

# Glaxo italia

Business, Marketing



Glaxo Italia S. p. A. is introducing the new drug, Zinnat, into the market. Glaxo has the option to directly sell or co-market the pharmaceutical. If the company were to sell the product directly, Glaxo's sales force would be the sole distributors of the drug. Using co-marketing, Glaxo would allow another company to sell the same product under a different brand name for a fee. We have compared the two options to determine which marketing strategy would be in the best interest of Glaxo Italia in terms of net present value, rather than the IRR or payback period used previously. We have decided that co-marketing with another company would be the best option for Glaxo Italia as it has the higher net present value.

#### Forecasting and Analysis

We have decided to extend the forecasts to 2010 because although it is difficult to predict beyond 6 years, the typical life cycle of a drug lasts between 10 to 20 years. Looking at the forecasts made by CFO Emilio Rottoli, we have decided to change several of the original assumptions. The first change we made was to include the expected Italian lira inflation rate of 4%, previously listed incorrectly at 0%. We have reflected this rate of inflation change in the transfer price of ingredients. A 20% cost for production and bottling and a 4% fee for customs and transportation were not previously taken into account in the transfer price, and have now been added.

We have assumed a constant total market demand from years 1997 to 2010, using the average from 1991 to 1996. We have also applied this method to the percent of Zinnat sold by Glaxo if they were to choose a co-marketing strategy. We assumed that the market share for Zinnat will decline by 5%

per year after the seventh year, as predicted by Rottoli. Gross margin of direct sales to Glaxo Italia and gross margin of ingredient sales to Glaxo Holdings are assumed to stay the same. We agree that the amount of samples given out will quickly decrease after the initial introduction of Zinnat. By 1999, samples will remain constant.

The costs for medical promotions, seminars, congresses, etc. have been based upon historical data. These marketing expenses are vital only to the introduction of a new drug. Thus, after year 6 these costs are unnecessary. The sales force was also increased to 440 representatives by the third year and remained constant after the increase. As stated in the case, the cost per salesperson will increase by 12% until year 6, where it will then increase by the Italian lira inflation rate of 4%. Sales force training expenses were kept at 1.6% of revenues based on 1996, the last forecasted year. Compensation for the sales force was forecasted by taking the percent of time spent on Zinnat for each marketing strategy multiplied by the cost per salesperson and the number of salespeople. All other forecasted assumptions are assumed to be correct.

### Evaluation Techniques

Glaxo Italia currently uses a payback evaluation to decide whether or not to undertake a project. Glaxo Italia deems any project with a payback of three years or less acceptable. This method is favorable due to its level of simplicity and cost effectiveness, because of the ease of calculation and time saved. The main advantage of this method is that it allows Glaxo to see how

soon they will be able to reinvest cash flows into new research and development.

The main problem with using the payback method as a means of project evaluation is that it is not based on any sort of financial practicality. Time value of money is not taken into consideration, with equal weights being placed on cash flows over different time periods. The payback method only considers the time up to the breakeven point, so cash flows past this time are not reflected. These future cash flows could change the internal rate of return and net present value, resulting in an inaccurate projection. In addition to being a poor quantitative measure, there is no basis to determine an accurate time period, so it tends to be a number arbitrarily set by the firm.

Another form of financial evaluation that Glaxo Italia uses is the internal rate of return. Using this method, the project with largest IRR would be accepted. The problem with this method is that it assumes the cash flows from the project will be reinvested at the IRR. In this case, the IRRs that we are looking at are 546% and 2125%, so expecting to consistently reinvest at this rate is unrealistic.

A more accurate measure for considering whether or not to accept a project is its net present value. It is not without flaw, as any deviation from forecasted amounts will alter the NPV. NPV assumes that cash flows generated from the project are reinvested at the company's required rate of return, rather than the IRR. This provides a more realistic measure of how a project will affect the firm while providing a dollar amount, rather than an

unreliable percentage. In comparing the evaluation methods, we feel NPV is the most appropriate for this case.

### Marketing Strategies

Glaxo's marketing strategy situation presents several qualitative tradeoffs regarding the antibiotic's overall success. The difference in performances between the marketing strategies is expected to be present in varying degrees throughout the entire useful life of the drug. However, the emphasis of Glaxo's decision will focus heavily upon initial market penetration, since their primary goal is to immediately begin capturing an increasingly large market share for Zinnat.

Under direct selling, the expected product launch would allow Glaxo's own sales force to exploit the potential revenues. While direct selling can potentially allow the highest returns, the demand increase in the sales organization of the company could likely end up problematic if the increased strain is not properly accounted for. An increased dissuasion to directly sell can also be attributed to Glaxo's recent success in co-marketing comparable products. This large co-marketing success strongly suggests that their brand's initially sacrificed market share does not have to be a detriment to the project, and can be greatly overshadowed by faster product integration in the market.

Increased penetration speed from co-marketing can predictably lead to further advantages, such as higher product volumes and faster market share growth. Significantly increased word-of-mouth advertising within the medical

field and expected lower introduction costs both provide a fostering environment for quick and sustained market share accessibility. The predicted increase in market occupancy with the co-marketing strategy is also expected to cause competing firms difficulty with integrating their brands into the market. Relative to the increased control in the market, Glaxo also expects increased lobbying leverage in regulatory environments by establishing close relationships with similar companies. In general, co-marketers typically benefit from increased sales productivity and stability.

The disadvantages of co-marketing are typically related to competition and friction between the partner companies. Glaxo is anticipating the need to increase their future sales force to ensure their potential co-marketers' products are not outperforming their own. Destructive price wars and lawsuits over resource allocation are highly threatening. Also discouraging to this strategy are increased possibilities of having Zinnat reformulated by its competitors, which often leads to licensing complications.

Assuming Glaxo maintains a very high level of concern and tactfulness while using the co-marketing strategy with another competing company, a substantial degree of potential disadvantages can be avoided. A constant awareness of potential threats from co-marketing partners is essential for Zinnat's success.

#### Final Recommendation

Our recommendation to utilize co-marketing for Zinnat is based on the net present value of each strategy. As stated in the case, the current UK cost of

debt is 12.5%. We have found the UK cost of equity from the CAPM using the given beta, risk-free rate, and market premium for Glaxo Holdings. Using their given market values of debt and equity, we calculated their capital weights and found Glaxo Holding's WACC. As shown in Exhibit 1, we have converted the UK WACC to its equivalent Italian cost of capital using the interest rate parity formula. As shown in Exhibit 2, the cash flows from capital generated for each strategy are discounted at this WACC to find the NPV for direct and co-marketing. Direct marketing only provides a net present value of 72.0 million ITL. Co-marketing Zinnat is the clear choice for Glaxo Italia, with a net present value of 140.3 million ITL.