

Cipla pharmaceutical company business model



**ASSIGN
BUSTER**

INTRODUCTION

This is an essay to identify CIPLA a generic Pharmaceutical companys business model and to explain the reasons why the company has to change its existing business model. This is done by first identifying the term business model and then using the definition to explain the business model adopted by the company, also determining the inherent changes in world policies and economic environment that prompt the change of the present business model. The second part of the essay addresses the issue of the conflict between the big ethical pharmaceutical companies' and the relatively smaller generic pharmaceutical companies' business models. This is addressed by highlighting the big pharmaceutical companies business model and comparing the two models (which will reveal the nature of their competitive relationship) thereby identifying if there seems to be a convergence in their models and they are both becoming competitors in the same market or companies producing the same products but competing in different markets or companies where a symbiotic relationship has become inevitable for their survival in this present economic situation.

“ Conceptualization” of a Business Model.

A definition of a business model is required to highlight the context to which CIPLA's (a generic pharmaceutical company) business model can be identified. Chesbrough and Rosenbloom (2002) describe a business model to be a concept where technology and potentials are changed into economic output through the market and customers, comparatively, Rayport and Jaworski (2001 cited in Wimmer 2004) defined a business model as the four choices of (1) a value proposition or a value cluster for targeted customers

(2) a market space offering which could be products, services, information or all three (3) a unique dependable resource system and (4) a financial model. However Shafer, Smith et al (2005) suggests ' that a representation of a firm's underlying core logic and strategic choices for creating and capturing value' (p. 202); is a design or creation, not an accident; what structures are in place to ensure firms capture value. Also Brink & Holmén (2009, p. 109 cited in Lambert n. d.) explains that ' The business model concerns how a firm creates value, the internal source of the firm's advantage and how the firm will capture value'.

Factually no sole definition can adequately cover all aspects of the term business model; however a combination of all the stated business model definitions will give a better explanation for the Generic pharmaceutical company business model. Firstly the focus will be on the definition of this model since most generic companies including CIPLA initially followed this business model before the need for change in 2005. The focus on India is also due to the fact that CIPLA originated from that country.

The Basic Business Model of ' Generic Pharmaceutical Companies'.

The Generic Pharmaceutical Company (GPC) business model in India is characterised by the production and selling of copy cat pharmaceutical drugs discovered and developed by the Big Ethical Pharmaceutical Companies (BEPC) such as GlaxoSmithKline (GSK), this was achieved through the reverse engineering of the drugs invented by the BEPC and sold at lower costs. This was made possible in India due to the availability of cheap labour in the country and the favourable environment encouraged by the Indian

government at the time, which allowed low restriction on process patents, limited multinational companies having equity share in pharmaceutical companies in India and imposed price ceilings on some bulk and formulation drugs. (Greene 2007)

Financial evaluation of CIPLA's business model

Using the Profit and loss account for 2000-2010, sales turnover steadily increases from 2000-2004 but in 2005 there is a decline of about 10% which can be attributed to the implementation of the WTO law that affected the number of drugs available for replication. This also affected the earnings per share which dropped from about 51 to about 13 in 2005. Investment and debt also showed a steep decline of over 100% from 2004 – 2005; this corresponds to the change in business environment which can infer a reduction of debt incurred for drug production.

However the excise duty showed steady increase from 2000-2005 indicating company focus on domestic market but in 2006 there is a steady decline in excise duties paid and this can be as a result of increased exportation of drugs following a change in business model.

Change in CIPLA's Business Model

The era of this type of business model however draws to an end as various changes in the economic situation and world policy will threaten the very successful model in which the generics pharmaceutical companies in India have been thriving. In 2005 Indian government changed its law concerning patent drugs and fell in line with World Trade Organization (WTO) Trade

Related Intellectual Property Agreement (TRIPs) this limited the production of certain drugs that was filed as a patent from January 1, 1995 (Greene 2007).

Another important point is that the rate at which ethical pharmaceutical companies come up with new blockbuster drugs is declining, as the well known procedure for creating chemicals to treat ailments is not as productive as in times past (Martinez and Goldstein 2007). With a shift of investment from Research and development (R&D) to marketing this trend will continue in the nearest future. This can be as a result of the immense cost to deliver a new drug to the market; costs can range from 802million - 1billion over a period of 10-15 years (Mogalian, Myrdal 2004). Yusuf Hamied (CEO of CIPLA) stated in an interview that it was his belief that since the implementation of the law in 2005 their businesses were at risk of being taken over by multinational drug companies. ‘

Most generic companies in India adapted to this setback in their business model by transferring focus from domestic market in India and increase export of copy cat drugs to Western Europe and the United States, also entering into R&D agreements, mergers and acquisitions of foreign drug companies and developing alliances with foreign pharmaceutical firms. CIPLA however chose a slightly different approach than most generic pharmaceutical companies in India by focusing on organic growth in India and only seldom indulging in strategic business alliances, technological services (such as knowhow transfer, plant supply etc) and in licensing with big pharmaceuticals. CIPLA however increased the exportation of generic drugs to countries like United States and Western Europe.

Some points in CIPLA's corporate presentation in August 2009 highlight the company's focus:

Business model based on international strategic alliances- Business focuses on organic growth and leads to reduced capital commitment and regulatory/litigation risks.

R&D targeted at ensuring efficient utilization of resources and focused at developing and launching niche products.

The graph below shows a steady increase in the value of India's pharmaceutical R&D expenditure from 2001-2006 as a result of a shift in business model.

Exhibit 1

Source: William Greene, US Trade Commission (2007) ' The emergence of India's pharmaceutical industry and implications for the US generic drug market', US Office of Economics Working Paper 2007-05-A

The graph above shows the increase in R&D expenditure in the generics companies in India where they now focus on creating their own branded drugs. This approach was also used by CIPLA to better compete in the changing business environment. They boasted of new drugs like Imidara, Lopimune, Bifilin and many more (CIPLA seventieth annual report 2005-2006)

Business models of Big Ethical Pharmaceutical Companies and rational for changes in the model.

The big pharmaceutical company business model is the traditional pharmaceuticals company business model which comprises of large scale Research and Development departments which discover new drugs for diseases and the sale of those drugs to consumers . This is a rudimentary definition of their business model as it also entails many more components than those mentioned above for instance in recent times we see a shift of emphasis from the research and development to sales and marketing campaigns due to the competitive nature of the environment.

Mogalanan and Myrdal (2004) describe the process of bringing out a new drug to entail the discovery of a new branded drug for which the company has to get approval from the Food and Drug Administration (FDA) by handing in a new drug application containing a report on the drug's efficacy and safety. The document also highlights dosage, strength and dissolvability of the drug. Once approved the company sells the drug exclusively under the brand name for as long as it is under patent protection.

However a new external threat has evolved apart from the usual competition of rival companies in the form of Generics pharmaceutical companies. These companies as mentioned in prior section of the essay have used the process of reverse engineering to create cheaper replicas of the drugs produced by these big pharmaceutical companies and selling the drugs at cheaper costs to consumers. This has been of great profit to the generics companies as they had to indulge in little or no cost consuming research for the development of new drugs in the first place and the availability of low cost of

production was just an added advantage to their business model. Martinez and Goldstein (2007) noted however the treat of the generic pharmaceutical won't be a problem if the big pharmaceutical companies were creating new block buster drugs, but that is not the case.

Exhibit 2: The decline in R&D productivity

Though the industry doubled its investment from 2002 till 2006 in R&D it yielded 43% less than it had in five years during the 1990's of chemical-based drugs. There is a change in the business environment for generic companies in India however with the 2005 adherence to WTO laws. They generics companies are focused on R&D to produce their own patent drugs and generic drugs have become more accepted in Western countries over the years, with the rising costs of healthcare these governments are looking to cut costs and are therefore encouraging the adoption generic drug prescriptions to patients.

Another major factor affecting the big pharmaceutical companies is the problem of expired patents. Companies like Pfizer that had a blockbuster drug called Lipitor a cholesterol lowering drug will be coming off patent in 2010 and this will allow the generics companies to bring in a cheaper replica of the drug which will reduce the sales of the company drastically. Similarly Martinez and Goldstein (2007) explain that the expiration of patent will affect big pharmaceutical profits adversely, where a drug formally grossing 90% - 95% profit under patent protection will fall in profit when its goes off patent and generic companies offer the drug at a reduced price (sometimes the cost

of production). Furthermore drugs meant to be under patent protection for 20years will fail to get to the market before 10years have already elapsed.

*Sales data is from IMS World Review (except for China and Poland)

** Patented/generic split is from ESPICOM. Generic defined as a drug whose patent has expired

***2001 values for China; 2000 values for Poland; 2003 values for Brazil reflects patented/unpatented (unpatented includes branded unpatented, generics, similar)

Sources: IMS; ESPICOM; Factiva; EGA; Mckinsey team Analysis

This development will result in the increased encroachment on the market share of the big pharmaceutical companies, though we can see from the chart that countries like China, Brazil, India and Poland have higher percentage of generic drug usage than US, Japan, Germany, France and UK the problem of the global recession may cause an increase in the use of the generic drugs in these countries as well since developed countries like UK are hoping to cut costs on public expenditure like healthcare costs.

Definition of relationships

Based on these new developments in the business environment of pharmaceuticals companies and my research I begin to recognize a trend where big pharmaceuticals and generics have increasingly instances of working together in order to thrive in the new environment. This aids me in my definition of in tension asked in the question, I identify this as the type of relationship generating between the big pharmaceutical and the generics

<https://assignbuster.com/cipla-pharmaceutical-company-business-model/>

companies and we can see that it is morphing from a completely competitive one to a more competitive-collaborative relationship, where we can even see a convergence in their business models in some cases.

We see the return of big pharmaceutical companies to India after the 2005 law passed by the government protecting their drugs, so they can benefit from the availability of cheap labor and low cost of innovative talent, they are even cooperating with the generics companies for Research and Development, in licensing and use of their distribution lines to transport their drugs to underdeveloped countries formerly catered to by mainly generics companies. Companies such as AstraZeneca, Bristol-Meyers and GlaxoSmithKline have announced their intention to outsource a portion of manufacturing to countries such as India, Eastern Europe and China since they believe it is of the same quality and at a cheaper cost to them (Martinez and Goldstein 2007).

However though we see them working together big ethical pharmaceuticals companies still have some strategies to compete with generics pharmaceutical companies. Some defensive strategies of the big pharmaceutical companies are to develop new generic subsidiaries of their organization so as to be able to better compete with generics companies. By having their own licensed generic companies, they are able to limit the rate at which generics encroach on their market share for drugs that are off patents, they accomplish this by allowing their licensed patents to release generic copies of their blockbuster drugs into the market just before they are off patent thereby gaining market share before the other generic companies release theirs. Novartis CEO Dr. Vasella foresees bountiful opportunities for <https://assignbuster.com/cipla-pharmaceutical-company-business-model/>

quick growth in generics as a result of impressive performance of its generic unit Sandoz which accounted for 20% of its overall revenue and grew about three times as fast as its initial operation (Martinez and Goldstein 2007).

Competitive strategies of the big pharmaceutical companies include investment in biotechnology and diversification. Biotechnology is of great appeal because of the inability for generics companies to create copies of the drugs as of now. Diversification on the other hand will allow the company to expand the range of services it offers its customers and allow it to get alternative sources of income.

CONCLUSION

In conclusion we make-out CIPLA business model to be the production of copycat drugs by reverse engineering of branded drugs and the sale of the generic drugs at cheaper prices to the Indian economy and any other country where the big pharmaceutical drugs do not have patent rights, however a change in the business model became inevitable in 2005 because of the Indian government adoption of WTO laws and caused a shift of the business model of CIPLA to focus more on R&D for the production of its own Branded drugs and strategic alliances which entail cooperation with Big Ethical pharmaceutical companies through in-licensing and know how transfer. Another point to note is the change in relationship between the generic company and the big pharmaceutical where we see a competitive symbiotic relationship brewing, with increased dealings between the two types of firms where big pharmaceutical companies benefit from the cheaper cost of production and access to generic companies distribution pipelines and generics gain from the in licensing agreements where they share profits

with the big pharmaceutical companies. However big pharmaceutical companies still maintain development of competitive strategies to combat the generic companies by creation of their own generic companies and increased investment in both diversification and biotechnology.

Bibliography

Brink, J., Holmén, M. (2009). Capabilities and radical changes of the business models of new bioscience firms: Changing Business Models of New Bioscience Firm., 18(2), 109-120.

Chesbrough, H., Rosebloom R. S. (2002). The role of the business model in capturing value from innovation: evidence from XEROX Corporation's technology spinoff companies. Boston Massachusetts. Harvard Business School.

CIPLA Corporate presentation August 2009

Lambert, S.(n. d.) Business Models available from http://www.audiencedialogue.net/documents/Businessmodels_Lambert_000.pdf (accessed 15 December 2010)

Martinez, B., Goldstein, J. (2007) Big Pharma Faces Grim Prognosis Industry Fails to Find New Drugs to Replace Wonders like Lipitor

Mogalian, E., Myrdal, P. (2004) What's the difference between brand-name and generic prescription drugs? USA. The University of Arizona's College

Rayport, J. F. , Jaworski, B. J. (2001). e-commerce. New York: McGraw - Hill/Irwin.

Shafer, S. M. Smith, J. H. Linder, J. C. (2005) The power of business models. In: business horizons. 48(3), 199-207

William, G. (2007) The Emergence of India's Pharmaceutical Industry and Implications for the U. S. Generic Drug Market . U. S. international trade commission 05-A, 1-36.

Wimmer, M. A. (2004) Knowledge management in electronic governance. 5th ed. IFIP International Working Congress.

(2009) CIPLA Pharmaceuticals' Yusuf Hamied: ' I Am Not Against Patents ... I Am against Monopolies. India Knowledge@Wharton, May 07 available from <http://knowledge.wharton.upenn.edu/india/article.cfm?articleid=4374> (accessed 10 December 2010)