

# Glaxo italia s.p.a.: the zinnat marketing decision essay sample

[Economics](#), [Money](#)



1. What are the relative advantages and disadvantages of co-marketing arrangements versus direct sales? Why is Glaxo considering co-marketing for its new Zinnat antibiotic? 2. Evaluate Glaxo Italia's criteria for evaluating decisions about sales strategies (i. e., payback and internal rate of return). What are the strengths and weaknesses of these criteria as opposed to net present value? On which criteria would you base your recommendation? 3. Evaluate the forecast. Are all relevant cash flows present? Are the assumptions reasonable? Should the cost of new sales recruits be included in the forecast? 4. If, in response to the question above, you believe the analysis should be modified, do so and prepare to discuss the results you obtain. What assumptions are the " key drivers" of your results? 5. Which marketing strategy should Rottoli recommend?

#### DESCRIPTION OF THE PROBLEM

In September 1990, Emilio Rottoli, financial controller of London's Glaxo Italia S. p. A., began to evaluate strategies for launching a new product called Zinnat, an oral antibiotic remedy to current drugs for flu-like feverish diseases. With the existence of an already massive market, Glaxo's general approach of rapid and massive distribution to capture a large market share found itself infeasible if the company wanted this product to remain profitable. As a result, Glaxo is considering two options; the opportunity to either directly sell the product or to co-market the product. Under the co-marketing distribution method another company would be given ingredients and rights to produce the same product under a different brand name in an

attempt to increase product marketing. Under the direct sales approach Glaxo's sales force would be the only medium of distribution.

Decision as to which form of sales methods the company would choose would highly affect the company's financial criteria, strength of brand equity, or lack of sales, so proper implementation of one of these programs was necessary for Glaxo to maximize their return on shareholder's equity. Mr. Rottoli focused highly on payback and IRR for his criteria for evaluating results. Based on these criterion, Rottoli's results specifically implied the co-marketing option would be the best method of distribution. The question is, however, whether Mr. Rottoli has properly taken into account all significant costs in his models and whether these generated results from the payback and IRR criteria accurately representing the firm's market position and value.

SUMMARY OF ANALYSIS We came to the conclusion immediately that Mr. Rottoli has not accounted for all of the relevant costs involved with this product.

He stated that soley manufacturing and promotional costs are considered relevant and that the remaining items, such as G&A, historical and future R&D, medical testing costs, real financial charges, and taxes, are not taken into account. We feel that these costs are in fact relevant and should be included in Glaxo's forecast. First we included R&D expenses, local production and bottling costs, and custom and transportation fess in our forecast. Calculated by 80%, 20%, and 4% of the transfer price and product mix we forecasted 3. 66 billion, . 91 billion and . 02 billion lira, respectively. We also decided to include the expected Italian Lira inflation rate of 4%

instead of using 0%. Furthermore, we felt that a 6 year forecast to 1996 was not sufficient enough for a forecast of Zinnat's potential seeing as most product lives are 10-20 years.

Therefore our second step was forecasting market demand of antibiotics and the specific market share for Zinnat through both the direct sales strategy and co-marketing strategy further into the future, up to year 2000. We used a rolling average of the market forecasts from 1993-1996 as our basis for any market forecast past 1996 and for the market share for Zinnat, we used the estimated rate of decline of 5% that Mr. Rottoli had estimated as a reasonable rate of decline beyond 1996(Glaxo Case Study, Footnote 13). After calculating both the expected market share of Zinnat and the market demand forecasts for antibiotics we were able to forecast expected quantities of units sold by Glaxo and furthermore, revenues. We then extrapolated Gross Margin and marketing expenses as percentages of revenues just as Mr. Rottoli had in his forecast and were able to determine the compensation cost for sales force #1 by assuming that the cost per salesperson would grow by 4%, the inflation rate of the lira(as noted in Glaxo Case Study, Footnote 12).

We then included our costs for other expenses that we calculated in our first step above to come up with our projected profits (or losses) for each year, which would prove to be our best proxy for Glaxo Italia's free cash flows (FCF's) outside year 1996. Once we finished calculating the FCF's, we calculated the necessary numbers to find the weighted average cost of capital (WACC) (shown in Tables 1 and 3 for direct sales and comarketing

respectively) so we could discount our FCF's and find the net present value (NPV) (shown in Tables 2 and 4 for direct sales and co-marketing respectively) of the firm in either case. We wanted the NPV of the direct sales and Co-Marketing methods to determine which method of business proved to be the highest value-adding activity for Glaxo to undertake. From this, we would be able to make our recommendation as to how sales of the new Zinnat should be made by Glaxo Italia S. p. A. Already given in Case Exhibit 7 was Glaxo Italia's beta of .90. The risk-free rate of 11.46% was assumed to be an average of Italy's yield on long-term government bonds between June 1990 at a rate of 11.32% and September 1990 at a rate of 11.60%.

We felt this average to be a fair representation of the risk-free rate because we feel the average does not over or under compensate for current trends in the market. Next, we took the market risk premium to be 5.6%, as stated in Case Exhibit 7, and we calculated the cost of equity to be 16.5% using the CAPM equation. As for the cost of debt, it was calculated using the interest rate parity formula  $[(K_{italy}) = (1 + K_{uk}) (1 + I_{italy} / 1 + I_{uk}) - 1]$ . Plugging in those numbers, we got a cost of debt of 7.14%, which was later used to find the WACC. The final numbers to be input into this WACC equation were a given marginal tax rate of Italy of 47%, present in Case Exhibit 8, and the weights of debt and equity for the firm. The capital structure was based on the Glaxo Holdings capital structure of debt and equity for the month ending September 1990.

The respective book value of debt amounted to 420 million Lira and market value of equity was 12. 193 billion Lira. Using these numbers, the weight of debt comes to 3. 33% and the weight of the equity amounts to 96. 67% of the firm's cost of capital. All put together, the firm's WACC amounts to 16. 08%. Finally, we took the FCF's of Glaxo Italia's direct sales and co-marketing methods and separately discounted each back by the firm's WACC to find the NPV of each method of sales for the new Zinnat.

**RECOMMENDATION** According to our NPV analysis, neither project appears to be extremely profitable if you project only to 1996, instead of the full useful life of the product. To take on a direct sales or co-marketing method, we would be forced to believe Glaxo would be undertaking projects that would more-than-likely hurt the firm's shareholder's equity.

To pick either method of marketing the new Zinnat would be to pick the lesser of 2 evils in this particular case, should you not project all subsequent years. According to our data, however, we found both methods of marketing to be a much better result than thought before when we projected data out to year 2000. Data shows how both projects now have a positive NPV, however, due to the mutual exclusivity of these projects, suggests the co-marketing method to be the better of the two values at a 188. 5 NPV (Table 4) compared to the close 108. 9 NPV (Table 2) of the direct sales method. The 12 month incremental speed and market penetration proved to be the truly better method of mass marketing the new Zinnat to be the most value-adding activity for Glaxo's shareholders.

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