The Drug Price Dilemma

By N. Craig Smith , INSEAD

Are drug companies primarily responsible for patients or making money for shareholders?

When Turing Pharmaceuticals raised the price of its anti-infection medication, Daraprim, by more than 5000 percent just one day after acquiring the drug’s only U.S. manufacturer, it ignited a controversy that engulfed the entire drug industry.

Prior to the increase in price of its dosage (from US$13.50 to US$750) it is likely few people would have heard of the pill used to treat AIDS and cancer patients suffering from toxoplasmosis, a rare parasitic infection. But the actions of the drug’s new owner prompted immediate cries of “price-gouging” from politicians and the media. As the public locked on to the scandal, the firm’s flamboyant founder and CEO, Martin Shkreli, reveled in the limelight, fanning the flames of controversy via social media and television news. After initially explaining that the rise in the out-of-patent drug’s price was part of a company strategy to fund better treatments for toxoplasmosis, Shkreli ultimately conceded, “I'm a capitalist trying to create a big drug company,… a profitable drug company.” The explanation provoked global condemnation and overnight the former hedge fund manager become the poster child for everything that is perceived to be wrong with the pharmaceutical pricing in the lightly regulated U.S. market.

Shkreli's actions and attitude are emblematic of the growing debate about the responsibilities of drug companies and business in general. They raise important questions; not least: Where do pharmaceutical executives' responsibilities lie when setting drug prices? And, what role should public policy-makers should take in this domain?

Taking the 'easy money'

Popular opinion over the Daraprim price increase was clear as social media discussion on the topic raged - Twitter posters called Shkreli "pharma jerk," and "a morally bankrupt sociopath" - while biotech companies' stock prices plummeted by nearly 25 percent. When evidence of similar practices by other firms emerged, the scandal catapulted to the forefront of political debate and politicians called for price controls, not just on Daraprim but on all pharmaceuticals.

Focus shifted to the number of older drugs which had undergone large and unexplained price increases and new designer drugs which were being marketed at tens of thousands of dollars per month.

Traditionally pharmaceutical companies have justified such high prices by citing the extraordinarily high costs of research to develop new drugs, however a handful of companies were now shown to be using these price increases as their main route to profits; the easy money rapidly pumping up their stock price, putting pressure on more traditional, research-oriented pharmaceutical firms to match their returns.

Costs of research

Pharmaceutical manufacturers may be private companies but they do serve a public good, with products that improve health and save lives. A recent **study** by Tufts University found that it cost $2.6 billion dollars to develop a new drug, taking into account the costs of unsuccessful research and lost investment opportunity. "There's a saying that it costs a billion to produce the first pill, and 10 cents to produce the second," noted **Rachel Sachs**, a fellow at the Petrie-Flom Center for Health Law Policy, Biotechnology, and Bioethics at Harvard Law School.

In exchange for undertaking the expensive and risky business of finding cures, pharmaceutical companies are given patents that allow them to charge high prices for their drugs for a number of years. Thus, while the industry has high risks, it also boasts one **of the most lucrative** profit margins in the business world.

Investor-minded companies, including established firms such as Valeant, Horizon, MallinckKrodt and Concordia, have been taking advantage of this money-spinning ability to boost short-term profits using similar strategies to Turing's: **buying** existing pharmaceutical companies, dramatically raising the prices of their older drugs.

The Daraprim scandal has drawn the spotlight onto price hikes of older drugs made by big name drug makers, like Pfizer and Biogen, and the eye-popping costs of new specialty drugs such as Sovaldi, developed by Gilead Sciences, which offered a cure for the public scourge of hepatitis C but costs $84,000 for a three-month treatment, and Eli Lilly's newly-patented stomach cancer drug, Cyramza, which costs $13,000.

The number of these high priced "specialty drugs" is growing, threatening to take over public health budgets at a time when governments around the world are grappling over where to draw the line when paying for expensive treatments.

To whom are drug firms responsible?

While set primarily in the United States, the Daraprim scandal raises questions of corporate social responsibility and public policy for the global healthcare industry and business in general. It invites greater exploration of the potentially conflicting demands of shareholders and stakeholders, the limits of industry self-regulation, and the need for government-imposed price controls, notably in the context of patent monopolies.

The role of generics

Theoretically, other generic drug manufacturers could have jumped in to make the generic equivalent to Daraprim, under the name pyrimethamine, thereby competing to keep the price lower. But, as the market for the drug is tiny (only about 2000 U.S. patients per year), there is little incentive or ability for them to do so. This was made more difficult by a Turing strategy to control distribution making the drug hard to copy; a practice that further incensed the community and made the company the focus of an investigation by the New York Attorney General's Office.

The Pharmaceutical Research and Manufacturers of America (PhRMA) also denounced Turing’s tactics, while BIO, the industry group for biotech companies, indicated it had kicked Turing out of its membership.

A capitalist society

Despite the backlash, and after being drubbed on television, in newspapers and across social media, Martin Shkreli continued to make himself a lightning rod in the debate on drug pricing. A day after then-Presidential candidate Hillary Clinton vowed to crack down on “price-gouging,” Shkreli promised (on prime time TV) to lower Daraprim’s price. Later, he announced he had “changed his mind”. In fact, when asked at Forbes 2015 Healthcare Summit what he would have done differently, he **told** participants he should have raised the price of Daraprim even further! “I could have raised it higher and made more profits for our shareholders, which is my primary duty," he said. “No one wants to say it, no one’s proud of it, but this is a capitalist society.”

While this attitude has done little to allay consumer alarm over drug pricing practices, pharmaceutical companies have remained one of the most profitable industries. And, as easy as it is to criticise these profits as excessive, the argument remains that big incentives are necessary to keep investors interested in the very risky world of drug development.

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About the author(s)

N. Craig Smith is the INSEAD Chaired Professor of Ethics and Social Responsibility. He is also Academic Director of the INSEAD Ethics and Social Responsibility Initiative (ESRI).

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