

# Rivalry, Risk and Reward in the Generics Market

FIRST IN A THREE-PART SERIES: THE PROMISE OF CHINA

By Mandy Chui

*For generic pharmaceutical makers, the decision whether to enter the Chinese market is almost a foregone conclusion. Despite a deepening global financial crisis, China remains a tempting target for multinational drug companies. Yet the challenges posed by increased local competition, evolving government intervention and uncertainty around healthcare reform makes the road to China far from smooth and worthy of intensive study and creative planning.*

## CHINA — THE RISING STAR

In an otherwise stagnant global drug market, China stands out as a hot growth area, fueled by a massive population of 1.3 billion people, aggressive government spending on healthcare and an increasing demand for drugs to treat chronic disease. Though plagued by recession like the rest of the world, many factors point to a promising future for generic drug makers in China.

## SUPER-CHARGED PERFORMANCE

While pharmaceutical sales in the mature, developed markets of Western Europe and North America tallied single-digit growth over the last few years, China's 'pharmerging' market experienced a compounded annual growth rate of 21.2% from 2004 to 2008, reaching USD \$24 billion.<sup>1</sup> In a recent study, which examined the global economic crisis' impact on the Chinese market, IMS projects full-year growth in the pharmaceutical sector in 2009 at a robust double-digit rate.

<sup>1</sup>IMS MIDAS 2008.

What is more, compared to other industries, the global economic downturn appears to be having a minimal effect on the pharmaceutical market in China, thanks to aggressive government funding of insurance coverage and the development of a more comprehensive healthcare infrastructure. In fact, the IMS study's industry modeling suggests that the recession's impact on the pharmaceutical market's rate of growth in China will be just 0.1 to 0.5 percentage points.

With pharmaceutical sales projected to almost double in four years from its 2008 level, according to IMS, China's pharmaceutical market, which was the world's tenth largest in 2006, is projected to climb to fifth by 2012. The future looks bright indeed for drug makers that can intelligently exploit growth opportunities in China.

## LOCAL PLAYERS STILL IN CONTROL

Since Otsuka Pharma of Japan set up the first joint venture in Tianjin in 1980, multinational activities in China have evolved — from purely importing finished drug products to increasing local production and research and development (R&D). By the beginning of the 21st century, multinational branded products had gained major market positions in the larger cities. Indeed, large pharmaceutical companies have captured leading market shares among the top 10 corporations in the Chinese hospital market.

Yet while the number of multinationals has increased, from 294 in 1999 to 329 in 2008, they are greatly outnumbered by local companies, which have grown from 1,281 to 2,424

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in the same period.<sup>2</sup>The extensive geographic reach of local companies, as well as their wide distribution networks, flexible promotion methods, and intimate engagement with local governments and hospitals, all have contributed to their strong market position. By contrast, multinational brands have penetrated the larger hospitals in the major cities, but have made only minor inroads in smaller cities and towns.

## THE “RETURN” OF TRADITIONAL CHINESE MEDICINE

Commensurately, traditional Chinese medicine (TCM) producers have increased their penetration of the market substantially, from 1% to 11%. As generics and TCM players have captured ever larger shares of the booming market, multinational brands have seen their share erode from 45% to 27% over the last decade. (See Figure 1 regarding share evolution of branded versus generics and TCM products in the China pharmaceutical industry in the last 10 years.)

## CHINA'S GENERICS PHARMACEUTICAL MARKET

### GENERICS LEAD THE WAY TO GROWTH

A driving force behind the explosive growth in pharmaceuticals is, in fact, China's generic drug sector. According to the IMS China Hospital Audit released in June 2008, sales of generics have outpaced overall pharmaceutical market growth, increasing generics' share of sales from 54% in 1999 to 62% in 2008.

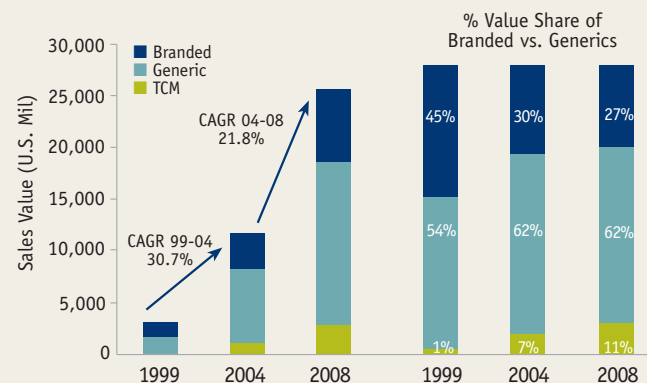
In fact, the rapid growth of generics can be traced to the increasing level of sophistication among domestic producers. In the period prior to 1980, China's domestic generics industry was no more than a group of predominantly state-owned manufacturers of active pharmaceutical ingredients (APIs) and commodity generics. Today, China's home-grown enterprises in both the public and private sector offer a broad spectrum of drug products capable of competing handily with the world's largest multinationals.

### LOCALS MOVING BEYOND TRADITIONAL CATEGORIES

Local companies dominate the Chinese generics market, accounting for over 99% of sales (see Figure 2). The domestic industry has expanded rapidly as companies have improved their manufacturing capabilities to become GMP-compliant (Good Manufacturing Practice) and invested significantly in their commercial competencies and R&D. Their goal in most cases is to expand product portfolios beyond traditional areas of anti-infectives to promising areas such as oncology, hepatic, cardiovascular and other chronic diseases.

These pursuits have cultivated a trend whereby companies focus on disease areas and specialist products, resulting in the emergence of niche players and biotech start-ups. Merger and acquisition (M&A) activity among local companies has also gathered momentum in the last few years, consolidating and strengthening their presence in the market.

**FIGURE 1: SALES & SHARE OF BRANDED, GENERICS AND TCM PRODUCTS FROM 1999 TO 2008**



Source: IMS China Hospital Audit, 1999 and MAT June, 2008 (at hospital purchase price level)

<sup>2</sup>IMS China Hospital Audit, 1999 and MAT, June 2008

**MULTINATIONAL GENERIC PLAYERS GROWING, BUT STILL NOT SIGNIFICANT**

Foreign generic companies are slowly making inroads in China, although they are clearly underperforming compared to overall market growth. Two of the world’s largest generic manufacturers, Teva and Sandoz, were below top-100 rankings, according to the IMS China Hospital Audit.<sup>3</sup>

Foreign companies’ penetration of the generics market has been impeded by the competitive advantage of local players. The low-cost manufacturing capabilities of the domestic firms enable them to compete on price. At the same time, their close government relations, a commission-based business model, and heavy investments in their sales forces and distribution networks, have contributed to sales in urban, rural and community hospitals across China.

Maintaining market share in such a highly competitive environment is a challenge — and the relative positions of the leading local entities is in a constant state of flux. While JS Yangzijiang Fty has retained its leadership in the rankings of China’s top local pharmaceutical companies for the last 5 years, its position is vulnerable due to competition from Hengrui and Shandong Qilu, which rose to the number two and three slots, respectively, in 2008.

**CHANGING BUSINESS MODELS**

Hengrui’s success underscores the changes taking place in the local industry as companies adopt strategies to differentiate themselves from other generic players. Hengrui opted to specialize in oncology and avoid the oversubscribed ‘me-too’ generic market. As a result, it has become the largest manufacturer of anti-neoplastics in China.

Its main activities focused on developing, manufacturing and distributing finished western medicines and APIs. According to their company report, Hengrui has grown organically by expanding its commercial and manufacturing capabilities continuously, and by investing USD \$30 million to set up an R&D center to strengthen its new product development capabilities. Investment in R&D accounts for 10% of revenue, and the company collaborates closely with Chinese medical institutes in its product development activities.

**FIGURE 2: BREAKDOWN OF FOREIGN AND LOCAL GENERIC MANUFACTURERS IN CHINA**

RANK	CORPORATION	SHARE OF GENERIC MARKET
1	JS. YANGZIJANG FTY	2.16%
2	JS. L.Y.G. HENGRUI	1.84%
3	SHANDONG QILU FTY	1.81%
4	HLJ. HAERBIN PHARM.	1.69%
5	KE LUN GROUP	1.54%
6	SH.ASIA PIONEER PH	1.27%
7	SHADOSNG RUIYANG	1.18%
8	GENERTEC GROUP	1.15%
9	SHADONG LUOXIN PH	1.14%
10	ZHUHAI LIZHU GROUP	1.13%
<b>TOTAL TOP 10 LOCAL PLAYERS</b>		<b>14.9%</b>
105	SANDOZ TOTAL	0.23%
109	RANBAXY GROUP	0.22%
260	TEVA PHARM	0.09%
353	SIGMA-TAU	0.06%
848	RATIOPHARM	0.01%
1000	ALPHARMA APS	0.00%
1001	DR. REDDYS	0.00%
<b>KEY FOREIGN PLAYERS</b>		<b>0.61%</b>
OTHER PLAYERS		84.5%
TOTAL GENERIC MARKET		100%

Source: IMS China Hospital Audit MAT; December 2008

Hengrui has also built up its commercial capabilities with the expansion of its sales force to 2,700 reps, according to a company senior executive. It has developed a strong presence in the developed eastern region of China, while also establishing sales and distribution channels in smaller cities inland, and rural areas for future potential revenue growth. The high-growth OTC (over-the-counter) market is also a target for Hengrui, which is expanding its product portfolio through the acquisition of a small player as a pilot project.

<sup>3</sup>For the 12 months ended December 2008

In contrast to specialist generics players such as Hengrui, the state-owned conglomerates have undertaken a diverse range of pharmaceutical activities. Beijing Pharma Group Corporation is typical of the large state-owned companies, with business units spanning R&D, manufacturing, distribution and retail pharmacy. It was appointed as one of the designated manufacturers for selected drugs to be centrally purchased among community health centers in Beijing.

**INCREASING DEMAND FOR WESTERN DRUGS FOUND IN DEVELOPED MARKETS**

The changing portfolio mix of local companies is reflected in the shifting generic market breakdown by therapeutic category. Most notably, systemic anti-infectives, which accounted for 41% of generic sales in 1999, have seen their share erode to 29% in 2008, whereas increasing demand for antineoplastic and immunomodulator drugs has boosted their share from 7% to 10% in the same period.

**MARKET DRIVERS LEADING TO SUCCESS FOR GENERICS**

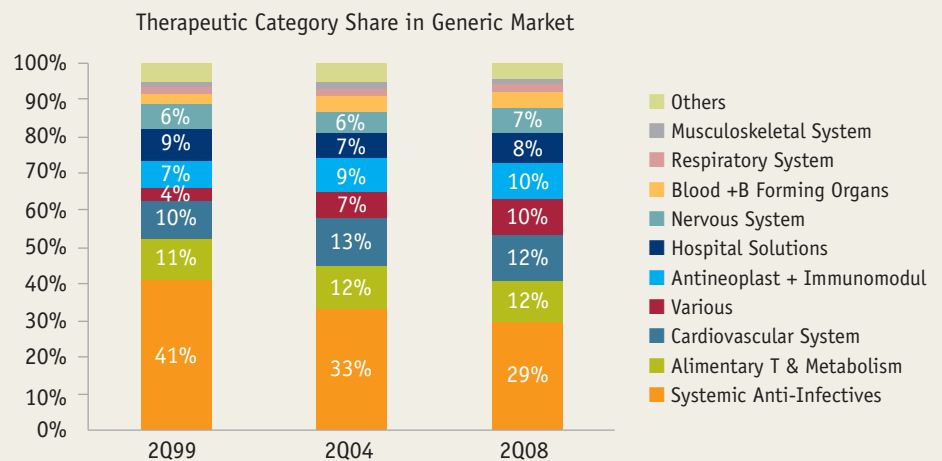
China’s economic boom, which has seen GDP grow at 8-12% in the last 15 years (based on reports published by the China National Statistics Bureau), together with the rapidly aging population, is fueling demand for pharmaceuticals. The trend toward unhealthy lifestyles and growth in the incidence of chronic diseases are also boosting sales

of products to treat hypertension, diabetes, heart disease and cancer. Consumption of pharmaceuticals, especially generics, can also be expected to expand as the government’s healthcare reform policies take effect.

China’s multi-tiered healthcare system has failed to keep pace with the economic and social boom of the last decade. Insufficient government funding combined with market-driven policies have contributed to a hospital-led system in which healthcare is costly, of variable quality and frequently inaccessible. There are wide disparities in healthcare provisions across the nation as a whole, across regions, and among urban and rural populations and income groups. China has set a goal of redressing the inequities of the current situation by providing an affordable healthcare system that will cover all urban and rural residents by 2020.

The replacement of the centrally planned system with a market-oriented economy has left the rural and urban populations without adequate medical insurance coverage. Accelerated development of a multi-level insurance system has become a government priority as part of its health reform program. The government has set an ambitious target of bringing virtually all the population within the healthcare insurance framework by 2010. This will further boost demand for drugs, particularly generics.

**FIGURE 3:  
BREAKDOWN OF GENERIC MARKET  
BY THERAPEUTIC CATEGORY  
(% SHARE) FROM 1999 TO 2008**



Source: IMS China Hospital Audit, MAT, June 1999-2008

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## NEXT-GENERATION INSURANCE PROGRAMS

There are three key insurance programs that will help shape the healthcare landscape for years to come.

- **BMI** — By 2010, some 270 million employees are expected to be covered by the urban employee basic medical insurance scheme (BMI). The benefits provided by the BMI vary among cities, with inpatient and outpatient medical services and drugs covered in some cities such as Beijing, Shanghai and Hangzhou. In other cities, only inpatient services and drugs are covered.
- **RCMIS** — Established in 2003 to provide farmers with basic health insurance, the rural co-operative medical insurance scheme (RCMIS) will cover the rural population of 760 million by 2010. Funded by central and local governments and the insured, the scheme provides limited basic inpatient benefits.
- **URMIS** — The urban resident medical insurance scheme (URMIS), established in 2007 to provide coverage for major illnesses for urban residents not covered by the BMI, is expected to grow from 41 million residents in 2007 to around 300 million by 2010. Treatment of serious diseases for inpatients is covered, although individual cities may also opt to include certain outpatient services.

Development of the generics market will be encouraged by this far-reaching expansion of medical insurance for the rural and urban resident communities, which will rely upon inexpensive medicines to address the broader coverage.

## THE KEYS TO SUCCESS FOR GENERICS MAKERS

Both foreign and domestic companies based primarily on a generics model stand to prosper over the coming decade in the Chinese market.

## ADAPT TO FAVORABLE MARKET TRENDS

China's rapidly aging population, combined with improved access to healthcare services, augurs well for development of the generics industry. Players that are prepared to explore new business models to take advantage of healthcare reforms are more likely to be winners, while sustainable success will also depend on the ability to build organizational competencies and adopt more professional business practices.

## MATCH THE RIGHT PRODUCT PORTFOLIO WITH THE RIGHT COMMERCIAL MODEL


Selecting appropriate generic products according to different commercial models will be critical for the success of any venture.

- Commodity generic companies with a large basket of products and sufficient scale to achieve cost leadership stand to gain access to the large rural population and the developing community health centers by winning tenders for products on the essential drug list.
- Being first to market with copies of patent-expired products in high-growth and high-value categories will

**FIGURE 4: POPULATION COVERED BY URBAN & RURAL MEDICAL INSURANCE SCHEMES (MILLION) FROM 1999 TO 2010**

Medical Insurance Scheme	1999	2004	2007	2010
Urban employee	21	124	170	270
Urban resident	-	-	41	300
Rural Co-operative	-	91	730	760
Total	21	215	941	1330

Source: MOH Statistics



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## Foreign companies seeking to gain a better foothold in China's complex marketplace will benefit from fostering alliances with local generic companies.

give companies a head-start in penetrating key sectors, while specialty players focusing on 'difficult-to-make' generics or launching generic versions ahead of originators' brands will enjoy a more favorable price advantage.

- There are increasing opportunities for companies that pursue a strategy to transform themselves into innovative players by developing new delivery forms or new drugs to address diseases that are more prevalent in China, such as cerebrovascular diseases, hepatic diseases and certain types of cancer, such as liver and gastric cancers.

### **FORGE STRATEGIC PARTNERSHIPS**

Local generic companies stand to gain tremendously by:

- Fostering cooperative relationships with international players to broaden their portfolio and/or upgrade their commercial and manufacturing capabilities
- Pursuing M&A opportunities, either to expand their overseas footprint or upgrade their capabilities
- Becoming an integral part of the value chain of foreign players

Likewise, foreign companies seeking to gain a better foothold in China's complex marketplace will benefit by such alliances. Partnerships with and investments in local

manufacture and API suppliers will engender cost efficiencies for foreign companies, enabling them to compete with vertically integrated concerns. Product differentiation and the establishment of strong brands will also help overcome some of the obstacles foreign players have encountered in penetrating the Chinese market.

In summary, when local and international companies adopt well-conceived strategies that play to China's evolving healthcare infrastructure and markets, the potential rewards are great. Chinese companies that remain flexible in their business operations stand to gain in both the local market and overseas. Indeed, the relatively untapped Chinese generics market could help bolster the international generics industry as access to healthcare in China increases exponentially over the next 5 years. ●

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## ABOUT IMS

Operating in more than 100 countries, IMS Health is the world's leading provider of market intelligence to the pharmaceutical and healthcare industries. With \$2.3 billion in 2008 revenue and more than 50 years of industry experience, IMS offers leading-edge market intelligence products and services that are integral to clients' day-to-day operations, including product and portfolio management capabilities; commercial effectiveness innovations; managed care and consumer health offerings; and consulting and services solutions that improve productivity and the delivery of quality healthcare worldwide.

## HOW IMS CONSULTING CAN HELP

To have a deeper discussion about opportunities in the changing pharmaceuticals market in China, please contact:

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