Here’s who’s profiting the most in health care

By Tara Bannow and Brittany Trang Jan. 2, 2024
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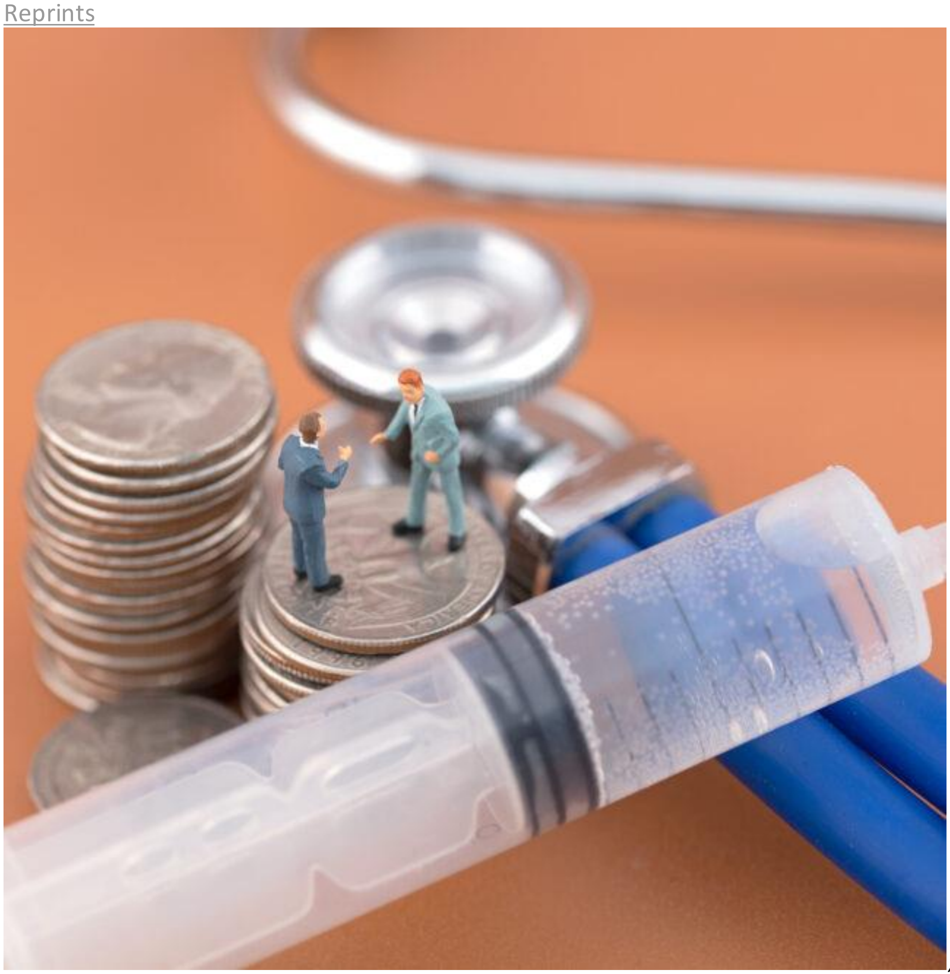

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For all the flak they get, the country’s four biggest pharmacy benefit managers reported a surprisingly tame average profit margin in the first three quarters of 2023: 4.5%, less than a third of their drugmaker peers.

But don't take their numbers as gospel, experts warned.

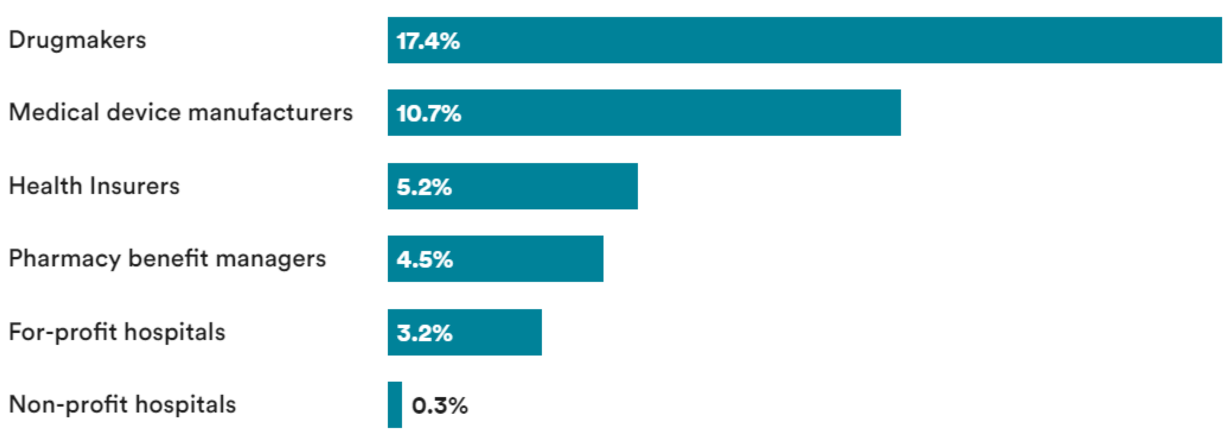
"It's really easy to move money around inside the books of a vertically integrated organization," said Karen Van Nuys, a senior fellow at the USC Schaeffer Center for Health Policy and Economics. "If one segment of your vertically integrated organization is not publishing any financial data, it's a good place to hide stuff."

Ahead of the annual J.P. Morgan Healthcare Conference in San Francisco next week, STAT took a look at who profits the most in the $4.5 trillion health care industry. Drug and device makers continue to be far and away the most profitable sectors. Health insurer profits, while higher than hospitals, weren't much higher than PBMs. The big three drug wholesalers drew lots of revenue, but comparatively meager profit.

Most of the drug and device makers in STAT's analysis are preparing their slides for the highly anticipated investor conference. Health insurer attendance at JPM is more patchy, and nonprofit health systems have dwindled from the agenda over the years. None of the for-profit hospital chains are attending this year.

Profit at biggest companies in each sector

Average profit margin for biggest companies by revenue in each sector for the first nine months of 2023



Note: Health insurers and PBMs are reported pre-tax, the rest are net income.
Chart: J. Emory Parker/STAT • Source: Companies' financial filings

The fuzziness around the PBM profit reporting underscores how the rise of multi-sector conglomerates muddies the public's ability to learn who's pocketing what. Companies like UnitedHealth Group and CVS Health have used vertical integration to mount massive empires that span health insurance, PBMs, medical groups, and more. Congress is working to require more transparency from PBMs, but the Senate hasn't yet passed its version.

To be clear, experts aren't accusing the PBMs of fraud. It may just be that the lines between PBMs and their associated insurers are opaque, but not necessarily dishonest.

"Who the hell knows how they organize their business? It could be that the way they do costs is different than the way you would like them to do costs," said Zarek Brot-Goldberg, an economist at the University of Chicago.

And even though their financial filings break out their health plan and PBM businesses, experts say they still don't tell the whole story. For one, UnitedHealth, CVS, Cigna, and Elevance don't disclose net income by sector, only pre-tax income, so it's impossible to learn how much their insurance and PBM divisions truly take home. Those four companies reported pre-tax PBM profit of almost $15 billion in the first three quarters of 2023. Humana, which does not break out its insurance and PBM divisions at all, did not respond to a request for comment.

"When companies are vertically integrated, it's very hard to disentangle the profitability precisely," said Michael Chernew, a health care policy professor at Harvard Medical School. One reason, he said, is they routinely pay themselves for services, and the prices they set impact profitability.

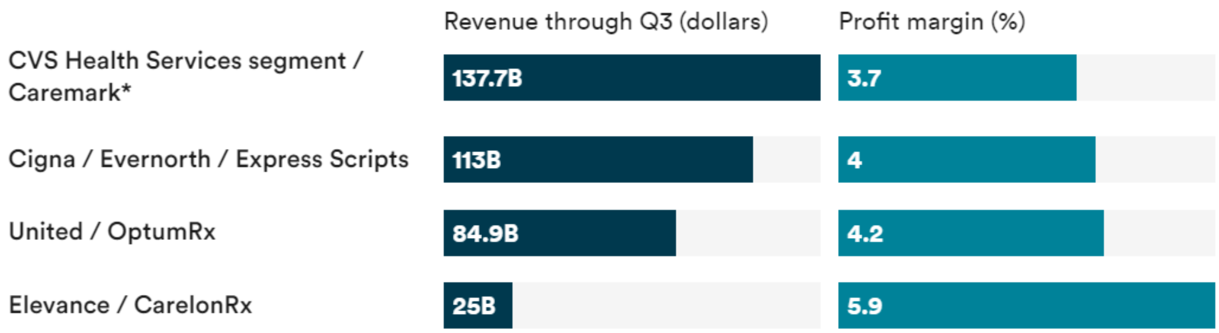
CVS Health, which owns both the health insurer, Aetna, and the largest PBM, Caremark, noted in a statement that its financial statements are prepared in accordance with Generally Accepted Accounting Principles (GAAP). Spokesperson Ethan Slavin wrote in an email that CVS' combination of businesses allows it to "improve the patient experience, lower the total cost of care and improve health outcomes."

The insurer Elevance, which owns the PBM CarelonRx, does not report net income by division because investment income and certain corporate expenses are not allocated to operating businesses. "This is a relatively common practice," spokesperson Hieu Hguyen wrote in an email.

Experts say there's a reason drug and device makers draw the most profit: They assume the most risk. As such, U.S. law rewards them with patents that shield them from competition. Bringing a drug or device to market can take decades, if it gets there at all, and the accompanying research and development is akin to a long-term investment. In fact, a 2021 study that treated R&D as such found that drugmaker returns fell below the S&P 500, while biotech manufacturers, wholesalers, and PBMs were significantly above it.

Pharmacy benefit manager revenue and profit

Pharmacy benefit managers' revenue and profit margins for the first nine months of 2023



Income is pre-tax as reported by companies.
*Includes Caremark PBM plus health care services and provider enablement solutions.
Excludes Humana's PBM, which does not report profit or revenues separately; also excludes Prime Therapeutics / Magellan Rx and MedImpact Healthcare Systems, which are both private

Chart: Brittany Trang & Tara Bannow/STAT News • Source: Companies' financial filings

But there's some evidence that more and more of the money spent on drugs is going to middlemen. List prices for insulin spiked 40% between 2014 and 2018. Within that, the shares retained by PBMs and pharmacies grew by 155% and 229%, respectively, while the shares retained by drugmakers and insurers declined, according to a JAMA Health Forum study.

"Are intermediaries delivering more value every year and that is somehow compensating them for that greater value that they're delivering? I don't think so. I don't see it," said Van Nuys, the lead author on the insulin study. "And if they're not earning it by delivering greater value, how are they earning it? It might be anticompetitive behavior."

For PBMs specifically, almost $15 billion in pre-tax profit seems like a lot for a sector that doesn't take on any risk, Van Nuys said. PBMs, for example, never actually hold the drugs.

"They're not even subject to the risk that a hurricane hits your warehouse and wipes out your inventory," she said. "They don't even have that. They're just moving paper around. So yeah, it is a lot of return for the risk that they bear."

The three big drug distributors — McKesson, AmerisourceBergen, and Cardinal Health — are massive companies that draw slim margins. While their combined revenue approached $600 billion in the first three quarters of 2023, their average margin was just 1%.

Then there's the industry's black hole: group purchasing organizations. GPOs amass groups of hospitals and other health care facility clients and then negotiate discounted rates on supplies. The largest GPOs are Vizient, Premier, and HealthTrust, but the only one that shares its financials is Premier.

Profits for nonprofit hospitals range widely, and many are in the red. The country's nine largest nonprofit health systems drew a paltry 0.3% average profit margin in the first three quarters of 2023. For-profit hospitals fared better, with a 3.2% average margin in that time across the four largest companies.

The lower profit at nonprofit hospitals is partly because there's no incentive to generate profit, said U Chicago's Brot-Goldberg. After all, no one can claim that profit, unlike at for-profit hospitals, where it goes to shareholders. There's a theory that nonprofit systems might sink profits into wasteful investments like buying land and doing things that are of marginal value, he said, or it's given to C-suite leaders so that it looks like labor costs.

“Excess profits have to go somewhere,” Brot-Goldberg said.

Profits aren’t inherently bad because they encourage innovation, said Harvard’s Chernew, who also chairs the Medicare Payment Advisory Commission, a group of experts that advises Congress on Medicare spending. Chernew was not speaking for MedPAC. He gave the examples of Covid-19 vaccines, the new obesity drugs, or the drugs that cure Hepatitis C, an infection that’s still deadly for those who can’t access them.

“It’s not how profitable they are, it’s whether you’re getting the right amount of innovation,” he said. “I wouldn’t say, ‘We need to lower the prices,’ I would say, ‘If we lower prices, what does that do to innovation?’”