Cipla business model and tension between generics

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INTRODUCTION

Cipla is one of India's largest pharmaceutical firms that have been made to adjust their operations due to the recent changes in the environment. The aim of this essay is to therefore analyse the business model of Cipla. The essay also proposes that despite continuous competition between generic firms like Cipla, there is the potential to form a collaborative relationship with big pharma firms like GSK.

This essay is divided into six parts. This introduction is followed by Section two which gives an overview of business models. Section three provides an analysis of Cipla's business model using certain measures. Section four explains why and how Cipla's model needs to change in response to different changes in its operating environment. Section five is an overview of the generic and big pharma models and the relationship between them. Section six explains areas of differences between the two models and proposes a collaborative model between generic and foreign firms to leverage on strengths of each other.

THE CONCEPT OF BUSINESS MODELS

Weill et al (2005) noted that despite the common use of the term ' business model', the term remains seldom studied. They defined business models as consisting of what a business does, and how it makes money doing those things. According to Rappa (2003), a business model is ' the method of doing business by which a company can sustain itself'; the business model is clear about how a company generates revenues and identifies where it is positioned in the value chain. The business model of a firm is not necessarily

permanent. Froud et al (2006) affirmed that ‘ business models are dynamic and develop in response to changing industry conditions’. The firm is therefore not immune to external environment and has to adjust its strategies appropriately to sustain its revenue.

ANALYSING CIPLA’S BUSINESS MODEL

Over the years, Cipla has improved from a sales turnover of Rs. 1. 5 crores in 1972 to Rs. 5657 in 2010. It also recorded a net profit of Rs. 1081. 49 in 2010(Cipla 2010). In order for Cipla to have recorded this steady increase; there are certain internal competitive advantages which it possesses. Under the Business Model Institute definition, competitive advantage is a major sub component of the business model of any firm, competitive advantage is ‘ what a firm does best and better than others’ (Muehlhausen 2008). Potter (1980) states that ‘ a firm can attain two basic types of competitive advantage, ‘ low cost or differentiation’. These, combined with the target audience of a firm, lead to three generic competitive approaches- cost leadership, differentiation and focus. Focus can be either cost focus or differentiation focus.

Low cost

Cipla’s model entails the reverse engineering of new processes for the mass production of high quality drugs at low cost due to the absence of product patent. According to Tufts University, it costs about $1. 2billion to bring new pharmaceutical products to the market (GSK 2007). Cipla simply reverse engineered the process. As a result, Cipla had a low cost business model. Cipla also enjoys relative cheap labour and high skilled manpower in India.

Therefore, Cipla can produce drugs much cheaper than those produced by the patent owners’. A notable example of this is the Cipla brand of anti-retroviral combination which was sold in year 2000, for $800 per patient per annum. On the other hand, big brand names sold the same combination for about $12, 000 per patient per annum. Subsequently, Cipla further reduced the price to about $300 per patient per annum and subsequently to around $140(Greene 2007). The low cost model is therefore enabled because Cipla need not invest in R & D and testing of these drugs.

Organic growth

Chittoor and Ray (2007) identified Cipla as an ‘ explorer’. They defined an explorer as one in which despite continuous exploitation of its legacy capabilities, is still engaged in acquiring new capabilities. Cipla holds the largest market share among Indian companies with a market share of 5. 16% in the domestic market sales and was able to overthrow GlaxoSmithKline with 4. 89% (Mukherjee 2007). More recently in 2009, Cipla maintained its top position with a market share of 5. 38% showing an 18% increase over the previous year (Jayakumar 2010). Founded in 1935, Cipla pioneered bulk drug manufacturing in India and had emerged as a major player in the domestic market during the process patent regime, leveraging on its significant process skills and reverse engineering capabilities. Post-1995, building on its reverse engineering capabilities, it developed new generic products for other developing economies similar to India and became one of the largest exporters of drugs from India, with foreign sales reaching up to 50% of total sales (Cipla 2010).

Business scope – expanding to other countries

Over the last three years, Cipla has forayed into developed markets such as the US and Europe using specifically developed generic drugs and marketing them through tie-ups with generic MNC majors such as Andrx (Cipla 2009). As at year 2005, Cipla's R&D was primarily aimed at developing new processes and generic drugs and hence remained at about 4% of sales. Even though its drugs are sold in over 100 countries, it has not made any overseas acquisitions. Exports which were negligible a few decades ago are now in excess of 50% of turnover (Cipla 2010).

WHY IS THERE A NEED FOR CHANGE?

World Trade Organization (WTO) Regulations

The 2005 enactment of the Trade Related Intellectual Property Rights (TRIPS) agreement signed by India, led to the reinstatement of the patent law for the first time since 1972. As a result, the reverse engineering which underpinned the Indian industry expansion in now illegal. This has led to the need for Indian generics companies to change their business models. As it expands its core business, Cipla and other Indian generics are being forced to adapt its business model because of the recent changes in its environment.

Patents expiring

Until the mid-1990s when India signed the WTO agreement, many leading Indian pharmaceutical companies relied on the domestic market alone. Since 2002, over $80 billion worth of block busters have lost their patents. Another $74 billion worth is expected to be exposed to generic competition as a result of loss of patent between 2009 and 2012(Long 2009). As a result,

Indian generics are taking advantage of the global generics market and expanding to developed countries. Cipla is well positioned as it has a competitive edge of low cost manufacturing and advance chemistry capabilities.

Return of Multinational pharma companies to India

Many of the foreign MNCs that fled India as a result of the former conditions are now returning to India to become full-fledged research based multinationals. Within the next five years, it is estimated that ' Indian generics will lose about $650 million of the local generics market to patent holders' (Singh 2006). This is as a result of big pharma defensive strategies which include undermining the credibility of generics with health care providers, offering their own authorized generics, engaging in fierce price wars with generics and slowing the rate at which generics hit pharmacy shelves(Christopher 2006). This has created the need for Cipla to increase sales of its products to other countries.

HOW WILL CIPLA'S BUSINESS MODEL CHANGE?

Luo and Pend (1999) identified three strategies open to Indian firms as they make steps to respond to institutional and market changes and maintain their market share. These are; 1) Exit strategy: exit the market by divesting the business; 2) A defensive strategy targeted at the defence, protection and consolidation of the firms position in the domestic market in the same product market domains; 3) A bold, assertive and aggressive strategy of leveraging the current stock of capabilities and dynamically building new capabilities to expand geographically through internationalization. Cipla is

presently carrying out a defensive strategy by expanding domestic sales and also expanding to other countries through its partnerships.

More strategic partnerships

The industry is changing its model from its ‘ reverse engineering’ model to a ‘ consolidation model’ where companies can pool resources together with other domestic and foreign firms. Cipla has formed Ciplagenpharm with an Australian company after entering into agreement in 1997(Ciplagenpharm 2005 cited in Malhotra 2005). Cipla also went into a research alliance with Avesthagen, a Bangalore-based biotech company to develop bio therapeutic products. (Cipla 2005). Cipla tied up with Morton Grove Teva/Ivax, AkomWatson, and Sandoz /Eon for the US market. In the UK with NeoLabs, and with Medpro in South Africa (Bisserbe 2006).

Cipla’s strategy is more suitable to today’s scenario, in which competition is growing and pricing pressure is persistent. Cipla is geographically diversified, it now exports to 160 countries and its exports account for around 50% of its revenues (Cipla 2009). It is present in markets through partnerships and is focused on its core competencies of product development and manufacturing.

More R & D spending

Cipla is rising up the value chain. From being a pure reverse engineering firm focused on the domestic market, Cipla is moving towards basic research driven, export oriented global presence, and enlarging its market reach. Cipla recently invested Rs. 250 crores in a new R & D facility in Mumbai (Cipla 2009. The total expenditure on R & D as a percentage of total revenue

increased to about 5 % in 2009(Cipla 2010). Cipla's R & D now includes development of new drug formulations, patenting of newer processes and products of the domestic and international markets and development of new products specifically for exports.

More Exports

Previously, Cipla was engaged mostly in sales to its domestic market. More recently this has changed as Cipla is reducing its over-dependence on the domestic business by generating strong consistent growth in export markets. Cipla has also begun to export its products to developed countries (Cipla 2009).

In 2001, there was a sales growth of 84% in the export division. Total export for that year amounted to Rs. 2583 million. This was attributed to the launch of Dinex, Cipla's chewable anti-retroviral drugs in the same year (Cipla 2002).

PRESENT SITUATION IN PHARMA INDUSTRY-GENERICS AND BIG PHARMA

As innovative blockbusters continue to go off patent, the market for generics which is already a significant share of the global healthcare market will continue to grow. This is in a bid by payers to counter increasing healthcare costs and still provide appropriate patient care. While originator companies are expected to continue showing innovation despite dwindling pipelines, generics continue to use speed to market products, with the right molecules as the essential success factor. According to Long (2009), ' conventional lines of demarcation are blurring: many MNCs are already buying into and

owning generics businesses. Generics companies are also attempting to move into proprietary brands'.

CONNECTIONS AND DIFFERENCES BETWEEN GENERIC AND BIG PHARMA MODELS

Among academics, there have been debates about the relationship between the generics and ethical pharma business models. As a result of the recent economic transformations in India, a unique business environment has been created for firms.

Luo and Tung (2007) have conceptually argued that the present conditions may prompt Indian firms to recognize their unique competitive assets such as low manufacturing and development costs and the large pool of readily available scientists that could be exploited in international markets either in other emerging economies or in developed economies. Hu (1995) suggested further that firms from emerging economies may have a competitive advantage over developed economy firms in entering other emerging economies owing to the benefit of operating in similar institutional setting quite like their home setting. Thus, to improve their competitiveness and to develop new resources and capabilities, firms based in emerging economies may be forced to internationalize their operations (Hoskisson et al., 2004).

On the contrary, Prahalad and Lieberthal (2003) believe that ' MNC's possess superior resources and capabilities when compared to domestic firms'. The firm-specific advantages of many emerging economy firms are valuable only in their home country and may not be sustainable. MNC's are also now developing generic brands of their products and now compete with Indian

generics in the domestic market. Hamied (2005), predicts that by 2015,' multinational companies will make 60% of all patented drugs sold in India' and that Indian generics will be affected by ' predatory pricing and be wiped out'. As a result of the economic reforms, the most preferred options for most firms may be to enter into partnership or joint venture along with foreign firms to improve competitiveness or even sell out entirely to a multinational firm (Dawar and Frost, 1999).

REASONS WHY THE BIG PHARMA WILL BE WILLING TO PARTNER

Expansion of generics market in developed countries

From exhibit 1, the generic share of dispensed prescription has increased from 51. 1 % in 2003 to 68. 3% in 2008. This is as a result of over $80 billion of branded drugs losing patents in 2002 and thereby being exposed to generic competition. A further $74 billion will lose their patents between 2009 and 2012. This shows the level of competition presently between generics and branded firms in developed countries like the USA.

Exhibit 1 Share of USA market held by generics

Reduction in number of new drugs produced

Exhibit 2 shows a reduction in number of new products approvals from 45 in 1999 to 27 in 2007. This signifies a historically low level for drug approved for branded drug manufacturers.

Exhibit 2 Trends in New Chemical Entity (NCE) approved in the USA

Reduction in Healthcare Expenditure

As a result of the reduction in real prescription drug spending growth, a “ turning point” has been created in healthcare with several policy implications. Average growth in prescription spending which averaged 9. 9 % between 1997 – 2003 has fallen to 1. 6 % in 2007. As a result, there is the need for big pharma such as GSK to provide less costly drugs in order to maintain their market share (Aitken 2008).

CONCLUSION

It has been argued that Cipla like other Indian generic companies is changing its business model and investing more in R & D and pursuing an expansion strategy to other countries while still retaining their market share in the home country. There is the opportunity for generics and big pharma companies to work together to achieve their distinct organisational aims. Despite the inherent competition, there will be a significant opportunity for generics and big pharma to leverage each other’s strengths to cooperate. The generics that boast strengths in mass production alongside big pharma who are innovative can work together to create a model that would be far more successful in the future. As a result , a model of cooperation and competition can be formed at the same time.

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