

Analyses of supply chain models to understand the sustainability of market entries in Emerging economies

The Central & Eastern European (CEE) markets are forging themselves a place as rising stars in the pharmaceutical sector. One cannot disregard anymore the double-digit growth rates of pharmaceutical sales, aging populations, stabilization of political landscape and sustainable GDP growth. These developments create opportunities which unfortunately are not risk-free due to unexpected legislative swings, fierce competition and unpreparedness of the markets. Nevertheless, this is an occasion in time and space that is not to be missed.

There is more than one way in competing in the Pharma sector – and not exclusively at manufacturing level. Pharmaceutical distribution is one of the high potential pieces in the puzzle of the sector, that is currently lagging behind on consolidation and optimization. Companies or players leveraging this part of the supply chain, through acquisition, VI or VVI¹ will be able to gain a sustainable competitive advantage.

Getting to know the market will help to benefit from arising opportunities at acceptable risk. Selection of the ‘best’ investment target market may be done solely based on detailed and thoughtful market screening. This article sheds light on the structured approach to this type of exercise and provides information on some factors that should be taken into consideration by potential investors looking for a sound ROI.

¹ VI: Vertical Integration; VVI: Virtual Vertical Integration



Understand the drivers the pharmaceutical market growth

When evaluating the pharmaceutical market attractiveness it is good to start with screening country specific factors, such as politics, economics and demographics, as these areas determine the overall conditions of business development. Comparison in terms of nations’ wealth, diversification of the economical pillars, pace of economies’ growth, political stability and population structures provides insight into pharmaceutical markets background and their prospects.

Let’s focus for a moment on the characteristics that the most attractive market should have. There is a direct relationship between average GDP/capital and how much the countries spend on ethical drugs. Requisite conditions for societies to grow economically at accelerated pace are low inflation and diversification of the economy, which turns into sustainable, socially isotropic GDP growth. Obtained as such, this economic growth contributes to improvement of living standards and decrease in unemployment rate that fuels private and public spending,. The

entrance of the female to the working force diminishes the birth rate, which quickly creates societies with growing number of older people who demands more medicaments for longer terms, due to increase longevity. The previously depicted economical sustained growth, reflects the ideal country to invest, with stable and business oriented political tendencies, that is inter alia more likely to pursue coherent and consistent tax policies, creating favourable business conditions.

In reality, looking at the Central & Eastern European countries, there is no one leader that can be singled out in terms of “best practices” for socio-economic policy evolution. Actually, there are “two-speed” lanes; Those countries with established governments, western-European like legislations and aging communities are characterized by relatively stable GDP growth, low inflation and economic levels converging with the UE average income (Hungary, Czech, Slovakia...). Those with very high economic growth, driven by strong governments, do not have a diversified economy, neither a business – or political stable environment (Russia, Ukraine, Romania, Bulgaria...). Finally, there is a series of countries in transition (Poland, Croatia...) which solid evolution towards the former group .

Comparison of pharmaceutical market size for these countries and its forecasts highlights the high correlation between economical growth and pharmaceutical sector intensity, and provides decision makers with a more clear differentiation. *Graph 1* depicts some of the CEE countries constitute three groups with similar features. Romania and Bulgaria are countries with double-digit pharma market growth, though they are moderately rich and their populations are of medium size. Czech Republic and

Slovakia show highest pharmaceutical sales per capita, still their population potential and forecasted pharmaceutical market growth are low in comparison to the three other countries.



Last but not the least, Ukraine has the biggest population size, however its market is relatively poor and grows at moderate pace as compared with other CE countries. Recognizing the socio-economic characteristics and shape of pharmaceutical market is just a first step in prioritizing markets for the purpose of potential investment.

Unveil the pharmaceutical supply chain landscape.

The second step in the market selection process involves understanding the pharmaceutical supply chain characteristics in order to find a space for expansion and mitigate the risk of failure of the potential undertaking. The approach is to recognize market concentration and its dynamics as well as the main players, their characteristics (ownership, sales, scale of operations, etc.) and relations between supply chain elements. Subsequently, the strategy can be discussed (acquisition, partnership), and the availability of potential targets is assessed based

on the information on local players' activity and research on shareholders intentions. Besides that, a thorough investigation of legal issues concerning the operations of the pharmaceuticals distribution outlets is equally important, as it determines the possibility of any merger or acquisition in a given target market.

The dynamics of the pharmaceutical distribution sector aligns with that of other industrial or services observed in the last 10 years: Concentration of the players and benefits of economies of scale and scope. There has been a steady decrease in the number of active wholesalers, together with increase in deliveries intensity. The consolidation leads to few players' high concentration – for example, in 2007, the top 10 distributors held approximately 85-95% of sales in some CEE markets, for example, in the Czech Republic, where 96% of the market is in the hands of 4 players, or in Bulgaria, where 2 wholesalers generated 64% of sales. Simultaneously, to the ownership concentration, the number of retail outlets is increasing – for example the number of pharmacies in Ukraine has grown almost threefold within the last decade. This is the result of two different reasons; first, coverage of the population at same service levels than in WE, second, jockeying for positioning, since pharmacy chains and VI groups from WE are winning strong position on developing markets. Recognition of the large-scale players, their size, potential and owners, is essential for investor to render the expansion strategy, which can range from acquiring large-scale player, consolidating smaller market participants, or opting-out to .

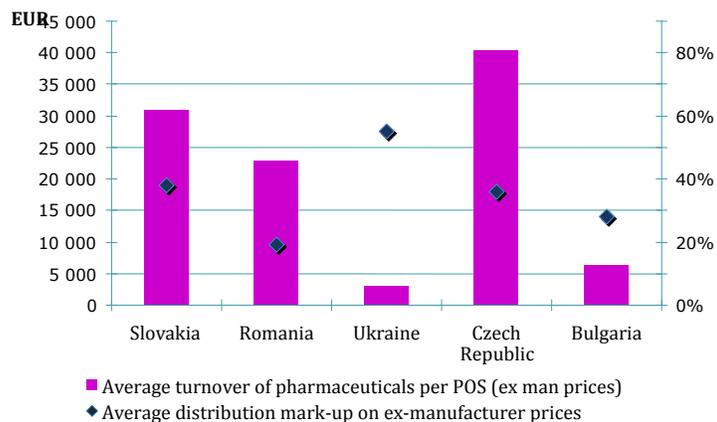
It is worth mentioning that the horizontal expansion and vertical integration is accompanied by external investment inflow, as pan-European players are already present both

on the wholesalers and retailers side in some of CEE countries, and actively looking for first-entrant advantages.

The regulatory environment shaping the supply chain, comprising, among others, concentration, geographical, demographical and ownership restrictions have a huge impact on the market landscape and may be a real burden or even a knock-down for any investment in a given market.

For instance, despite the European tendency, the number of pharmacies in Bulgaria maintains a decreasing trend. This may be attributed to an introduction of law allowing solely a pharmacist to own one pharmacy fostered by high market saturation (below 2 000 citizens per pharmacy). Yet another example of law influencing the shape of distribution channels is Slovakia, where officially pharmacy chains are not allowed and those pharmacies which seem to operate as a chain form 'associations'.

Financial characteristics of pharmaceutical distribution landscape in selected Central European countries



Recognizing where does the biggest profit lay

Ultimately, prior to the final decision, the main question emerges: how much can one get out of the investment back? An additional study at this point is to be made based on RoI – with the knowledge of where and how the margin, in the whole supply chain, is kept. For this, a comparison of the basic parameters of distribution financial performance is needed. For example Czech Republic and Slovakia followed by Romania are countries with the highest average turnover per pharmacy outlet. On the other side there are nations with low purchasing power: Bulgarians and Ukrainians. Still, Ukraine has the most liberal distribution surcharges restrictions covering minority of the registered pharmaceuticals, therefore allowing high mark-up to be shared between wholesalers and pharmacies. For all markets, the recognition of the mark-up split between wholesaler and retailer is crucial to fully identify the revenues distribution across the market.

Apart from the aforementioned financial factors there is a long list of other parameters that define the overall attractiveness of the market in terms of profitability. The level of co-payment and reimbursement scale, varying from non-existent to covering most of pharmaceuticals, just to name a few.

Making the right choice is not difficult – just takes strict analyses

Selection of the target market has to be based on thorough understanding of the markets and followed by appropriate profit and risk analysis.

It is worth remembering that the data used in the decision making process has to be comprehensive on one hand and fully

comparable on the other. Lack of data coherence and consolidation can drive to misleading profiling and ill-definition of strategies.

Before taking any actions, each investor has to answer some key questions about the factors that may drive his success on a target market and assess if the markets characteristics are aligned with his strategy, way of conducting business, etc. CE markets are becoming ‘red oceans’, the competition gets more fierce and hostile. Hence, customised market screening followed by selection of target market gives an advantage for those who are willing to become the ones who succeed.

Features described in this article are a quick glance at pharmaceutical distribution in CE markets, an introduction to the deeper discussion on their development and opportunities they offer.

For further information on entry strategies management, emerging markets and options for business development, check www.zarzia.com or contact us at office@zarzia.com