

Maurer's Healthcare Insight (87)

Japan Is (Is Not) an Attractive Market

Part 2

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In my previous article I outlined a pessimistic perspective of the Japanese healthcare market as presented to a conference late April in Tokyo. This role is usually reserved for Japanese speakers who are always willing to tell a listener how tough it is to do business in Japan. Ask any Japanese executive, "How is business?" and the typical answer is, "Lousy." A most optimistic answer is, "So-so."



This is a useful tactic if foreigners buy into the pessimism and elect to stay out of Japan. That is, license out their assets to Japanese companies who quietly make a lot of money. The "tough market to crack" perception also serves the best interests of consultants who provide expensive advice on how to get into Japan.

What follows is a rebuttal of the arguments put forth to support the premise that Japan is not an attractive market. Companies who forfeit the Japan market risk doing battle with Japanese competitors who use profits from an uncontested home base to fund international expansion. Think of Toyota versus GM as a prime example.

Robust Volume Growth

Japan and the US are an interesting contrast because of quite opposite factors impacting on market growth. In value terms the Japan market is in a deflationary spiral because of a long history of reimbursement price cuts, while the US market is inflated by aggressive price increases. Which is better?

If we look at the picture at the end of the patent life for a drug, price increases in the US create a price umbrella under which low cost generics can reduce the value of the original drug drastically within months of patent expiration. This "falling off a cliff" phenomenon is an ever present threat to company P&L's, particularly when blockbuster products are involved.

Ethical Market Growth

	1991-1995	1996-2000	2001-2004
Japan wholesalers' price basis	+5%	+1.3%	+2.9%
Price	-1.8%	-4.0%	-2.2%
Volume	+6.9%	+5.5%	+5.2%
US wholesalers' price basis	+9.7%	+14.7%	+8.9%
Price	+3.8%	+3.1%	+4.0%
Volume	+5.9%	+11.6%	+4.7%

However, because prices are reduced in Japan during exclusivity, a price umbrella hardly exists when generics enter the market, and are priced at 70% of the original drugs' reimbursement price. This means original products in Japan have a "long tail," do not fall off a cliff, and continue to contribute revenue and income to the originator long after the patent expires.

In terms of quantity, the Japanese market is growing at about 6 percent per annum, in fact faster than the US as seen on the chart. The main driver behind this growth is aging of the population which will continue into the future. And, as noted above, the growth is not coming from generic manufacturers as their market share of volume is about 17% at best.

The Market Is Big, and Cannot Be Ignored

While Japan's share of the global pharma market has declined, it remains the second largest single market after the US. It is bigger than all of the rest of Asia, Africa, and Australia/New Zealand combined. It is about three times the size of Latin America.

Yes, the market in China is expanding by 15% to 20% per year, but consider:

1. The Japanese economy in nominal terms is currently twice the size of the economy of China.
2. If you get on top of the highest building in Tokyo on a clear day, what you can see represents a pharma market as large as what exists in all of China.
3. The per capita GDP of Japan in 2004 was US\$36,500 while in China it was US\$1,083, and Japan spent 8% of its GDP on healthcare.

So, the next time someone suggests flying over Japan to go to China think of the lost opportunity cost.

You cannot ignore Japan for another reason. It is the source of new drugs, along with the US and Europe. China and India may be low cost centers for drug development, but not for drug discovery. You can also count on strong protection for intellectual property in Japan, and regardless of the patent status, new drugs are now receiving an eight-year period of exclusivity.

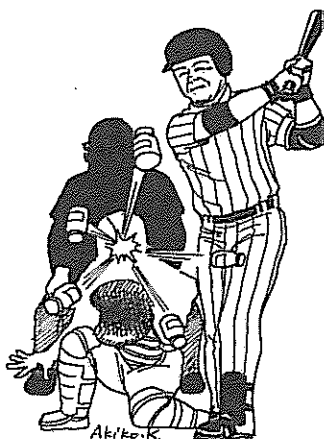
The Drug Lag will Be Eliminated

Important to remember that during the 1980s and early 1990s the MHLW was approving more drugs faster than the FDA. Then these positions were reversed as the FDA implemented newly introduced user fees to hire additional reviewers and significantly reduced the review time. Meanwhile, in Japan the ministry went through a series of reorganizations, the clinical trial system was changed from top to bottom, and companies

initiated their clinical trials in countries where the cost was lower, patient entry was faster, and the control systems were more sophisticated, thus delaying development in Japan.

If you live in Japan you are witness to a process of consensus whereby everyone will agree the system must be fixed. Every week this publication reports on various proposals to eliminate the drug lag and as important, reward innovation by stopping the deflationary effects of price revisions.

Building a consensus is a messy, time consuming process, but once achieved the Japanese will run you over. Many observers now believe the system will be fixed - it is only a matter of time. Meanwhile, the FDA appears to be moving in the opposite direction as noted by the number of "Approvable Letters" issued, and their heavy handed approach to drug safety issues. Ideally, it would benefit everyone if the PMDA, FDA, and EMEA would get on the same page regarding data requirements.



Pharmaceutical Production

1975	¥1,792.4 billion
2004	¥6,525.3 billion

Recent slowdown but long-term growth

R&D Expenditures of the Pharma Industry

1975	¥95.2 billion
2005	¥1,047.7 billion

R&D expenditures as a percentage of sales increased from 4.91% to 10.01% during this time frame.

Number of Bio-Technology Patents Published in Japan by Country of Origin

	1997	2005
Japan	671	2,138
US	721	1,683

Japan lagged, but then exceeded the US in both 2004 and 2005.

Mortality Rate in Males of Selected Causes in 2001

(per 100,000 population)	US	Japan
Diabetes	22.9	9.0
Hypertensive Disease	13.0	5.8
Heart Diseases	241.0	116.6

National Health Care Expenditures

1975	¥6,478 billion
2004	¥32,111 billion

Number of Medical Care Personnel per 100,000 Population

	Physicians	Nurses
1970	114	261
2004	212	898

In Short

Japan is a rich country with a GDP per capita in 2004 of US\$36,500 versus the EU at US\$31,700, and the US at US\$39,700. All of its citizens are entitled to National Health Insurance, National Pension for people aged 65 or older, Long Term Care Insurance for people 65 or older and the disabled in need of care. It has a long history of rewarding innovation versus old technology (generics). It does not restrict access to healthcare or drugs. Its aging population will drive growth in the healthcare sector and its people will demand the best the world has to offer. Japan's door is open to those who do not believe the market is tough to crack.

P. Reed Maurer is willing to listen to pessimists but not act on their advice.

Changes Abound in the Corporate Arena

Ten years ago the following did not exist or were not allowed in Japan

- * Holding companies, including financial holding companies
- * Share buybacks
- * Treasury stock
- * Corporate stock swaps
- * Stock options
- * Consolidated taxation
- * Committee-system ("US style") corporate boards

Following has become easier:

- * Corporate spin-offs
- * M&A/takeovers
- * Corporate reorganization/bankruptcy
- * Appealing to concept of "shareholder value"

Positive Aspects of the Healthcare System and Industry

Number of Pharmaceutical Approvals Granted in Japan

1975	921
2005	1,267

Up and down over the years, but basically steady year to year.

Number of Pharmaceuticals Included in the NHI Price List

1975	13,389
2005	13,311

Products come and go, but no attempt is made to restrict the number of drugs available.