Thin pickings in dietary supplements

Consumers around the world may be demanding more and more dietary supplements but this does not mean the business prospects are necessarily good for pharmaceutical companies. Jean-Michel Peny analyses the market.

Although the synergies between dietary supplements (see box on page 38) and ethical medicines are not entirely obvious, the pharmaceutical industry is certainly taking note of the current consumer appetite for anything that enhances their well-being.

Some of the more diversified healthcare companies such as American Home Products, Warner-Lambert and SmithKline Beecham are actually making moves, capitalising on their over-the-counter (OTC) franchises to build significant businesses in this area. While other players, despite also having a significant OTC commitment, remain hesitant. An analysis of the current market situation should help them decide if they want to play in this particular market.

In 1998, the global dietary supplements market was estimated to be worth US$14 billion at manufacturers' selling prices. This was around one-third of the total OTC market but its annual growth was slightly higher at 8% vs 7% for the latter. Another feature is that it is dominated by Japan which, in the same year, accounted for 46% of sales in value. This was followed by the US with a 29% share, Germany (4%), UK (3%), France and Italy (2% each) and Spain 1% (see Figure 1).

There are five basic factors that are shaping the future of this market. The first is the state of the world economy and how this impacts on personal consumption. Annual growth rates in GDP for the 1998-2003 period are expected to be around 3.5%, similar to that observed from 1993-1998. Although positive, such rates are not thought to be capable of generating a significant increase in consumer expenditure.

The second major influence on the market is governed by the national authorities. The absence of a specific status for dietary supplements, for example, hampers their acceptance by the general public, as does the inability of manufacturers in most countries to communicate the properties of their products.

How much can be said about a product varies from country to country. In the US, the Dietary Supplement Health and Education Act (DSHEA) of 1994 states that a company can make a claim regarding a food or dietary supplement's ability to affect the structure or function of the body, the well-being it can provide and its mechanism of action. However, no statement related to disease can be made. The situation is not so clear elsewhere. In countries such as Japan, UK and Italy 'light' health claims are tolerated, for example, but not in Germany, France and Spain.

As the market expands, more regulations are being introduced to guarantee better quality products and more ethical business practices. In the herbal category, for example, the US Pharmacopeia (USP) is developing monographs on 90% of the herbal products marketed in the US in an effort to standardise their quality. Similarly, in Europe, the European Commission and the European Medicines Evaluation Agency (EMEA) have established a working group to develop guidelines to assess

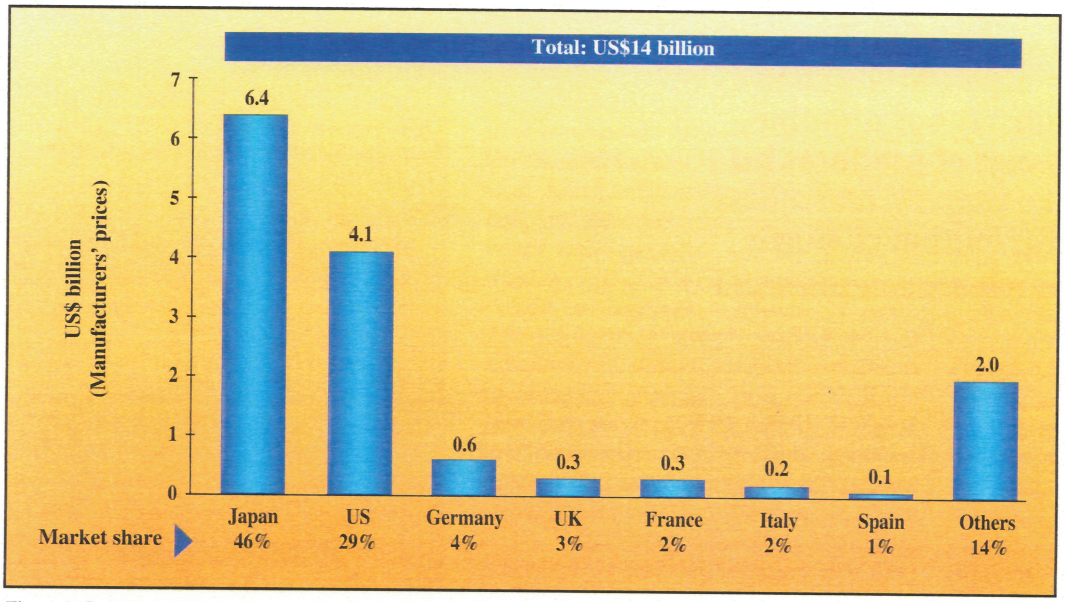

Figure 1: Structure of the dietary supplement market in 1998.
Source: ISO Health Care Group estimates adapted from Euromonitor 1998.

the quality, safety and efficacy of these products.

In the absence of clear regulations, business practices can be, at best, dubious. Cases of dietary supplements that contain lower amounts of active ingredients than indicated, for example, are not exceptional. False or misleading claims are also frequent. Because such practices damage the credibility of the market and because authorities are keen to promote disease prevention in an attempt to contain healthcare costs, there are moves to track offences more systematically, particularly those committed on the Web, and to invest money establishing whether such products actually work. The US National Institutes of Health, for example, invested US$4.3 million in 1997 to conduct clinical trials on St John's Wort.

The third driving force of this market is the nature of the competitive environment which is extremely fragmented. There are not only different regulatory requirements in the various countries, but multiple categories of products led by niche players and a host of distribution channels. Apart from marketing companies such as Herbalife and Amway, only Roche, Novartis and American Home Products have a substantial presence in more than two countries.

It is within countries that one gets a better picture of what is going on. The US market is dominated by three speciality companies – General Nutrition Companies, recently acquired by the Dutch group Numico; Pharmavite; and Rexall Sundown. These companies are particularly strong in herbal supplements where, except for Pharmaton, owned by Boehringer Ingelheim, the multinationals have been weak. However, in 1998, American Home Products and Bayer decided to enter the herbal supplements market through extensions of their well-recognised vitamin and mineral brands, Centrum and Once-A-Day respectively. And shortly afterwards, Warner-Lambert introduced its Quanterra line. These companies have already started to explore possible launches of their herbal supplements in Europe.

Among the Japanese market leaders – Otsuka, Taisho and Takeda – only Otsuka has an overseas business, in the US through its subsidiary Pharmavite. The UK market is largely dominated by multinationals Merck KGaA and Roche whose respective umbrella brands, Seven Seas and Sanatogen, had a combined market share estimated at 42% in 1998.

Photograph by Oscar Burriel/Science Photo Library

As vitamin pills become part of the daily diet, the supplements market can seem deceptively attractive.

In Germany, SmithKline Beecham and Klosterfrau are the leading manufacturers, followed by Strathmann, Novartis and Lichtwer. Klosterfrau and Strathmann concentrate their activity locally while Lichtwer has developed activities in the US and UK where it markets its two popular brands Kwai (garlic) and Kira (St John's Wort). The French-based company, Arkopharma, leader in its domestic market, has some modest operations in other European markets.

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For some time now, the market has been consolidating and this trend looks set to continue. In 1996, Merck KGaA bought Seven Seas (UK) and the following year, Roche acquired Rhône-Poulenc Rorer's European dietary supplements line. American Home Products reinforced its international presence by acquiring US company Solgar in 1998 which is represented in 35 countries. And Arkopharma consolidated its US presence by taking over Oakmont, a small company concentrating on essential fatty acids, earlier this year.

All the major markets also have small or medium-sized companies with well-known brands. But these are often not strong enough to withstand the levels of promotional spending that are now required. Lichtwer, for example, budgeted to spend US$15 million advertising Kwai in the US in 1999.

More significant competition comes from the development of private labels. In the UK, 40% of dietary supplements are sold under private labels. In the US, the figure is 25% but may increase to 60% in categories such as single vitamins. In the other countries, private labels are virtually non-existent with a less than 2% market share. But this may well change with the evolution in distribution channels that is currently ongoing in the various markets.

Distribution is the fourth factor impacting on the dietary supplements market. In the US, health food stores are the most important distribution channel for dietary supplements with a 30% market share. In Europe, pharmacies dominate distribution with a market share of 40% in the UK and Germany, 60% in France, 70% in Italy and 80% in Spain. In Japan, pharmacies have a 50% market share.

Two important changes can be observed. First, there is a general trend towards consolidating the different distribution channels in all the major countries. Even in Germany, France, Italy and Spain, where pharmacy chains are not permitted, pharmacists are entering into buying groups to negotiate better prices from suppliers. Where chains have been able to develop, the profitability of manufacturers has also gone down. Distributor chains are also launching private labels to directly compete with manufacturers' brands. In the UK, for example, the 1,230 Boots pharmacy outlets control 32% of all supplement sales, offering original brands at attractive prices and their own labels at even lower ones.

Secondly, distribution is shifting from speciality retailers like pharmacies or health food stores to mass market outlets such as drugstores and supermarkets. In mature markets like the US and the UK, 40-50% of dietary supplements are sold in this way. Well-established stores such as Kroger or Safeway in the US, and Tesco or Sainsbury in the UK not only sell dietary supplements at competitive prices, but also provide good services from their in-store pharmacies. US discounters Wall-Mart and K-Mart are also developing this line of business which offer much more profitable margins than conventional grocery items.

In countries where pharmacy chains are not allowed, stores such as Carrefour in France and El Corte Ingles in Spain have opened health corners or 'parapharmacies' that offer a large array of supplements. The German discount supermarket Aldi is also developing its supplements business and in 1998, sold US$50 million worth of its own-label dietary supplements. And grocery stores will push supplement sales by positioning them by their fresh products, thus promoting the 'whole health concept'.

These mass market outlets offer consumers a broad choice of branded products, cheaper alternatives from the private labels plus the convenience of one-stop shopping. The dietary supplements market is therefore growing rapidly. Simultaneously, the consolidation of distribution and the increasing importance of private labels in certain markets are squeezing manufacturers' prices and margins.

The fifth factor impacting on the market is the current fashion for staying fit. Irrespective of age, people are taking much greater control of their health than they did in the past. This can be achieved through a healthy lifestyle which increasingly includes the use of dietary supplements.

Demand varies from market to market. In the US, 75% of the population claims to regularly use vitamins and 30% to use herbal supplements. Among the latter, ginkgo biloba (memory enhancer) St John's Wort (anti-depressant), ginseng (psychostimulant) and garlic (cholesterol reducer) are the most popular. In the UK, fish oils and γ-linolenic acids are the most popular products after vitamins. Tonics and nutritive drinks are the leading categories in Japan and France with 46% and 22% market shares respectively. In Germany tonics and 'melissengeiste' (cure-all) comprise the top categories. Lecithin consumption is relatively important in Italy as evening primrose oil is in Spain.

To fulfil consumer demand for more effective products, complex formulations of vitamins, minerals and other supplements are being marketed. For example, US company Nature's Bounty introduced a product in 1998, Radiance, that combines green tea extract, garlic and ginseng with vitamins and minerals. Similarly, Seven Seas, the leading UK player, recently launched Advanced Formula Multibionta which combines vitamins, minerals and, for the first time, probiotic nutrients, to combat stress.

Consumers are also looking for more specific products, adapted to well-defined pathological conditions and population groups. The market has responded with multivitamins, for example, that are marketed for men, for women, for pregnant women and people recovering from illness.

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But after several scandals, consumers and the medical community also want guarantees about the efficacy, safety and quality of supplements. As a result, Centrum Herbals from American Home Products are claimed to be 'bioactively standardised' and Warner-Lambert's Quanterra line of herbals to be 'clinically proven by doctors'. But these efforts are unlikely to be sufficient to create a sustainable brand preference as the market is one where brands are hard to secure and product advantages easy to duplicate.

Market opportunities

From 1998 to 2003, the impact of price decreases resulting from distributor pressure should be outweighed by volume increase as dietary supplements become more widely accepted. As such, the market is expected to grow at an average rate of 6% a year, a slight decrease on the 7% growth during the 1994-1998 period and faster than the OTC market, forecast at 5%. Within this, the more established vitamins and mineral categories should grow by 3.8% while other supplement categories by 5.9% on average per year.

Pharma companies tempted to enter the market should realise that its attractiveness and the key success factors vary substantially between the different countries. The US, Italy and the UK, for example, are expected to show double-digit compound annual growth rates over the 1998-2003 period while the Japanese, German, French and Spanish markets are likely to remain stable over the same period.

Because of the different country characteristics, it is possible to define three market models as shown in Figure 3 on page 40. These are the mass market model to be found in the US and the UK, the speciality market model to be found in France, Spain and Italy, and the hybrid market model in Japan and Germany.

In 'mass market' countries, competition is intensifying because of distribution consolidation and the growth of private labels. Indeed, in the US and the UK, the market

What are dietary supplements?

In the absence of an official definition that is accepted across the different national markets, it is necessary to propose a working definition that takes into account the reality of the current business situation. Thus, the following categories that are not registered as drugs but are known for their bioactive properties could be considered as dietary supplements:

- •Vitamins.
- •Minerals.
- •Metabolic factors (eg, α-lipoic acid, coenzyme Q10).
- •Essential oils (eg, evening primrose oil, fish oils).
- •Herbal products (eg, ginseng, ginkgo biloba, garlic, St John's Wort).
- •Other natural products (eg, royal jelly or fish cartilage).

In most countries, vitamins and minerals are either considered as an OTC drug or a dietary supplement, depending on their dosage. Similarly, a given herbal supplement may be registered as a drug (either OTC or semi-ethical) in a country and considered as a foodstuff in another. This is the case, for example, of the popular St John's Wort which is a reimbursable drug in Germany and a dietary supplement in the US.

Dietary supplements are generally marketed under pharmaceutical dosage forms like syrups, powders, tablets, capsules, soft gels that are packed in bottles or blisters. When added to food, they are known as nutraceuticals or functional foods.

Key driving forces	Mass market model US - UK	Speciality market model France - Italy - Spain	Hybrid market model Japan - Germany
Economic context	•GDP growth: 2.5% a year during the 1998-2003 period	•GDP growth: 2.5-3.0% a year during the 1998-2003 period	•GDP growth: 2.0-2.5% a year during the 1998-2003 period
Authorities	•Health claims authorised under specific rules (US) or tolerated but illegal (UK)	•Health claims prohibited but tolerated by Italian authorities	•Health claims authorised under specific rules (Japan) but prohibited in Germany
Competitors	•Fierce competition from distributors' private labels •Increasing competition from multinational pharma companies •Products highly advertised	•Non-significant competition from private labels •Stable competitive structure •Products moderately advertised	•Non-significant competition from private labels •Market strongly dominated by local companies in Japan •Products highly advertised
Distributors	•Increasing importance of mass market channels (40-50%) at the expense of speciality retailers •High pressure on manufacturers' selling price	•More than 60% of dietary supplements sold through independent pharmacies •Moderate pressure on manufacturers' selling price	•Decreasing importance of pharmacy channel (40-50%) benefiting mass market retailers •Moderately high pressure on manufacturers' selling price
Consumers	•Strong demand from consumers for products that help them maintain their wellness •Low brand loyalty	•Moderate but increasing awareness and acceptance of dietary supplements •High brand loyalty	•Strong demand from consumers for products that help them maintain their wellness •High brand loyalty

Figure 3: The dietary supplements market can be sub-divided into various models according to the situations prevailing in the various countries. Source: ISO Health Care Group.

has become as competitive as that of fast-moving consumer goods. The private labels of Wall-Mart or GNC in the US and Boots or Tesco in the UK are now held in such high regard that the promotional investment to establish a new brand or product line is similar to that of the OTC market generally but with a much lower chance of success.

Moreover, product 'innovations' are generally not patentable and therefore easy to replicate. And the acquisition of an existing company or product line can seem riskier than starting from scratch. Minimum investments to maintain sales will become higher and higher and average market profitability will shrink. Only a handful of large companies with a portfolio of household names, regularly enriched with the introduction of new products, should be able to generate sustainable but limited profits.

In 'speciality market' countries, the environment is relatively better for newcomers. Independent pharmacists largely control distribution but they allow more comfortable margins than those permitted by distribution chains. Private labels do not seriously challenge the original brands and leading players manage to obtain operational margins of around 10-12%.

There is also a slight shift towards mass market distribution but this is slow and should not significantly change the market structure in the next four to five years. France, Spain and Italy, which all belong to this market model, may offer a window of opportunity for pharma companies. Those with OTC activity in these markets could complete their existing product range with a supplements line.

The most appropriate approach would be the acquisition of, or preferably an alliance with, a dietary supplements manufacturer who has a strong herbal line and is well established in pharmacy distribution. Companies such as Plantes & Médecines (Pierre Fabre) in France, Body Spring or Aboca in Italy, La Leonesa in Spain or Arkopharma in all three countries fulfil these characteristics.

The 'hybrid market' model that includes Germany and Japan is highly competitive with little prospect of growth and therefore not particularly attractive to pharma companies. Distribution has already started to shift from pharmacy to mass market channels. Brands are supported by heavy advertising and promotional campaigns to secure consumer loyalty. Consequently, private labels are still marginal but are expected to reach 5% to 8% market shares by 2003. As consumers tend to be loyal to existing brands, any new entrant should be prepared to invest heavily but with little guarantee of success.

Acquisitions or alliances should be considered as a preferred way in to these markets. In Germany, local companies such as Klosterfrau, Strathmann or Lichtwer enjoy good competitive positions in tonics and herbal supplements and could be attractive targets. In Japan, joint ventures or licensing agreements are the most common mode of entry. Roche entered into a joint venture with Taisho in 1997, for example, to market a range of vitamins under the umbrella brand Sanatogen.

On a country-by-country basis, opportunities may exist for pharma companies already involved in the OTC business. However, these opportunities should be considered as an extension of an existing OTC portfolio.

In itself, the dietary supplements market is less attractive on a global basis than the OTC market. It is moving, at different speeds according to the country, from a branded speciality market to a commodity mass market. Consumers are increasingly purchasing dietary supplements on a regular basis and it is probable that in four to five years, the market will be dominated by distributors' private labels and the food companies. Indeed, General Mills, Kellogg, Nabisco, Nutricia and Danone are already making inroads and indeed, are better positioned than pharmaceutical companies to succeed because of their long experience in the mass market and more powerful negotiating power vis-à-vis the distributors. The pharmaceutical industry may then realise, once more, how attractive its R&D-based activity is compared to other sectors, and that it is perhaps the best market to play in. SM

•Jean-Michel Peny is vice-president of the international consulting firm, ISO Health Care Group, and a lecturer at the HEC and ESCP business schools in France.