# Career Path: Why Aren’t More Pharma Companies Nonprofits?

**Health Law**

**Skills and Professional Development**

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Today's article is about the power of incentives. When you look past the surface of things to the incentives that drive behavior, you sometimes find surprising things.

Full disclosure: I believe in the shareholder model of capitalism and the theory that companies pursuing their own long-term profit will drive the maximum benefits not just to shareholders but to society as a whole. I say this despite having worked for more than a decade on sustainability topics and also believing strongly in the benefits of a broad [environmental, social, and governance (ESG)] strategy. Having run a global sustainability program, I am aware of the growing chorus of calls for companies to discard the idea of shareholder primacy as having long-since served its purpose.

## Stakeholder framework

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My principal objection to stakeholder capitalism is that we have yet to identify a consistent framework for choosing priorities among competing stakeholders. A company has many stakeholders, all of whom rightly believe their concerns are paramount. Stakeholders respond to the competition by ratcheting up the pressure on companies to pay attention to their issue. The public pressure leads to misallocation of resources in which companies waste money in areas where they do not have the greatest potential impact.

But I have come to understand two necessary modifications to my beliefs.

First, we can solve the problems of the stakeholder model by allowing companies to determine in good faith their unique opportunities for greatest stakeholder impact. What would happen if we allowed those companies who genuinely want to make positive contributions to determine freely where and how they would do so? I expect we would see much better performance on those metrics. True, not always in those areas that some stakeholders would prefer. But I ask you what's better in the long run? Second-rate forced compliance on topics the company doesn't fundamentally agree are important, or enthusiastic all-in commitments on selected topics?

Second, some types of business are ill-suited for the shareholder model. The reason is the very thing that makes the shareholder model so effective: incentives. The normal incentive is for companies to grow their long-term profits, which accrue to the benefit of many stakeholders, including shareholders. The emphasis on the long term is what keeps companies from committing harm to certain stakeholders. No company is successful over the long term that breaks the law, underpays employees, squeezes suppliers, or cheats customers. The mechanisms are not perfect, and we see many temporary exceptions that outrage us, but it is hard to argue with the improvements in much of humanity's quality of life that have been brought about by modern capitalism.

## Mismatched incentives

That said, is it possible for a company's good faith successful pursuit of long-term profitability to create incentives that are harmful for their customers and for society as a whole? The staggering cost of healthcare in the United States combined with relatively poor outcomes strongly suggest this is so, at least for some market participants.

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Healthcare costs have been steadily increasing such that Americans now pay more than people in any other country for their care. But Americans are not getting healthier. For evidence we can look at developments in life expectancy, preventable years of life lost, and the leading causes of death.

Here's the mismatch between pharmaceutical companies' incentives and their customers' incentives: Pharma companies wish to have proprietary drugs approved so they can exclusively sell them to patients for the greatest profit; customers wish to be healthy and well. Drug trials are designed to prove the efficacy of a drug compared to not taking the drug. The trials are not designed to prove the efficacy of that drug compared to other interventions, including non-pharmacological inventions.

As a result, the US Food and Drug Administration (FDA) approves many drugs for use *without any evidence that they provide the best outcome for patients*. Perhaps a diabetes drug does reduce the risk of heart complications in one out of several hundred patients. That small benefit may be enough to warrant approval of that drug to treat patients. But nowhere must the pharma company describe or even mention that a program of diet and exercise might be vastly more effective at treating both the diabetes and cardiovascular risk.

What kinds of patients are the ideal customers for pharma companies? Those who never or only sparingly take medications in favor of lifestyle interventions? Or those who become lifelong customers of a drug? The patient's desire to become healthy and well cuts directly against the pharma company's interest in selling its medications.

Now I must point out a great irony. I think the great majority of employees who work for pharma companies are honest, well-meaning, and believe they are making positive contributions to society. Everyone I know who ever worked for a pharma company expressed personal satisfaction at the strong social benefit they presumed their company delivered. Almost no one is alert to the fact that, in this special case, their company's incentives are grossly misaligned with their stated values.

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Would today's pharma company be just as effective if they were organized as not-for-profit companies? If we assume employees are genuine in their desire to help cure disease and be a positive force in society, and I do believe this, I see no reason why not. In contrast, I see every reason why the shareholder model is counterproductive in the case of pharma companies, which leaves me with today's question.

Why aren't more pharma companies nonprofits? I genuinely have no answer. Let me know if you think you do.

Be well.

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