to leverage large amounts of data to improve outcomes, and have experience with transformative technologies such as artificial intelligence (AI) and machine learning (ML) to build better predictive models to diagnose and treat patients more effectively (as the opening quote from the CVS CEO suggests). Pharma companies would be well-advised to take notice and adopt the preceding areas of expertise to develop better customer insights and demonstration of value. Mergers like the CVS-Aetna deal also places individual pharma companies at a disadvantage when it comes to negotiations over drug prices, formulary placement, and demonstration of value when entering into performance-based contracts (which will accelerate given these mergers). This is a big threat to pharma, as mergers like CVS-Aetna will likely focus more on negotiating lower prices and limiting access to branded drug therapies than on the "do-good" activities for patients as touted by the opening quote from the CVS CEO. Companies like Amazon are masters of using logistical and technical expertise to extract added profits from the business, which has margins much lower than the high-margin pharma business (typical marginal costs of production as a percent of average selling price (ASP) can be in the single-digits (small molecule drugs) to 15-20% for injectable, large molecule, genomic, and biologic drugs).

2. What should pharma companies do in response to the CVS-Aetna merger?

The pharma sector has been undergoing rapid and evolving environmental changes. The CVS-Aetna merger is an additional change to the pharma environment. The important question to ask and answer is what should pharma companies do in response to this and similar events? Below are some suggested strategic policies (non-exhaustive list).

a) *Pharma companies can't be an expert in all things, especially in those areas mastered by change-agent companies.*[2] Pharma companies have a "comparative advantage" of developing on the basic science to produce novel drugs that address unmet medical needs. They should stick to what they do best.[2] However, pharma companies need these capabilities mastered by change-agents in order to compete effectively, they need them now, and they cannot hope or wait to build these capabilities internally. The process will either take too long or will not be done right. Instead, pharma companies should partner with organizations that have deep and broad-base analytics, large database management, AI/ML, and pharma commercial operations expertise needed to leverage predicted outcomes from their drugs that will align to the objectives of patients, providers, payers (public and private), and pharmacies.

b) *Pharma companies need to better understand and leverage the claims / electronic health record data space for commercial advantage.* Roche's acquisition of Flatiron Health earlier this year for $2 billion was designed to get more involved with and increase access to real world evidence (RWE). RWE will be critical to show the benefit of specific expensive drug treatments like in cancer. The 21st Century Cures Act passed by Congress and avidly supported by FDA Commissioner Scott Gottlieb places a greater role for RWE in new drug applications for demonstration of value-based evidence. Pharma companies should partner with organizations that can assist them as they search for ways to commercialize RWE into sales/marketing/payer strategic plans.

c) *Pharma companies need to leverage AI/ML technologies for patient-centered outcome predictive analytics.* If healthcare is moving to a more retail-oriented patient-centered type industry, then applying AI/ML for real-time analytics will be crucial to generate on-going monitoring of progress on the drugs they consume, and to ensure that contracted performance-based outcomes are on track to be achieved.

d) *Pharma companies need to partner with medical device companies to help with patient data collection and monitoring treatment progress.* We are increasingly seeing more smart phones and wearable devices with medical apps. The data collected by these devices will become more crucial to demonstrate on-going value of drug utilization for a pharma company to support performance-based contracts.

e) *Pharma companies need to find allies in the healthcare sector to counterbalance the growing influence from mergers like CVS-Aetna.* As consolidation occurs in the healthcare sector between organizations like health insurance companies and pharmacies, and we see new competitors enter the fray that have no history or traditional mission within healthcare (e.g., Amazon, tech giants, large financial service companies, etc.), who is a natural partner with pharma that can speak for patient care, access to the best medicines, and delivery of outcomes? The opening quote from the AMA president suggests a fear of reduced access to quality healthcare, lower competition that drives up prices and profits shifted to consolidated agents at the expense of other actors in healthcare, and healthcare decisions made more on cost containment than on delivery of outcome. Thus, a natural collaboration between pharma and healthcare systems (along with their providers) would be not only in their own mutual interests but also, and more importantly, to those of patients. These two groups are more closely aligned, ensuring the identification of the best treatment options for patients and delivery of health and economic outcomes. This means pharma companies have to change their commercial focus and embrace what they are truly selling – not new prescriptions or boxes of product, but instead selling the achievement of superior healthcare through the utilization of novel medicines that produces health and economic outcomes supported by healthcare systems. This represents a formidable collaboration that can act to counterbalance the economic forces and concerns noted by the AMA president in the opening quote.

3. Conclusions

So, what is the answer to the question posed in the title of this white paper – is the CVS-Aetna merger a transformative event or more a response by inside-actors repositioning themselves in the shifting healthcare and pharma sectors? Strong arguments can be made for either case. However, what is clear are the following facts. Dramatic and structural changes are already occurring in the pharma industry. Significant economic forces will force change, whether pharma companies are ready or not. These significant changes are not favorable to pharma. This means pharma companies must manage both the disruption coming from outside the industry and restructuring happening within the industry as a result of these changes. These changes will increase the importance of pharma being very shrewd and calculated in pricing and contract negotiations, and the analytics needed for successful outcomes, as much as being good at commercializing RWE and demonstrating value. The good news for pharma companies is, there are existing organizations they can partner with to navigate successfully through these changes. Companies that are able to adapt successfully to these changes can use these environmental shifts as a source of significant competitive advantage relative to those that lag behind and fail to adjust. However, the time for pharma companies to act is now – delay is not an option.

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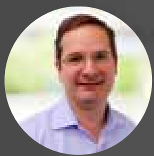
George A. Chressanthis, Ph.D.
Principal Scientist, Axtria Inc.
300 Connell Drive, Suite 5000
Berkeley Heights, NJ 07922
E: george.chressanthis@axtria.com



Randy Risser
Principal, Axtria Inc.
300 Connell Drive, Suite 5000
Berkeley Heights, NJ 07922
E: randy.risser@axtria.com

Contact Us

+1-877-9AXTRIA
info@axtria.com

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