

**On the occasion of Hon'ble Prime Minister of India CII presents Survey
Number 2 "China's Drugs & Pharmaceuticals Market"**

According to a CII survey China is fast becoming a major opportunity that can't be ignored. Indeed, by 2010 we expect the country to emerge as the fifth-largest pharmaceutical market in the world, with revenues of over \$24 billion—more than triple its current size. Such growth would catapult China's market, which currently ranks seventh behind the markets of Italy and the United Kingdom, to a position right behind the drug markets of France and Germany. Driving this growth are China's ongoing economic development and its recent entry into the World Trade Organization (WTO).

China Will Become the Fifth-Largest Pharmaceutical Market

Estimated Market Size for Ethical and OTC Drugs (U.S. \$billions)

1996 Top 10	2000 Top 10	2005 Top 10	2010 Top 10
United States 91	United States 150	United States 262	United States 466
Japan 52	Japan 58	Japan 65	Japan 81
Germany 20	Germany 17	Germany 24	Germany 27
France 18	France 17	France 21	France 28
Italy 10	United Kingdom 11	United Kingdom 16	China 24
Brazil 8.4	Italy 11	Italy 15	United Kingdom 24
United Kingdom 8.2	China 5.8	France 14	Italy 23
Spain 6.0	Brazil 6.7	Brazil 10	Canada 17
South Korea 4.5	Canada 6.3	Canada 10	Spain 16
Canada 4.3	Spain 6.2	Spain 9.8	Brazil 15
China 4.2			

Source: BCG analysis

The most promising opportunities will emerge in the areas of greatest unmet need: innovative ethical, or prescription, drugs and differentiated over-the-counter (OTC) products. The market for ethical drugs in China, valued at

- ❖ \$5.8 billion in 2000,
- ❖ will climb to approximately \$19 billion by 2010.

Innovative drugs will fare particularly well, commanding 30 percent of revenues and, more important, about 70 percent of the profit generated in the ethical category. The OTC market, practically nonexistent today as defined by Western standards, will grow at a compound annual rate of 19 percent, from about **\$1 billion** in 2000 to about **\$5.7 billion** in 2010.

Best positioned to fill these needs are multinational companies (Indian companies), which possess superior R&D capabilities as well as scale and experience in marketing, distribution, and sales. But if they are to become major players in China. According to CII Indian companies must move forward more aggressively as changing regulations and economics open the

window of opportunity. That means better anticipating the needs of the market as it evolves in order to build true local capabilities as well as relationships with regulators and distributors.

The Transformation in China

Several powerful forces will converge over the next decade to transform China's competitive landscape.

- ❖ First, China is a rapidly developing nation with a rising gross domestic product. As the country and its economy modernize, demand for advanced health care will increase, and with it health-care expenditures. The population will move beyond the basic anti-infective treatments common in China today to embrace drugs that will improve the quality of their lives. This latter category includes medicines that address chronic conditions that are widely treated in already developed nations.

- ❖ Second, although China's rural areas will remain less developed, pockets of wealth are already emerging in urban areas such as the Shanghai Delta and the Beijing-Tianjin and Guangdong-Pearl River Delta regions. Increased affluence in these areas will usher in increased demand for-and ability to pay for-world-class ethical and OTC drugs. In fact, this trend is already taking shape, as evidenced by the success of Heptodin, a treatment for hepatitis B. Although not currently covered by the state, Heptodin has become a top-selling drug in China, largely because patients demand it and are willing to pay for it.

- ❖ Third, China's entry into the WTO in December 2001 promises to bring the country's regulations and distribution networks in line with world-class standards over the next five years. Among its most important changes in the pharmaceutical arena, the WTO agreement specifies that China will do the following:
 - ❖ **Enhance its protection of intellectual property rights (IPRs).** China is now obligated to enforce foreign and international patents in accordance with the Agreement on Trade-Related Aspects of

Intellectual Property Rights (TRIPS) of 1995, the most comprehensive multilateral agreement on IPRs. TRIPS mandates that drugs receive at least 20 years of patent protection.

- ❖ **Reduce import tariffs on pharmaceuticals.** Within three years of joining the WTO, China will reduce tariffs on imported pharmaceuticals from, on average, today's 9.6 percent to 4.2 percent.

- ❖ **Increase foreign participation in the drug distribution industry.** China has already opened pharmaceutical retail in Beijing and Shanghai to foreign companies. Within three years, the nation's retail and wholesale markets will open entirely.

- ❖ **Comply fully with global regulatory standards.** As a WTO member, China must guarantee efficiency and quality when licensing drug companies and approving or denying drugs. In addition, the WTO requires transparency from regulatory agencies; this will ensure that companies have information about regulatory decisions that affect drug pricing and availability.

Significant changes will sweep China in the wake of its entry into the WTO, thereby providing foreign players with new opportunities in health care. We focus here on the largest of the opportunities: branded ethical drugs and OTC products.

Delivering Innovative Ethical Drugs:

The shift to breakthrough drugs will be further fueled by the enormity of the opportunity: the unmet need for sophisticated drugs is vast in China, and the potential payoff is significant. China is, after all, a nation where 100 million to 150 million people carry the hepatitis-B virus and where neck and head cancers are more prevalent than anywhere else in the world. China also has its share of patients with chronic conditions routinely treated in the West, such

as high blood pressure, high cholesterol, diabetes, depression, osteoporosis, and arthritis. In addition, AIDS is just beginning to be acknowledged in China, and demand is emerging for the pharmaceuticals used to treat the disease and its related complications.

Differentiating OTC Products for Consumers

Like branded ethical drugs, OTC medications are significantly underrepresented and often misunderstood among the Chinese today. That's because OTC drugs tend to be dispensed and reimbursed as prescription medications, are not widely available for purchase, and are not marketed. Many Chinese also have a strong attachment to traditional home remedies.

As the country phases out government reimbursement for OTC drugs, however, consumers across the nation are likely to behave as we have already seen in China's more affluent areas-where a willingness to self-medicate with home remedies translates quickly into demand for Western OTC drugs. In addition, as Chinese authorities encourage growth in the retail pharmacy arena and open it to foreign players, consumers will gain an outlet (which they currently lack) for selecting and purchasing OTC drugs on their own-further accelerating the development of the OTC market. In this transformed environment, the key to succeeding in the OTC sector will be a company's ability to market directly to the consumer.

To date, the prohibitive cost of establishing a strong OTC brand with consumers-exacerbated by the lack of clarity in OTC regulations as well as a general lack of marketing expertise in China-has deterred most drug companies from aggressively pursuing the OTC sector. There are, of course, some notable exceptions, such as Harbin Pharmaceutical Group, Xian-Janssen, and Tianjin Smith Kline & French. Eventually, however, one expects that on the heels of China's entry into the WTO, a handful of large, international players will emerge to lead this segment. Today that space remains open.

Positioning for Competitive Advantage in China

In an increasingly competitive and global business environment, multinational pharmaceutical companies cannot afford to ignore the real opportunities imminent in China. To stake out a position in this frontier market, Indian companies must pursue two goals simultaneously:

Assemble and prioritize a portfolio of patented and OTC products tailored uniquely to the Chinese market.

- The first step is to review your existing global portfolio of drugs. Your company may be able to meet the needs of the Chinese market simply by tweaking its current product offering. You may, however, need to make a more significant investment in overhauling the portfolio, either by accelerating well-suited products still in the late stages of development or by inlicensing promising drugs from other players.
- The best drugs for China will be those in therapeutic areas likely to experience the highest growth, including medicines for chronic diseases already treated in the developed world. Following this logic, your company might want to focus resources in the cardiovascular, central-nervous-system, and endocrine areas, addressing conditions such as heart disease, depression, and diabetes.
- Once the right mix of products has been identified, corporate and local resources should coordinate closely to begin securing Chinese regulatory approval for these offerings—a process that could take as long as 48 months. Because we believe that the window for enhanced IPR protection in China will begin to open in about 18 to 24 months, it is critical that Indian companies initiate this step immediately so they can best exploit the impending opportunities.

Focus the head of Chinese operations on assessing and sharpening local capabilities in the sales, marketing, and distribution of ethical and

OTC products. Companies' marketing capabilities in particular will become more critical as self-pay patients and commercial insurers become more common. Of course, you should keep in mind that when it comes to consumer marketing, the superpowers in consumer products-Ranbaxy, for example-may currently exceed pharmaceutical companies in scale and skill. But Indian companies in the drug industry needn't cede this space automatically. Certain drug players, for example, may determine that they themselves possess superior skills that they can enhance for greater advantage. For instance, companies such as Ranbaxy & Aubindo Pharma, Dr. Reddy's could further exploit their current strengths in marketing to consumers in China.

Ultimately, to accomplish both goals-improving the portfolio of drugs and developing marketing and other capabilities-Indian companies must build critical mass in human resources, supporting their Chinese operations with world-class regulatory specialists and marketers. Future contenders will need to staff up now to gain scientific and marketing expertise in all the therapeutic areas critical to China, including those that may not even be recognized there yet. Consider, for example, that although cholesterol and obesity are not yet prevalent among the Chinese, as the economy changes, diet and health trends will also change-and so, too, will treatment needs. Companies seeking to stake a claim in China will also need to hire more systematically and train more intensively the human resources they deploy "on the ground." Relying solely on a handful of Western expatriates or less-expensive and less-experienced locals will expose a foreign company to the high risk that its few key experts could be lured away.

Because none of these tasks will be easy, Indian companies will also need to engage their corporate and local leadership in an ongoing dialogue about which expectations can be realistically achieved-and when. Previously, without such alignment, many corporate leaders entered China overly enthusiastic about the near-term potential. Once disappointed, many have since become too conservative about investing in the market. In contrast, by understanding local realities, Indian companies will view China more

accurately: as a burgeoning opportunity that will take a few years-and some investment-before it blossoms fully.

Source: Indian Pharma Companies based in China and various websites

