

Japan Is Not (Is) an Attractive Market

Part 1

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At a recent conference in Tokyo I was asked to give a pessimistic perspective of the Japanese healthcare market. I would like to share my presentation with the readers of PHARMA JAPAN, then follow it up with an optimistic perspective in a subsequent article. Perhaps truth is at neither end of this pessimistic/optimistic spectrum, but in reviewing the arguments it may prompt a reality check of your own biases and how they influence your behavior and decision-making in Japan.



Sumitomo results went south, suggesting this is a matter of one plus one equals one half. Mitsubishi and Tanabe announced their intent to merge, but given their respective results this looks more like a rescue of Tanabe by Mitsubishi. Perhaps Mitsubishi will do a better job with Tanabe than they did in rescuing Yoshitomi and Green Cross.

That was last year. If we look at the past five years up to March 2006, the top five companies increased their sales by 23%. The other 25 listed pharma companies increased sales by a mere 7%.

Over a 10-year period from 1994 to 2004 the 20% gain in the Japanese market pales in comparison to the US market which tripled in value, while the global pharma market doubled. Thus, the share of Japan in the global market dropped from 25% to 10% in 10 years.

Looking ahead to the next five years, forecasters say the US market will grow in value by 6 to 8%, Europe 5 to 7%, and Japan an anemic 2 to 3% per year. Add in the so-called BRIC countries which will grow at double digit rates and you have a global market growing far faster than Japan.

In short, Japanese companies are losing share in their home market and consolidation is not reversing the trend. And the Japan pharma market is becoming less significant in the global market.

Anemic Growth in Value

The chart shows sales and growth of the top 10 domestic companies in 2006 as measured by IMS. For reference IMS reported the total market declined by 0.6%.

Top 10 Domestic Companies - 2006

	Company	Sales (billion yen)	Growth % 2005-2006
1	Takeda	461.0	+2.4
2	Astellas	319.4	-7.5
3	Eisai	263.7	+2.4
4	Daiichi	253.2	-3.1
5	Sankyo	246.4	-2.3
6	Dainippon Sumitomo	213.1	-5.8
7	Otsuka	203.4	+1.0
8	Mitsubishi	199.8	+1.5
9	Shionogi	180.4	-5.7
10	Tanabe	173.0	-0.3

Only four of the 10 companies eked out positive growth, and for two of those the growth was marginal. The two with significant growth have eschewed mergers, electing to focus their resources on building up their presence outside Japan without the distractions of a domestic merger.

Most observers would agree the consolidation of Yamanouchi and Fujisawa into Astellas has gone well, but if you are a shareholder looking at the loss of market share in Japan in 2006, you must question the promises of synergies proudly proclaimed when the merger was announced.

Daiichi and Sankyo merged in April of this year, but given the results of last year you must wonder if this is a case of one plus one equals one. The Dainippon

Value Growth Impeded by Price Reductions

The next chart shows NHI drug price reductions since 1965.

NHI Drug Price Revisions Since 1965

Year	% average change in NHI price	Cumulative reduction rate (%)
1965	-11.0	11.0
1967	-10.2	21.2
1969	-5.6	26.8
1970	-3.0	29.8
1972	-3.9	33.7
1974	-3.4	37.1
1975	-1.1	38.2
1978	-5.8	44.0
1981	-18.6	62.6
1983	-4.9	67.5

1984	-16.6	84.1
1985	-6.0	90.1
1986	-5.1	95.2
1988	-10.2	105.4
1989	+2.4*	103.0
1990	-9.2	112.2
1992	-8.1	120.3
1994	-6.6 (-7.4**)	126.9
1996	-6.8 (-8.5**)	133.7
1997	-4.4*	138.1
1998	-9.5 (-9.7**)	147.6
2000	-7.0	154.6
2002	-6.3	160.9
2004	-4.2	165.1
2006	-6.7	171.8

Source: MHLW

* includes consumption tax adjustment

** includes effect of re-pricing of high selling products

A drug introduced in 1965 at a reimbursement price of 100 had a price of 0 by 1986. Over each 20 year period the cumulative reduction rate is 100%. Pharma companies operating in Japan must cope with chronic deflation which impacts on their revenue growth. With price increases a rare event, the only way up the price curve, or the only way to generate positive revenue growth is to introduce a new product at a high reimbursement price.



Value Growth Impeded by Gridlock in the Development and Regulatory Process

This brings us to the problem commonly called the Drug Lag. The reality of a lag is noted every time a new drug is approved in Japan. Here are quotes from this paper announcing the marketing approval of two drugs on April 18, 2007:

“Since the first approval in the EU in 1998, Adoair Diskus has been available in more than 120 countries...”

“Zetia was first launched in Germany in October 2002 followed by the US in the same year. It has been approved in more than 90 countries....”

What is the problem? Three factors:

1. Infrastructure for clinical trials. Clinical trial sites are scattered over many small medical facilities and patient entry is slow and outrageously expensive.

2. Number and quality of reviewers in the PMDA. One could add a PMDA attitude that approving a drug involves a risk, delaying approval involves zero risk.

3. Company policy regarding initiation of Japan trials. If trials in Japan are not started until five years after they are started elsewhere, the drug lag is self inflicted.

Biggest Negative Impact Is on Japan Firms

Upon the April 1 merger of Daiichi Sankyo, Mr Y. Suzuki, GM Domestic Sales & Marketing Division, made the following statement:

“In order to become ‘a global pharma innovator,’ it is essential for us to support our overseas investment with profits from our domestic business.”

Mr Y. Suzuki

GM Domestic Sales & Marketing Division
Daiichi Sankyo

In other words, a favorable or supportive home market and a strong position in that market is a prerequisite for becoming a significant global competitor. As I noted earlier, Japan has not been kind to its own industry for a long time.

Therefore, it is not surprising to note that in the top 20 global companies there are only two Japanese companies: Takeda at #16, and Astellas at #19. Amgen, ranked #13 is bigger than Takeda.

Japan Pharma Companies Are Small Fish in a Big Pond

On April 4, 2007 the market capitalization of Pfizer was US\$183 bil-

lion. The market cap of all Japan’s listed pharma companies, plus listed generic companies, medical device companies, and wholesalers was US\$183.6 billion. Furthermore, the dividend yield of money invested in Pfizer stock is 4.32%, four times the return you get by investing in Japan pharma equities.

The small fish analogy is even more striking in the capitalization of bioventures. The US is at US\$400 billion, Europe at US\$40 billion, and Japan at US\$4 billion. If Japan is going to be a global pharma innovator (Mr. Y. Suzuki’s words), it has a long, long way to go to match the resources available to innovators in the US and Europe.

Japanese Health Care System

Officials in Japan often cite two reasons why they believe their healthcare is the best in the world:

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1. The infant mortality rate is the lowest
2. Life expectancy is the longest.
3. But, note the following:

The infant death rate in Japan per 1000 is 2.8. The US is 6.8. However, the death rate of Afro-American infants is 14, not a figure anyone can be proud of, but the infant death rate for Caucasian infants in the US is lower than Japan at 2.7.

And this quote:

“Japanese American men in Hawaii have a longer life expectancy than men living in Japan”

J. Gerontol 45:206-211, 1990

Finally, there are healthcare negative factors rarely mentioned:

1. Low nurse/bed ratio (1 nurse for 3 beds)
2. Low Doctor/bed ratio (one fifth US level)
3. Small, low-tech hospitals (56% less than 150 beds)
4. Poor standardization of care (lack of peer review)
5. No CME requirement (52% of MDs + 45 years old)
6. Low doctor compensation

Does this sound like an industry and system that will attract Japan's brightest and best young men and women? Or will they follow the money and join Nomura, Morgan Stanley, or Mitsubishi UFJ? The best career in healthcare may be as an accountant.

P. Reed Maurer did not stay in Japan for 37 years because he is pessimistic about the opportunities available to improve the system.
