Winning strategies in the French hospital market

Jean-Michel Peny and Sandrine Barrelet examine the French hospital market and outline some strategies for success in this increasingly competitive environment.

What does the future hold for pharmaceutical companies in the French hospital market and what strategies should they employ to improve, or at least maintain, their position in this increasingly competitive sector?

The plans announced by the French government in November 1995 to restructure the social security system and reduce healthcare expenditure placed special emphasis on curbing hospital costs. The increased pressure this will bring to bear on hospital drug prices will lead to more intense competition between pharmaceutical companies, resulting, inevitably, in a fall in profit margins. In this context pharmaceutical companies need to review their strategic objectives, and their approach, to remain competitive and profitable in this market.

Market environment

Since the government introduced a global budget in the 1980s, growth in hospital expenditure in France has slowed considerably. Nevertheless, in 1995 public and private hospitals still accounted for 49.5% of healthcare expenditures and 57.2% of total reimbursement spending by the social security health insurance. Further analysis shows that employment costs account for around 70% of total spending on hospitals. However, for social and political reasons, the French authorities have not yet proposed any cost reduction programmes targetting hospital employment levels, nor are they likely to in the near future. Hospital medical goods are the second most important item of expenditure, accounting for 13% of the total. Hospital drugs represent 46% of medical goods spending (ie 6% of total spending).

So far, the main efforts to contain hospital costs have been focused on medical goods. The hospital drug market has thus become more and more price-sensitive as hospital pharmacists, who are responsible for drug purchasing, have come under increasing pressure. In competitive therapeutic areas, where the presence of me-too products or generics considerably reduces product uniqueness, the level of price discount may be very high – around 60% for example, for low molecular weight heparins and certain third-generation cephalosporins. In addition, small and medium hospitals are tending to join with large regional hospitals for the purchase of high-volume drugs, while private hospitals are strengthening their negotiating powers with the pharmaceutical industry by creating purchasing groups such as CAHP, CACIC or Club H.

The hospital drug market is likely to be further affected by the hospital reforms recently proposed by the French Prime Minister and by the competitive changes that will follow. Meanwhile, a number of new market constraints have emerged. These include:

- The reduction of annual budget growth limits for public hospitals from 5.2% in 1993 to 3.4% in 1994, 3.1% in 1995 and 2.1% in 1996.
- A decrease in the National Quantified Objective (OQN) which sets the annual growth for private hospital expenditures reimbursed by social security health insurance. This fell from 3.5% in 1994 to 3.1% in 1995 and 1.9% in 1996.
- The increasing cost-consciousness of hospital pharmacists in charge of drug purchasing.
- The growing involvement of hospital financial directors in drug purchasing decisions.
- The introduction of new generic products.
- Increasing price competition in the more

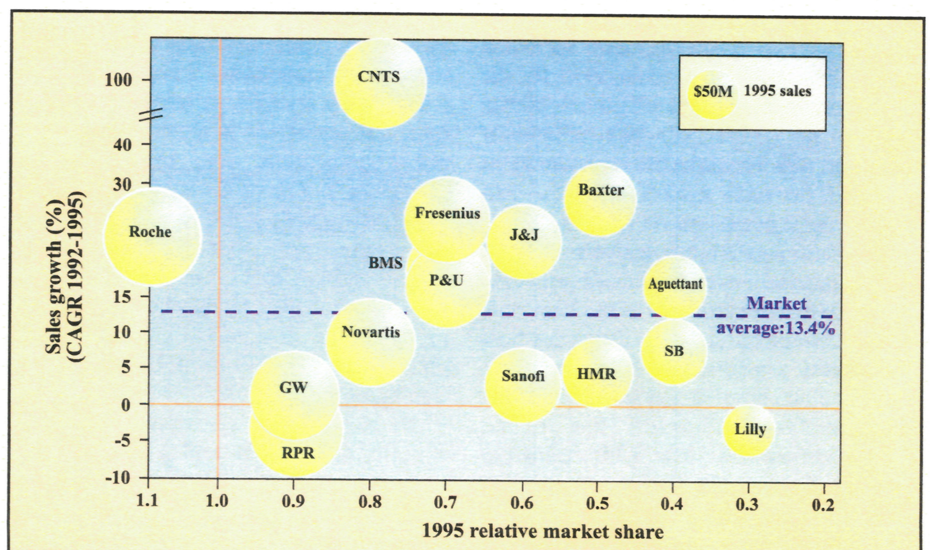

Figure 1: For individual companies, sales growth in the French hospital market is independent of relative market share. Instead, growth is largely driven by innovative products. Source: LMH-IMS, TOP CIP, AT Kearney.

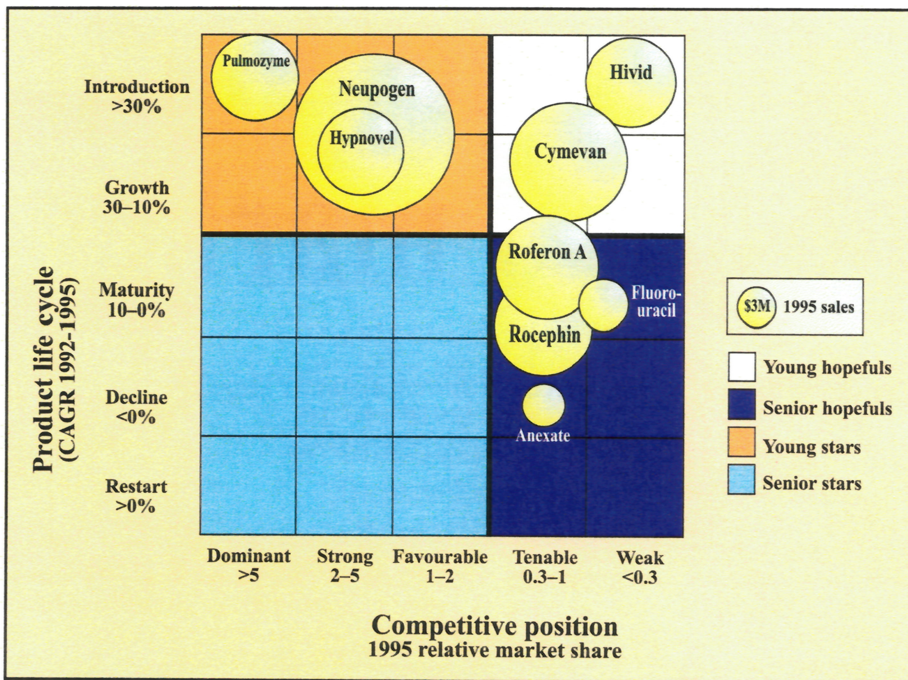

Figure 2: A matrix representation of Roche's product portfolio, based on the competitive positions and life-cycle status of individual products. Source: LMH-IMS, AT Kearney.

crowded therapeutic categories such as antibiotics.

•A more systematic use of drugs for which hospital prescriptions generate large sales on the retail market through prescription renewal (eg antihypertensives, insulins).

Market opportunities

Of the US$17 billion of pharmaceutical products sold in France in 1995, sales to hospitals accounted for US$1.8 billion compared with US$1.4 billion in 1992. The compound annual growth rate (CAGR) for the period 1992-1995 was 8% for the hospital market and 6% for the retail market. Market growth in the hospital sector is mainly driven by the introduction of innovative drugs whose market share increased from 7% in 1992 to 11% in 1995. In the current environment, annual growth for the sector in the period 1995-2000 is unlikely to exceed 6%. Nevertheless, this compares well with the retail market where the estimated annual growth rate is 4%.

Based on profitability analysis it is possible to segment the hospital drug market into three distinct product categories:

•Generics (eg erythromycin Dakota) whose profitability expressed in terms of PBIT (profit before interest and taxes) currently averages 15%.

•Commodities with 30% PBIT, defined as basic products competing with therapeutic equivalents belonging to the same class (eg the calcium channel blockers Loxen and Amlor), or to different classes (eg the antibiotics Augmentin and Claforan).

•Innovative products with 60% PBIT which represent therapeutic breakthroughs (eg Neupogen) or me-too products offering a significant therapeutic advantage (eg Fortum versus the other third-generation cephalosporins).

Currently, therefore, the profitability of innovative products is on average twice as high as that of commodities and four times that of generics. However, by 2000 the profitability of generics, commodities and innovative products is likely to be reduced to 10%, 15% and 50% respectively and there will also be changes in sales value in the three categories. As a result of increasing price competition, sales of commodities are likely to decrease by 21% (CAGR 1995-2000) whereas sales of generics are estimated to grow at 5%, slightly below the overall market trend. On the other hand, sales of innovative products, which are less prone to the deleterious effects of price cutting, are likely to grow by 20% a year during the same period.

> **"By 2000...more than 90% of the profits generated on the hospital drug market are likely to come from innovative products"**

By 2000, sales of innovative products are expected to represent around 75% of a hospital market expected to be worth around US$2.4 billion, while those of generics and commodities are unlikely to exceed 19% and 6% respectively. Moreover, more than 90% of the profits generated on the hospital drug market are likely to come from innovative products compared with 70% in 1995.

In short, by the end of the century the generic and commodity segments will have been hard hit by fierce price competition and will be barely profitable – the only segment likely to remain attractive is the innovative one.

Products and growth

For individual companies, sales growth is independent of relative market share, as can be seen from Figure 1.

Corporate growth in the sector is mainly driven by recently introduced innovative products such as Neupogen (Roche) and Taxol (Bristol-Myers Squibb), or older products that are still in a monopolistic situation (Johnson & Johnson's Eprex and Bristol-Myers Squibb's Prodafalgan).

Fast-growing corporations such as Roche, Bristol-Myers Squibb or Pharmacia & Upjohn derive more than 50% of their sales from innovative products. Figure 2 shows Roche's product portfolio on a matrix divided into four quadrants ('Young stars', 'Young hopefuls', 'Senior stars' and 'Senior hopefuls') based on a product's competitive position and life-cycle status. Thus Roche's growth rate (CAGR 1992-1995: 23%) is mainly driven by the 'Young star' product, Neupogen. In addition, Roche possesses several other fast-growing 'Young' products (eg - Pulmozyme, Hypnovel, Cymevan and Hivid) to secure its future growth. By contrast, Rhône-Poulenc Rorer's product portfolio lacks 'Young star' products with significant sales to drive its growth (CAGR 1992-1995: –3%). Further, Hoechst Marion Roussel's intermediate sales growth (1992-1995 CAGR of 5%) can be explained by the fact that its current portfolio is dominated by 'Senior hopefuls' such as the antibiotics Targocid, Oflocet and Claforan, which offset the impact of its 'Young' products on growth.

Structure and organisation

Leading companies are tending to adopt similar organisational structures to address the hospital sector. It is rare to find a corporation with several hospital divisions, although Hoechst Marion Roussel is an exception. Instead, most of the leading corporations in the French hospital market have grouped their hospital activities into a

	Innovative products	Commodities	Generics
Advantages	High profitability: High price Low promotional costs (eg 30 representatives) Rapid market penetration: Neupogen achieved annual sales of US$41 million two years after launch Lower competitive intensity: Monopolistic/oligopolistic market environment	Good performance from value-added commodities: New formulation New convenient dosage regimen Better pharmacokinetics More convenient packaging	Good performance from value-added generics: New formulation New convenient dosage regimen More convenient packaging Limited investment required Low (if any) medico-marketing skills required Low-risk business (possible outsourcing of manufacturing)
Disadvantages	No/limited sales on retail drug market High scientific skills required by medical representatives	Medium/low profitability: High-price competition against me-toos, generics or other substitutable products Higher promotional costs (60 representatives) Low growth/negative growth markets	Low profitability: Price competition Cost leadership strategy Low growth/negative growth markets Difficult to build a sustainable competitive advantage

Figure 3: The main advantages and disadvantages of the three strategic segments in the hospital drug market. Source: AT Kearney.

single business unit. Sanofi, for example, recently created a new single hospital structure including Dakota Pharm (the hospital generic company it took over at the beginning of 1994) and, following the acquisition of Syntex, Roche integrated Syntex' hospital activities into its hospital division in 1995. In mid-1996, Rhône-Poulenc Rorer also created a hospital business unit managing its specialised hospital product portfolio.

Concentrating all marketing and sales activities into one single business unit is likely to improve operational efficiency through such means as the sharing of competences, a reduction in complexity and better coordination, as well as increased negotiating power. It can also reduce operational costs by streamlining structures, sharing clients, and spreading fixed costs.

Drugs exclusive to hospitals such as cytostatics, anaesthetics and immunosuppressants, or non-exclusive hospital drugs with major hospital sales (eg certain third-generation cephalosporins like Rocephin, and low molecular weight heparins) are generally promoted by fully dedicated hospital representatives. The average team size is 30 representatives for specialised drugs like oncology products and 60 for more widely prescribed drugs like antibiotics. Non-exclusive hospital drugs with low hospital sales but high secondary sales on the retail market are usually promoted by medical representatives covering the retail as well as the hospital market. The promotional activity of medical representatives at the hospital is mainly focused on prescribers, who receive scientific information as well as pharmacoeconomic data. On average, they call on nine or ten doctors a day and visit each of them approximately ten to 11 times a year.

The increasing government pressure on hospitals to make them stay within their budgets has led to individuals other than doctors playing a role in the drug purchasing decision. Both pharmacists and the hospital administrative staff (eg financial director, hospital director) influence the choice of products (through the formulary committee) and the price paid. As a result, most of the leading companies in the sector have recently created the function of commercial representatives, also called negotiators. These people are responsible for building good professional relationships with hospital pharmacists and to a lesser extent with financial directors, providing them with pharmacoeconomic information and negotiating drug prices. Negotiators meet on average five or six hospital pharmacists a day and call on them two or three times a year.

Strategic options

The three market segments – innovative products, commodities and generics – offer a number of strategic options to companies seeking to secure a significant position in the hospital sector. The main advantages and disadvantages of these segments are shown in Figure 3.

Focused coverage of the innovative product segment (as practised by Immuno) provides pharmaceutical companies with the best prospects for sustainable profitability and the fastest return on investment. However, by addressing both the innovative and the commodity segments (eg Novartis, Roche, Glaxo Wellcome), companies can secure larger sales at a reasonable profit level. Companies such as Hoechst Marion Roussel or SmithKline Beecham, which cover the commodity and the generic segments, generate low to medium profitability whereas those which choose to cover all three market segments, Sanofi and Rhône-Poulenc Rorer, for example, can expect medium to high profitability, depending on their product mix.

The key factors necessary for success in each of the segments are summarised in Figure 4. As can be seen, irrespective of the segment, a good relationship with the hos-

Innovative products	Commodities	Generics
R&D efficiency Early entry in the market Set up of clinical trials in leading hospitals Product therapeutic leadership (better therapeutic benefits) Scientific competence of medical representatives Good relationship with medical practitioners	Low manufacturing costs Global product advantage (best product/services/price package) Negotiators' skills (product bundling, discount policy) Good relationship with hospital pharmacists, financial directors and practitioners)	Low manufacturing costs Product price leadership (lower price) Product quality image Good relationship with hospital pharmacists and economic directors

Figure 4: The key factors necessary for success in each of the three strategic market segments. Source: AT Kearney.

pital pharmacist is a primary success factor in the race for hospital sales. For innovative products, the most important success factor is the therapeutic benefit the product offers, which means that the doctor remains the key target of promotional efforts. Commodities must offer the best product in a package that includes the best service and the lowest price, while success in generics will depend essentially on cost advantage. Generics are virtually not promoted, while for commodity products medical calls remain one of the most effective promotional means to induce hospital prescribing.

> **"For commodity products medical calls remain one of the most effective promotional means to induce hospital prescribing"**

Depending on their product range, pharmaceutical companies operating in the hospital market can follow two different strategic objectives. For non-exclusive products with limited hospital sales but good potential for high secondary sales in the retail market, the primary objective should be to maximise hospital prescriptions. To achieve this, companies could consider providing products free, or at a nominal price, to hospitals. In this case hospital activity should be viewed as a promotional investment for the retail market. However, companies following this objective should make sure that the additional sales generated on the retail market will be enough to cover their hospital promotional investment.

For products exclusive to hospitals (eg Neupogen, Sandimmun, Retrovir) or non-exclusive but for which the hospital represents a sizeable market (eg Lovenox, Rocephin, Peflacine) the company's primary objective should be to generate direct profits from sales to hospitals. To protect or increase their profit margin from these sales, corporate managers can act on two fronts.

Firstly, they need to develop their product portfolio by strengthening the position of their current products, for example through service offering, product line extension or bundling. They also need to speed up the introduction of innovative products by, for instance, co-development programmes or licensing-in agreements. In practice, players which operate only or mainly in the commodity and/or generic segments will face intense price competition that will seriously threaten the profitability of their hospital business.

The second element involves optimising corporate organisation by building a strong commercial team, including perhaps three to five negotiators with selling skills and good contacts with hospital pharmacists, and streamlining hospital activity, for example by incorporating all hospital drug business into a single unit.

While these strategies involve considerable investment, this may be the price of survival in what has become a highly competitive market. SM

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