The Company Outsmarting Big Pharma in Africa

By Laurence Capron & Will Mitchell

Cipla, an India-based producer of low cost antiretroviral drugs (ARVs) is one of the biggest success stories in the pharma industry. Most of its sales are in the developing world (including 40% in Africa) — where it sells its HIV drugs for about $350 per year per patient — yet it is as profitable as the pharma giants of Europe, North America, and Japan. It has doubled its market cap in the five years and sales reached almost $1.5 billion in the year ended March 2012, up close to ten times since 2000.

What's the reason for Cipla's success and should it worry the likes of Merck and Hoffman La Roche?

You could argue that Cipla's formula is simply to piggyback on other companies' products, so it doesn't have to pay for R&D. That may be true, but then the firms that do carry out the R&D are also dominant in their developed domestic markets, where their margins can absorb the fixed costs of R&D and there's nothing to stop them from competing on a cost basis in Africa, particularly given the low production costs of most drugs. What's more, these are markets that traditional developed market firms are increasingly targeting for their own growth goals.

You could also argue that since Cipla produces many of its products in India, they pay less for labor and don't have to worry about quality. But firms from around the world are now using production facilities in India (where costs are rising in any case) and Cipla's facilities have received GMP (good manufacturing practice) approvals from regulatory authorities in the US, Canada, Europe, Brazil, and many other countries. So it's hard to see that Cipla's location in India provides it with a sustainable advantage.

A more plausible explanation for Cipla's success, we believe, is that it matches its business model to the markets it want to grow in, rather than attempting to force a developed market business model on markets where it does not fit.

Big pharma, by contrast, has historically done the reverse: it tries to fit emerging markets to the model it uses successfully in developed ones. Needless to say, this approach has not worked in reaching lower and middle income segments of emerging markets that require price and marketing strategies that fit both consumers' ability to pay and the nature of the purchasing environment, which is often more diffuse than in the U.S. and other traditionally developed markets.

This is where Cipla has found success, with a business model that suits high-growth markets both in emerging economies like Brazil and South Africa and in developing countries such as Uganda. To access these markets profitably, Cipla offers a broad portfolio of products, so that it can achieve economies of scale in marketing and distribution, and carefully monitors overheads (its SG&A is 20% versus the traditional big pharma 30%).

But there's an additional, perhaps less obvious contributor to their success: Cipla has built up a portfolio of skills and resources in a wide variety of highly targeted ways. In addition to investing in its own product development and marketing capabilities internally, it has created a network of alliances and licensing agreements with an extraordinarily wide range of other organizations with complementary skills and resources.

Upstream, it has an alliance with the Drugs for Neglected Diseases initiative in the U.S. to develop and produce an improved first□line antiretroviral combination therapy tailored for children with HIV/AIDS.

Downstream, it works closely with local distributors to reach widely disparate health care facilities, pharmacies, and other distribution channels, such as a production and marketing partnership with Medpro in South Africa and a minority stake in Quality Chemical Associates in Uganda. It has also formed a partnership with the Clinton Foundation to distribute ARVs in Africa. In the US, Cipla sells its products generic pharmaceutical companies such as Teva and Eagle.

Cipla is not a stranger to M&A either. It has not hesitated to purchase or take substantial stakes in other firms when it needed substantial integration either to build its technical competence or to expand its geographic presence.

The deals have been relatively small and highly targeted. For example, the $28 million acquisition of Meditab in 2010 provide formulation skill as well as production and marketing expansion in China and Uganda, while the acquisition of [illegible]laç Ticaret Anonim [illegible]ll [illegible]sion in Turkey. tal[illegible] Hong Kong and Mab in 2010, together costing about $65 rid[illegible]noclonal antibody sin[illegible] Cipla also holds 48% of Jiangsu Cdyma, which produces active pharmaceutical ingredients (APIs) and intermediates for anti-cancer and hormone drugs, as well as about 17% in Shanghai Desano, which makes anti-viral and anti-malarial APIs as well as finished antibiotics, antiretrovirals and cardiovascular drugs.

To their credit, established pharma firms have started to experiment a little in the way they approach emerging markets at least. GlaxoSmithKline, for instance, took a minority stake in Aspen in South Africa in 2009, and then sold rights to 25 older products to the South African company in August 2012. Abbott recently bought Piramal Healthcare's branded generics business in India, a relatively small, targeted acquisition.

But if big pharma is to prevent the likes of Cipla from extending its already substantial lead in the markets of tomorrow, it needs to go much further in this direction. Rather than try to force a business model that works in one market on a market that has different fundamental characteristics, the pharma giants must use their strategic insights to create business models that match markets. And, in creating those new business models, they must use a full portfolio of strategies for acquiring the resources and skills they don't already have rather than relying on one or two traditional plays.

Laurence Capron is the Paul Desmarais Chaired Professor of Strategy & Director of "M&As and Corporate Strategy" Program at INSEAD. Will Mitchell holds the Anthony S. Fell Chair in New Technologies and Commercialization at the University of Toronto. They are coauthors of the book *Build, Borrow, or Buy*.

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