MICHIGAN
ROSS SCHOOL OF BUSINESS

WDI PUBLISHING

case W74C85
April 19, 2022

Aradhna Krishna

When is Pricing Unethical? Pharmaceuticals, Rideshares, Soft Drinks, and Travel

OxyContin® was an opioid manufactured by Purdue Pharma and prescribed by doctors to manage severe pain.[1] In a nationwide scandal, many patients were prescribed more of it than necessary and for ailments where it was less suited. In a remarkable example of its marketing, the consulting firm McKinsey came up with a rebate scheme for Purdue "turbocharging" sales, the *New York Times* reported.[2]

Source: Photo © Steveheap (https://www.megapixl.com/steveheap-stock-photos-portfolio) on Megapixl.com.

In this arrangement, Purdue would pay CVS and other pharmacies a rebate of $14,810 if a customer overdosed on OxyContin that they had prescribed, the *New York Times* reported. In a 2017 presentation, according to records filed in court "on behalf of multiple state attorneys general, McKinsey laid out several options to shore up sales. One was to give Purdue's distributors a rebate for every OxyContin overdose attributable to pills they sold."[3]

Both Purdue Pharma and CVS made money from sales of opioids. However, if a customer overdosed and/or died, the prescribing doctor could be sued, but typically CVS could not. So why would this rebate be offered by Purdue Pharma to CVS? One possible answer was quite ugly: If the customer died of an overdose, CVS lost future revenue because the customer would not be buying more opioids. So, according to this theory, the $14,810 rebate would incentivize CVS to unhesitatingly sell OxyContin.

The decision framework for a CVS pharmacist was to (a) be extra-cautious about selling opioids, so as to avoid a possibly fatal overdose, or (b) give priority to reducing the customer's pain, despite the risk. Addition of the rebate would change the (b) part of the framework to "reduce the pain and bring in more money."

Published by WDI Publishing, a division of the William Davidson Institute (WDI) at the University of Michigan.

Author Anand Giridharada, a former McKinsey employee, said the firm's work with Purdue showed "the banality of evil, MBA edition. They knew what was going on. And they found a way to look past it, through it, around it, so as to answer the only questions they cared about: how to make the client money and, when the walls closed in, how to protect themselves."[4] These decisions, once they became known, were heavily criticized by the public on social media.

CVS said the rebate plan was never implemented, but the fact that it was under consideration seemed very obviously unethical—knowing that people could die of pharmacy-supplied opioid overdoses and putting strategies in place that could facilitate fatalities. But, there are other examples spread across two major pricing contexts—value pricing and dynamic pricing—where the ethical question is more subtle. In these contexts, we need to ask: Will the pricing be considered unethical by consumers and thus lead to substantial negative publicity?

Pricing Context 1: Value Pricing

Value pricing implies pricing a product based on what value it holds for the customer—the higher the benefits for the customer, the higher the price. Thus, with value pricing, the price does not depend on how much it costs to produce the product.

Below are different examples of value pricing. Examples 1-3 provide real-world possibilities. Examples 4-8 take you on a historical pricing journey of highly-publicized pharmaceutical company decisions. After reviewing each example, please decide whether you find it unethical or not. Remember, this is your opinion; there is no right or wrong answer.

Example 1: Drip-free Paint

A famous chemicals firm produces a drip-free industrial paint. It saves clients $5 per gallon of paint application because cleaning up drips is virtually eliminated. As such, the economic value for the consumer of this new paint is $5 per gallon higher than for competitive products. The chemicals firm decides to charge $5 more per gallon for this drip-free paint versus its other paints. It costs them $0.25 per gallon to produce drip-free paint.

Example 2: Wireless Headphones

The leading headphones company produces a wireless headphone for the first time (think of the 1990s). It does market research and finds that customers value their freedom from wires at $80. So, it charges $80 more for these headphones, double the price of regular headphones. The company's cost is $3 less for these headphones versus the regular ones.

Example 3: Self-Drive

An automaker installs full self-drive software as an option in one of its models and charges $8,000 for it. Market research has shown that many consumers will pay at least that. The automaker's marginal cost for the software is basically $0.

Now, let's talk a historical walk through some famous and controversial (value-based) pharmaceutical pricing examples.

Example 4: HIV/AIDS Drugs (2001)

HIV/AIDS spread around the world in the late 1990s. By 2000, about 2.2 million people had died from AIDS. Of the newly infected, the vast majority were from developing nations in Asia, Latin America, and Africa and most received no treatment to alleviate the disease or the suffering caused by it.[5]

In the spring of 2001, large pharmaceutical companies such as Bristol-Myers Squibb, GlaxoSmithKline, and Merck became controversial regarding their social responsibilities for the affordable treatment of this group. These firms were offering the triple-therapy drug for around $1,000 per year of treatment. Other companies, such as Cipla of India, offered to sell the same drug for $350 per year per patient.[6] However, patents held by the large pharmaceutical firms prohibited Cipla from manufacturing and selling the drugs in South Africa, a country known for pharmaceutical production. In response, the South African government invoked legislation that would permit firms to produce medications at lower prices. But, this legislation was fought by the pharmaceutical companies, who said that the South African government was failing to enforce their legal patent protection and that it possessed too much discretion over the pharmaceutical market. That position led to global public pressure on the large companies.[7]

In February 2006, the *New York Times* reported that "one of the newest and most powerful AIDS drugs (atanazavir) will be licensed (without charge) to generic drug makers in India and South Africa so that it can be made inexpensively for patients in many poor countries."[8] The Bristol-Myers Squibb decision to license the drug out demonstrated pharmaceutical companies' response to mounting pressures regarding drug accessibility.

Example 5: Genentech and Avastin® (2006)

Avastin®, produced by biotechnology company Genentech, was a drug used to treat colon, lung, and breast cancer. While the drug was quite popular, producing sales of more than $3 billion in 2005, the drug's price tag was enormous, amounting to about $100,000 a year.[9]

On February 15, 2006, the *New York Times* reported that Genentech planned to charge $100,000 a year for Avastin and patients were being priced out because their out-of-pocket co-pays could run $10,000-$20,000 per year. Drug makers had typically defended high prices by noting the cost of R&D. But now, Genentech was "...citing the inherent value of life-sustaining therapies."[10] In other words, Genentech thought that it could charge the value of a life, or a near infinite amount.

The actual cost of producing Avastin was considered to be a fraction of what Genentech charged for it. Furthermore, other medications comparable in price to Avastin were prescribed only in extreme cases that better justified such a price. Furthermore, the drug was found to have only minimal effects on prolonging the life of cancer patients, while also exposing patients to severe side effects. In 2011, the FDA revoked approval for Avastin as a breast cancer treatment, calling the high costs of the drug further into question.[11]

Example 6: Daraprim® (2015)

Daraprim® was an antiparasitic drug used to treat toxoplasmosis, an infection caused by a parasite that, in severe cases, could trigger damage to the brain, eyes, and other organs. In 2015, Turing Pharmaceuticals increased the price of the decades-old drug from $13.50 to $750 per pill, i.e., by a factor of 56 or a hike of more than 5,000%.[12] One reason for this increase was the skyrocketing demand for Daraprim since the early 2010s.

The company's then-CEO, Martin Shkreli, became incredibly notorious and eventually went to prison on a seven-year sentence for securities fraud. In January 2022, a federal judge ordered Shkreli to pay $64.6 million and be barred for life from the drug industry for violating antitrust law.[13]

Example 7: Gilead Science's Sovaldi® (2015)

Gilead Science's Sovaldi® was deemed a breakthrough hepatitis C treatment. Prior to this new drug, patients needed to take treatment for nearly their entire lives. However, this wonder drug could cure hepatitis C with one, 12-week series of treatments, and with fewer side effects. The price would be $84,000.[14] Was it worth it?

Example 8: EpiPen® (2016)

This handy auto-injectable device delivered the drug epinephrine.[15] Epinephrine was a life-saving medication for a severe allergic reaction called anaphylaxis. Epinephrine was the only available medication that worked on the entire body for anaphylaxis and the only drug recommended for the condition.[16]

Mylan Inc. bought the EpiPen from Merck in 2007. It increased marketing and also increased the device's U.S. price from $100 (per two-pack) in 2007 to over $600 in 2016. At the same time, the EpiPen was priced at $85 in France.[17]

Questions

So, which of these examples bothers you and why? Is it price gouging, i.e., a severe price hike for a necessary medication? Is it unreasonable profit margin, i.e., the cost is low but the margin is very high? Or, is it something else?

While thinking about this, let's also consider dynamic pricing.

Pricing Context 2: Dynamic Pricing

In dynamic pricing, price increases with demand, so prices are higher when demand is higher. For example, a plane ticket bought at 9:00 a.m. might cost $150, but by 9:00 p.m. the same ticket costs $225. Some firms had very sophisticated algorithms for tracking demand and supply in real time and changing prices accordingly, also in real time (e.g., Uber and Lyft). Other firms followed simpler structures, where prices varied from weekday to weekend or from daytime to evening (e.g., movie theaters).

Below are examples of dynamic pricing. Decide which of these bother you from an ethical perspective, and which do not. Again, this is your opinion; there is no right or wrong answer.

Example 1: Hotel Rooms, Movies, Airlines, etc.

Most hotels, movie theaters and airlines follow dynamic pricing. For instance, hotel room prices in Europe differ greatly between summer and winter, being much higher in the summer due to the large tourist inflow. Similarly, movie prices are higher on weekends versus weekdays and in the evenings versus daytime—again to reflect the higher demand. In like vein, but using a much more sophisticated algorithm which changes prices in real time, airlines charge much more for flying around Thanksgiving, Christmas and other high-travel periods.

Example 2: Coca-Cola and the Variable Price Coke Machine (1999)

In 1999, Coca-Cola and other soft drink giants experienced eroding earnings as price wars became more common. In response, Coca-Cola tried dynamic pricing in its vending machines by using temperature as a proxy for demand. When it was hotter outside, the price for Coke would be higher. Doug Ivester, the Coca-Cola chairman at the time, indicated that the company had the technology to vary prices by temperature and thought it was fair that Coke should be more expensive when it was hot. In an interview, Ivester described how desire for a cold drink can increase during a sports championship final held in the summer heat. “So, it is fair that it should be more expensive. The machine will simply make this process automatic.”[18]

Coke drinkers were furious, and there was great backlash and discontent. Clever journalists eager for some drama turned to Pepsi for comment. Pepsi remarked, “We believe that machines that raise prices in hot weather exploit consumers who live in warm climates. At Pepsi, we are focused on innovations that make it easier for consumers to buy a soft drink, not harder.”[19]

Coca-Cola eventually backtracked and removed the dynamic pricing.

Example 3a: Uber, Lyft, and New Year’s Eve (every year)

Uber, Lyft and other rideshare companies used pricing algorithms based on current rider-to-driver demand. Thus, prices increased at high travel times such as commute-to-work times or on Friday evenings, sometimes doubling or more. Such an increase is also known as “surge pricing.” An extreme example was New Year’s Eve, when people noticed a price surge of up to five to six times the regular price.[20]

Uber customers accused the company of ripping them off when they needed a ride the most. However, Uber chief executive Travis Kalanick said that surge pricing was necessary to keep rideshare services operational. “Higher prices are required in order to get cars on the road and keep them on the road during the busiest times. This maximizes the number of trips and minimizes the number of people stranded. The drivers have other options as well. In short, without surge pricing, there would be no car available at all,” he stated.[21]

Example 3b: Uber and the Sydney Siege (2014)

On December 15, 2014, a café siege occurred in Sydney, Australia, ultimately leaving three people dead. A gunman held about 40 individuals hostage inside a Lindt café for sixteen hours, claiming political motivation. People tried to flee the area as fast as possible, and nearby buildings were evacuated.[22] At this time of critical demand, Uber’s surge pricing algorithm raised its fares to four times the regular rate as people rushed to leave the area. This incident provoked a huge social media backlash, and Uber eventually responded by refunding the cost of the rides that had been influenced and offering free rides out of the city. According to the BBC, “The company said that its priority was to help as many people get out of the central business area safely, but that was ‘poorly’ communicated, and led to a lot of misunderstanding about its motives.”[23]

Questions

Which of the examples in this case concern you from an ethical perspective? Why or why not?

Think across the examples from the beginning of this case: Purdue Pharma, the value-pricing examples and the dynamic pricing examples. For the examples that you find unethical, is there a common underlying reason? In other words, why are these ethical dilemmas arising? Is there any underlying theme that knits together these dilemmas in making them unethical?

Endnotes

1 Purdue Pharma. "Learn more about OxyContin." *Oxycontin.com*. https://oxycontin.com/patient/index.html. Accessed 14 Feb. 2022.

2 Bogdanich, Walt, and Michael Forsythe. "McKinsey Proposed Paying Pharmacy Companies Rebates for OxyContin Overdoses." *New York Times,* 29 Nov. 2020. https://www.nytimes.com/2021/02/03/business/mckinsey-opioids-settlement.html. Accessed 14 Feb. 2022.

3 Bogdanich, Walt, and Michael Forsythe. "McKinsey Proposed Paying Pharmacy Companies Rebates for OxyContin Overdoses." *New York Times,* 29 Nov. 2020. https://www.nytimes.com/2021/02/03/business/mckinsey-opioids-settlement.html. Accessed 14 Feb. 2022.

4 Levine, Martin. "McKinsey's Values-less Consulting: Time for Philanthropy to Cut Them Loose?" *Nonprofit Quarterly Magazine,* 2 Dec. 2020. https://nonprofitquarterly.org/mckinseys-values-less-consulting-time-for-philanthropy-to-cut-them-loose/. Accessed 14 Feb. 2022.

5 "Fact Sheet – World AIDS Day 2021." *Joint United Nations Programme on HIV/AIDS,* 2021. https://www.unaids.org/sites/default/files/media_asset/UNAIDS_FactSheet_en.pdf. Accessed 14 Feb. 2022.

6 't Hoen, Ellen. "Driving a decade of change: HIV/AIDS, patents and access to medicines for all." *Journal of the International AIDS Society*, vol. 14, no. 15, 2011. doi:10.1186/1758-2652-14-15.

7 Swarns, Rachel L. "Drug Makers Drop South Africa Suit Over AIDS Medicine." *New York Times*, 20 Apr. 2001. https://www.nytimes.com/2001/04/20/world/drug-makers-drop-south-africa-suit-over-aids-medicine.html. Accessed 11. Mar. 2022.

8 McNeil Jr., Donald G. "Bristol-Myers Allows Powerful AIDS Drug to Be Sold Cheaply." *New York Times,* 15 Feb. 2006.https://www.nytimes.com/2006/02/15/world/bristolmyers-allows-powerful-aids-drug-to-be-sold-cheaply.html. Accessed 27 Feb. 2022.

9 Berenson, Alex. "A Cancer Drug Shows Promise, at a Price That Many Can't Pay." *New York Times,* 15 Feb. 2006. https://www.nytimes.com/2006/02/15/business/a-cancer-drug-shows-promise-at-a-price-that-many-cant-pay.html. Accessed 15 Feb. 2022.

10 Berenson, Alex. "A Cancer Drug Shows Promise, At a Price That Many Can't Pay." *New York Times*, 15 Feb. 2006. https://www.nytimes.com/2006/02/15/business/a-cancer-drug-shows-promise-at-a-price-that-many-cant-pay.html. Accessed 15 Feb. 2022.

11 Berenson, Alex. "A Cancer Drug Shows Promise, At a Price That Many Can't Pay." *New York Times*, 15 Feb. 2006. https://www.nytimes.com/2006/02/15/business/a-cancer-drug-shows-promise-at-a-price-that-many-cant-pay.html. Accessed 15 Feb. 2022.

12 Pollack, Andrew. "Drug Goes From $13.50 a Tablet to $750, Overnight." *New York Times,* 20 Sept. 2015. https://www.nytimes.com/2015/09/21/business/a-huge-overnight-increase-in-a-drugs-price-raises-protests.html. Accessed 15 Feb. 2022.

13 Robbins, Rebecca, and Cecilia Kang. "Martin Shkreli is barred from the drug industry and ordered to repay $64.6 million." *New York Times,* 14 Jan. 2022. https://www.nytimes.com/2022/01/14/business/martin-shkreli-barred.html. Accessed 27 Feb. 2022.

14 Pollack, Andrew. "Sales of Sovaldi, New Gilead Hepatitis C Drug, Soar to $10.3 Billion." *New York Times,* 3 Feb. 2015. https://www.nytimes.com/2015/02/04/business/sales-of-sovaldi-new-gilead-hepatitis-c-drug-soar-to-10-3-billion.html. Accessed 16 Feb. 2022.

15 Miller, Sara G. "How Do EpiPens Work?" *Live Science,* 24 Aug. 2016. https://www.livescience.com/55872-how-do-epipens-work.html. Accessed 16 Feb. 2022.

16 "What is Anaphylaxis?" *Allergy & Asthmas Network*. https://allergyasthmanetwork.org/anaphylaxis/. Accessed 16 Feb. 2022.

17 Khazan, Olga. "Have You Ever Tried to Buy an EpiPen?" *The Atlantic*, 24 Aug. 2016. https://www.theatlantic.com/health/archive/2016/08/epi-pens/497126/. Accessed 11 Mar. 2021.

18 Hays, Constance. "Variable-Price Coke Machine Being Tested." *New York Times,* 28 Oct. 1999. https://www.nytimes.com/1999/10/28/business/variable-price-coke-machine-being-tested.html. Accessed 16 Feb. 2022.

19 Smallwood, Kari. "That Time Coca-Cola Tried to Introduce Vending Machines that Charged More on Hot Days." *TodayIFoundOut.com*, 27 Feb. 2018. http://www.todayifoundout.com/index.php/2018/02/time-coca-cola-tried-introduce-vending-machines-charged-hot-days/. Accessed 16 Feb. 2022.

20 Cohen, Paula. "Don't Let Uber surge pricing ruin your New Year's Eve." *CBS News*, 31 Dec. 2015. https://www.cbsnews.com/news/uber-lyft-surge-pricing-new-years-eve/. Accessed 16 Feb. 2022.

21 Lowry, Annie. "Is Uber's Surge-Pricing an Example of High-Tech Gouging?" *New York Times Magazine,* 10 Jan. 2014. https://www.nytimes.com/2014/01/12/magazine/is-ubers-surge-pricing-an-example-of-high-tech-gouging.html. Accessed 16 Feb. 2022.

22 "Sydney Siege: Hostages held in Lindt café." *BBC News,* 15 Dec. 2014. https://www.bbc.com/news/world-australia-30473983. Accessed 16 Feb. 2022.

23 "Uber 'truly sorry' for price rise during Sydney siege." *BBC News,* 24 Dec. 2014. https://www.bbc.com/news/technology-30595406. Accessed 16 Feb. 2022.

Notes

WILLIAM DAVIDSON INSTITUTE
AT THE UNIVERSITY OF MICHIGAN

Established at the University of Michigan in 1992, the William Davidson Institute (WDI) is an independent, non-profit research and educational organization focused on providing private-sector solutions in emerging markets. Through a unique structure that integrates research, field-based collaborations, education/training, publishing, and University of Michigan student opportunities, WDI creates long-term value for academic institutions, partner organizations, and donor agencies active in emerging markets. WDI also provides a forum for academics, policy makers, business leaders, and development experts to enhance their understanding of these economies. WDI is one of the few institutions of higher learning in the United States that is fully dedicated to understanding, testing, and implementing actionable, private-sector business models addressing the challenges and opportunities in emerging markets.