

Maurer's Healthcare Insight (110)

## I Am Losing It

P. Reed Maurer

At one time during my tenure in Japan I had direct or indirect responsibility for over 4,000 people in seven separate organizations. It was the best of times as we launched new products, introduced innovative promotion and training programs, closed joint ventures, licensed in what turned out to be great drugs, and built new manufacturing and research facilities.



It was a time of great change which caused stress and pain in the organization. Some people believed we were moving too fast and making mistakes in the process. They wanted us to slow down. Others flat out objected to the changes and took every opportunity to find fault. Then there were those who enjoyed the ride and blossomed in the fresh air that change brings to an organization.

Whenever enthusiasm waned in the latter group my three words of advice were KEEP THE FAITH. That is, believe in what you are doing and why you are doing it. Do not waver in your commitment. Do not let the naysayers create doubt or uncertainty. The train is leaving the station. Get aboard or stay behind.

This philosophy is still alive and well in the work we do. But as a writer of this article I am a mere observer rather than a leader. As an observer of certain trends in the pharma industry I am losing faith. Is the industry failing to cope with change? To be specific let me cite a few examples.

### Wholesalers

Financial results of the top four wholesalers for FY ending March, 2009 were miserable. The operating profit rate averaged 0.58%. Sales increased, but that had more to do with the consolidation of acquired subsidiaries than new business. Allowances and rebates were down, causing wholesalers to accuse manufacturers of setting unrealistic invoice prices.

I once had faith wholesalers could effectively reduce discounts (*yakkasa*). Sadly this is not the case as they fight for market share in hospital and chain pharmacies with a single weapon, i.e. price. Since this does not increase demand it is a zero sum game.

Wholesalers look outside rather than inside for relief. Manufacturers should lower their invoice prices. Pharmacists should lower their discount expectations.

These are nonstarters for reasons any 16 year old can understand.

It is easy to blame bad results on outsiders, but tough to look inside. To change established practices that no longer work.

Take the role of MS. Wholesalers say they must charge manufacturers for services provided by MS. Once again, an outside solution versus looking inside to determine what services manufactures are willing to buy. In

my view there are only two; the ability to create demand or shift demand. These services justify fees or increased allowances.

I once had faith wholesaler consolidation would lower distribution costs and reduce SGA expenses. Sadly, this does not seem to be the case as the ratio of these costs is only slightly below the gross profit ratio. Manufacturers have zero motivation to lower invoice prices to raise gross margins if the internal cost structure of wholesalers is out of whack. In short, too many people provide too many unproductive services.

Wholesalers are not going to disappear. But an eight percent gross margin to provide no other value added services except physical distribution and billing is sure to attract competition from delivery services that do very well thank you on less than eight percent. This threat may expedite a re-think of the cost structure in the present business model.

Another example is the attitude of wholesalers toward generics. Not hard to understand why wholesalers shun generics. Just follow the money. There is less revenue and less profit in a generic versus its original equivalent. Second, wholesalers are loath to antagonize their pharma friends with whom they have had close relationships for a very long time.

So, do you forfeit the generic business to *hansha* or generic drug dealers, or do you find a way, possibly through a separate operating division, to lower your cost structure to make a reasonable profit and satisfy customers who want generics? Hard to have faith wholesalers will not forfeit the business.

### US Pharma Market

Medco Health Solutions of the US filled 586 million prescriptions in 2008 for their 60 million covered members. Amazing to note 64% of all prescriptions

dispensed were for generics. I remember well when Medco first started it struggled to get client companies to buy into their drug benefit program. Also recall when generics were a non-issue. Talk about change!

Having spent 22 years of my working life in Lilly and Merck, my faith was unshakable in the innovative power of the pharma industry to discover new drugs that were more effective and safer than older drugs. My mother took reserpine for hypertension. Does anyone alive today take reserpine?

Medco says over US\$66.0 billion in annualized sales will lose patent protection and face generic competition over the next five years. Credit generics for lowering costs for patients taking these drugs. But where are the new, patented drugs to replace these older drugs? My hypertension is well controlled with drugs far removed from reserpine, but where is a cure?

I believe it is wonderful to have a vibrant generic drug industry producing drugs of the highest quality at reasonable prices. But why are Pfizer and Glaxo spending money to buy generic companies? Why is Merck going into bio-similars instead of bio-origins? Why is Daiichi Sankyo pouring billions of yen into a generic company when it has such a good track record discovering new drugs?

Does anyone know how to measure "real" drug

prices in the US given the variety of drug benefit programs? I do know when I was getting my meds in Hawaii the price went up every six months when I went for refills. Not hard to figure out why the public image of drug companies is ranked at the same level as tobacco companies and lawyers.



### Keep the Faith

At the June 4 Study Group meeting I run for the benefit of foreign pharma company presidents our speaker discussed lessons of leadership and talent development he learned from Zulu tribes in Africa. There was much to digest from this presentation, but one fact stuck in my mind. A Zulu chief derives his status and respect not from money or the use of force. Rather it springs from a deep sense of humility.

Through meeting many senior executives in our industry it has been my pleasure to know men and women with humility. You know it when you see it. The people I met who were arrogant did not last long, and if they did their companies suffered under their watch. Through experience I know there are many more of the former. Not a bad thought to keep in mind when you begin to lose faith.

*P. Reed Maurer appreciates faithful readers of his articles.*