

Operation of different divisions term paper samples

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Overview of Novartis

Novartis, founded in 1996, is one of the leading multinational pharmaceutical companies of the world. It is a healthcare company with leading positions in pharmaceuticals, eye care, generic medicines, vaccines and diagnostics, and consumer health. It is focused on innovating to meet the new patient needs, increasing its presence in new and emerging markets, and raising productivity to generate future and increase shareholder return. According to IMS, the company ranked no. 1 in top 20 global corporations of 2012 by sales with USD 50. 76bn in sales.

Novartis has a diversified portfolio of operations having 5 unique divisions. Among the divisions Novartis works in, pharmaceuticals has been by far the largest. Pharmaceuticals covered 57% of the net sales of the company in 2012. Eye Care division, Alcon has become 2nd largest revenue generating division of the company in 2012. Generics division- Sandoz is the 3rd largest revenue generator for the company. 2012 Sales breakdown by division of the company is provided below:

Operation across Regions of the World

Novartis operates across all major regions of the world using all of its 5 divisions. The company's largest market in terms of sales is Europe, followed by United States.

2012 Net Sales by Region and Segment (% and in USD mn)

United States is the largest market for Novartis in Pharmaceuticals, Eye Care, and Vaccines & Diagnostics. On the other hand, Europe is the largest market for the company in Generics and Consumer Health.

Another classification was used in the above table which divides revenues of various divisions of Novartis in 2 regions: One is Established Markets and Emerging Growth markets. Emerging Growth Markets are all markets other than the Established Markets of the United States, Canada, Japan, Australia, New Zealand and Western Europe. And quite clearly, it can be said that across all divisions of the company have stronger business in Established markets than emerging markets as of 2012.

Novartis - Peer Comparison:

Using a few criteria, performance of Novartis is compared with other peer companies below:

Revenue Growth: Novartis has maintained a steady constant annual growth rate of approximately 9% from 2006 to 2012. On the other hand, revenue growths of other peer companies have been volatile, as indicated by the graph.

Gross Margins: Despite operating in low margin divisions such as generics and vaccines and diagnostics, Novartis has maintained gross margin level just below the average level of margins for peer companies, as per the graph beside.

Return on Assets: Return on Assets Novartis and some of the other peer companies have been declining from 2008. Only Roche has been able to increase ROA significantly during same period.

Asset Turnover: Asset turnover (Sales/Assets) is ratio that measures a firm's efficiency of utilization of assets in generating sales. Except Roche, major players in the sector including Novartis had a declining asset turnover from 2006 to 2010, but Novartis and few others have slightly done better in 2011 and 2012.

Macro and Industry Analysis

- The macro and industry value drivers of the healthcare business are as follows:

Aging, increasing population and shifting behaviors: The aging of the world population, along with the increasing health-risks of obesity and other unhealthy lifestyle elements, is driving the demand for treatments for numerous diseases. In addition, normal growth of population in the world is acting as a boon for Pharmaceutical industry.

Increase in healthcare spending: The global healthcare market continues to grow, led by increase in healthcare expenditure per capita in established and emerging economies alike.

Advances in science and new technologies: Personalized healthcare is opening new scopes for targeted therapies, thus improving outcomes on patient and cutting expenses. Social and portable technologies are helping the delivery of healthcare and increasing the contact among patients and providers.

Move to generics and OTC drugs: Facing increasing healthcare expenses, Governments worldwide are motivating people to substitute generics for patented pharmaceuticals. Consumers are also switching to OTC products in

trying to lower expenses.

- Rising Challenges in pharmaceutical Business are as follows:

Patent expirations and competition from generics: The innovative products of previous years are losing exclusivity due to patent expiration. The advent of generic competitors has been eroding sales of innovative products.

Regulatory and safety barriers: The costs associated with bringing a drug to market have increased as a result of heightened regulatory requirements. Even after a drug is approved, there is a possibility that safety events could occur and materially affect our results.

Manufacturing quality and complexity: The production of medicines is highly regulated as well as complex. It can result in numerous issues that can lead to long-term supply disorder and large liabilities.

Financial crisis: Challenges from global financial crisis of 2008 and recent EU debt crisis are affecting the world economy, governments, and patients- often leading to reduction in income and expenses by general people and governments in crisis, as identified by the graph beside showing a decline in Growth rate of GDP per capita in 2008 for North America and in 2009 for rest of the world.

Legal proceedings: The government investigations as well as litigations against companies in the healthcare industry are increasing. Any compliance failure of a company in one part of the world can affect its operation and reputation badly worldwide.

Business Strategies of Novartis

The company identifies its strategy as focused diversification of healthcare portfolio. This strategy is met by three priorities set by the company:

1. Continuous innovation through research and development: The core strategy of Novartis is to grow through science-based innovation, focused on high-growth segments of healthcare. In a more detailed term, Novartis is focused more on innovation themselves, whereas many other companies are outsourcing their R & D (Research & Development) and making less of a commitment to R & D. In 2012, the company spent USD 9.3bn in R & D – the largest among healthcare companies and any other industries.
2. Fastening growth with new launches and increasing presence in Emerging Growth Markets: Innovative products have continued to contribute in the group's overall performance; in 2012, recently launched products generated about USD 16.3 billion or 29% of total net sales.

The Company has also maintained growth with presence in emerging growth countries (defined by the company as all markets except the United States, Canada, Western Europe, Australia, New Zealand and Japan. In 2012, these markets contributed USD 13.8bn or 24% of total net sales.

3. Growing productivity through efficiency initiatives: The Company targets to operate as efficiently as possible by reducing cost and improving profit margins, to have flexibility in future investments. But innovation and R & D is still the main priority of the company. Taking into consideration of several income statement items' CAGR (Constant Annual Growth Rate) from 2005 to 2012, it is apparent that Novartis spent more on R & D, but was able to reduce Selling, General, and Administrative Expenses which allowed the

company to have a higher operating income growth than gross margin growth.

A major source of productivity growth for the company is mergers and acquisitions. For example, the company realized merger-related cost synergy of about USD 370mn through full integration of Alcon (eye-care) which has become second largest division in the group.

Effectiveness of Strategy in 2009 and 2012-13 when GDP Growths Fell Worldwide

The world has seen the largest financial crisis in 2008-09 since the Great Depression of 1930s. Yet to fully recover from that crisis, the world has seen another crisis in the form of European debt crisis in 2012-13. Financial crisis in such large economies has led to lower GDP growth in those regions.

Naturally such crisis had spillover effects in numerous industries. Novartis, a large player in pharmaceutical industry has also faced consequences of that to some extent. From the table below, it's evident that during 2009 when GDP growth in USA, European Union, Latin America, and the World, revenue growth and return on asset and equity slightly declined for Novartis. But during the same time, growth in emerging economies in South Asia and Africa was positive. As Novartis already had some foothold in those regions, which allowed the company shield the full impact of financial crisis.

Thus in 2012, when GDP growth in EU became negative again and world GDP growth declined, Novartis was able to withstand that blow mostly. It can be described by the following table which shows that since 2009, the company has diversified its operation of all divisions giving higher weights towards Emerging countries of Asia, Africa, and Australasia.

Contribution to net sales from Asia/Africa/Australasia region has increased in 2012 from 2009 across all divisions. On the contrary, contribution to net sales has declined in United States and in European Union (except Consumer Health division in EU) from 2012 to 2009. So, regional diversification has helped Novartis to withstand the effect of decreased GDP growth in USA and EU.

Another element that helped Novartis withstand the crisis was the timely decision to acquire majority stake in Alcon from Nestle, agreed upon in April 2008, and eventual full acquisition which immediately made Novartis world leader in eye care.

Also medicines or pharmaceutical drugs have inelastic demand (i. e. products with no substitutes or they are basic necessities). For example- insulin is something which a patient must need. This inelasticity of majority of the products of the industry was also beneficial for medicine makers like Novartis.

Key Features of Novartis' Strategy

Apart from regional diversification, some other features of Novartis differentiate from peers. One of them is its diversification across divisions. Unlike its large peers, Novartis has a very large generics drugs business- which current is the 2nd largest in the world, according to 2012 revenues. Despite lower margins in generics than patented pharmaceuticals business, Novartis has put a lot of emphasis on generics business Sandoz because patents of many major drugs in the industry are expiring and will expire. So to face that challenge or take the opportunity, Novartis has taken a head

start in generics business. This strategy will payoff for the company if the company can compete on cost leadership with generics competitors from emerging countries.

Another strategy is setting up manufacturing and R & D facilities in emerging markets. The cost of doing business in these markets compared to developed countries is enabling the company to reduce their cost of production.

Constant innovation and emphasis on R & D is another key strategy for the company. The company has focused its innovation around current patient needs, such as cancer, respiratory diseases and other chronic diseases that require new breakthrough therapies. Consistent emphasis on investment R & D has allowed the company to build a large and deep pipeline of upcoming medicines. Increased expenditure in R & D has allowed the company to innovate and get approval for more molecular entities from EU EMA (European Medicines Agency) and US FDA (Food and Drug Administration) than peer companies, as indicated by graph beside.

Conclusion:

In conclusion, Novartis has pursued some key strategies over the years - diversification across fields, across regions, and kept innovation the priority- all these have helped the company to have a stable growth for the future. The Company's diversification strategy has also allowed it withstand the macroeconomic risks in some major markets in 2009 and 2012-13. Also the basic inelastic nature of the pharmaceuticals products allowed the company to ride out the decline in GDP growth in United States and European Union.

And in recent times, the company's timely focus on emerging markets as both manufacturing/R&D and sales destinations is something that will have a bearing for a sustainable long term growth.

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