The pharmaceutical industry

This essay will analyse the factors that shaped the competition within pharmaceutical industry. It will look at the key players in the market and try to answer how they obtained the competitive advantage over their rivals. Moreover his paper will also examine the main business models in pharmaceutical industry and look how the companies react to the changing nature of competition, by re-assessing their strategies. According to the case, written by Holland & Batiz (2004), the pharmaceutical industry has its roots in 19th century but the R&D was firmly established during 1940s and 1950s.

This means that throughout that time pharmaceutical companies acquired practise and experience which helped them to obtain a competitive advantage (Porter 1985). However, the market was full of companies producing “ me too” drugs that did not have to risk lengthy and costly R&D due to no patent protection. Those companies were selling products that were not offering a significant benefits comparing with well known drugs. After all, governments imposed fixed 20 year patent protection that facilitated R&D companies firmly within the industry allowing abnormal profits and preventing new companies entering the market (Holland & Batiz 2004).

From a strategy standpoint we can draw a conclusion that the competition within pharmaceutical industry was imperfect as small threat of new entrants allowed existing companies to keep prices at high levels which is typical for oligopolistic market. However, this situation could not last for very long as big margins are always attracting new entrants (Lynch 2006). The entry of

new companies has profoundly affected the competition within industry, forcing R&D companies to review their strategies.

Generics offered a product that is the same in terms of its ingredients and quality but much cheaper than the original brand. Moreover the new firms have managed to capture a vast share of sales of a particular drug just after the patent expired. This has resulted in much intensive competition within pharmaceutical industry, being beneficial for the society as it led to innovation and increased R&D spending on pioneer drugs. Therefore it was necessary for every company to identify their opponents and outline an effective business strategy in order to achieve a competitive advantage (Meyer & Wit 2010).

One of good ways of starting analysis of any industry is Porter's Five Forces. These are five forces that determine the competitive intensity and therefore attractiveness of a market. Porter's five forces include - three forces from 'horizontal' competition: threat of substitute products, the threat of established rivals, and the threat of new entrants; and two forces from 'vertical' competition: the bargaining power of suppliers and the bargaining power of customers (Porter 2008).

From the analysis, we can draw a conclusion, that the competition within pharmaceutical industry is high as the companies compete intensively among themselves for intellectual property and innovative drugs (Johnson, Scholes & Whitington 2008). What is very characteristic for pharmaceutical industry is that buyers have enormous purchasing power. This is mainly

government that impose regulations on pharmaceutical industry in order to control its spending on healthcare system.

However, different business models are influenced by different customers, as prescription free drugs (OTC) are purchased mainly by society while drugs requiring prescriptions are bought by government. The competition in pharmaceutical industry is mainly taking place on the business level where the strategic issues about developing and sustaining a competitive advantage for the goods and services that are produced (Porter 1998). At the business level, the pharmaceutical firms formulate strategies in order to anticipate changes in demand and technologies and adjust their strategy to accommodate them.

Moreover they influence the nature of competition through strategic actions such as vertical integration (gaining control of distribution channels) and through political actions such as lobbying. Michael Porter identified three generic strategies (cost leadership, differentiation, and focus) that can be implemented at the business unit level to create a competitive advantage and defend against the adverse effects of the five forces (Akan et. al. 2006). Generic strategies provide direction for companies in designing incentive systems, control procedures, operations, and interactions with suppliers and buyers.

Within the pharmaceutical industry there are four main groups of competitors that have developed over the last decades. These are: generic, ethical, biotech (all require prescription) and OTC (prescription free). Each one of them uses different generic strategy to achieve and maintain

competitive advantage. R&D companies use differentiation strategy that requires them to create something about their product that is perceived as unique and innovative within the market. Differentiation often forces firms to accept higher costs in order to make a product or service appear nique (Herbert et. al. 1987).

In regard to strategy ethical pharmaceutical companies need to focus mainly on their R&D process as wells as advertising that makes their customers to perceive their products as being unique. As a result, the companies that invested their capital vastly in R&D became industry leaders. Therefore companies compete on who will enter the market first with the new product, since only the pioneer drug would benefit the company. A differentiation strategy is appropriate where the target customer segment is not very price-sensitive (Miller 1992).

Consequently ethical drug companies are seeking for blockbuster products that will enable them to obtain deep market penetration as well as enormous sales. Over the decades the risk-reward ratio has changed to the position where the companies risk vast amount of money being invested into R&D in order to create blockbuster drug. However, that makes ethical drugs companies vulnerable to the completion from generics after the patent expiry. From a strategy standpoint it is reasonable for ethical drug companies to make an effort to try to extend the product life cycle in order to maximise their sales.

One way of achieving that is shifting their costumers to new improved formulations of drugs with longer patent protection or moving their products

from prescription-only status to OTC. Therefore marketing and brand loyalty are useful tools of defending against generic drugs competition (Lynch 2006). Generics companies use cost leadership strategy that requires them to develop policies aimed at becoming and remaining the lowest cost producer or distributor in the industry. This strategy involves the firm winning market share by appealing to price-sensitive customers (Pretorius 2008).

In practice, the top generic firms achieve their position by shaving costs off every element of the value chain. A value chain is a chain of activities that all products pass through in order, and at each activity the product gains some value. The chain of activities gives the products more added value than the sum of the independent activity's value (Lynch 2006). Moreover generic drug firms restructure manufacturing and shift production sites to countries offering tax advantages in order to keep the manufacturing costs at minimum.

The big advantage that generic firms have is that they do not have to invest into R&D as their products are basically copies of existing drugs so they do not take such a big risk that is launching new research programs. Moreover generic companies don’t have to advertise as much as R&D firms because they are mainly focused on keeping cost at minimum level. Thanks to high manufacturing and distribution efficiency and also aggressive strategies generic companies became the fastest growing firms within pharmaceutical industry.

Generics are now a major threat for R&D companies. For example, if a company invested a significant amount of resources in developing a new drug but did not secure itself with an extensive patent protection, it might not recover all the capital after the drug comes of patent. Also companies producing generics are using AIDS and other tropical diseases to undermine the patent system in order to enter emerging markets and benefit from huge number of potential customers. Focus, the third generic strategy, involves concentrating on a particular customer or market niche.

The principle of the focus strategy is that the firm is better able to serve its limited segment than competitors serving a broader range of customers. Firms using a focus strategy simply apply a cost-leader or differentiation strategy to a segment of the larger market (Akan et. al. 2006). In pharmaceutical industry all strategic group may apply this strategy. However, this concept is appropriate for small, aggressive businesses that do not have the ability or resources to engage in a nation-wide marketing effort.

Those could be generic companies trading only at national level but through organic growth or acquisition may gain a strong position to trade globally. Both, generic and ethical, pharmaceutical companies consolidate for a number of reasons. Ethical drug companies are merging in order to improve R&D productivity, make it more efficient and benefit from a greater number of individual projects that gives a bigger chance to offset the costs. Moreover it is often the case that companies acquire other firms that will allow them to enter new markets and trade their products globally.

Also small biotech companies are acquired by cash-rich pharmaceutical companies that provide capital to finish off lengthy R&D and themselves gain new promising products. On the other hand generic drug companies integrate vertically taking over their suppliers based in emerging markets in order to control the production cost and keep them at minimum level (Holland & Batiz 2004). During the last decade the competition within the pharmaceutical industry has started to shift from western countries to Asia, South America and partly Africa.

Countries like China, India or Brazil experience booming economies and high birth-rate, allowing big multinational drug companies benefit from entering these markets. Although it is very important these days for pharmaceutical companies to adopt stake holder policy that addresses morals and values in managing an organization (Lynch 2006). In the past pharmaceutical companies were accused of focusing merely on developing blockbuster drugs but not spending enough resources on a cure for tropical diseases or HIV.

Therefore the companies are changing their strategies and supply critical drugs to poor countries on a no-loss, no-profit basis. From strategy perspective the companies implemented Corporate Social Responsibility standards in order to enhance their product liability that is one of the key factors determining success (Meyer 2010). To conclude, the competition within the pharmaceutical industry has changed tremendously over the last half of the century.

The drug companies had to reassess their strategies under the influence of governments imposing very tight regulations and also the presence of new entrants forcing squeezing on margins and developing innovative products. The industry has undergone deep consolidations that resulted big conglomerates capturing vast share of the market. Due to a big economic progress of emerging markets the pharmaceutical companies tend to shift its resources to those countries that have enormous potential for growth.