Interview with Glib Zagoriy, CEO, Darnitsa

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Tags: Darnitsa

Considering you only took over as CEO from your father in 2009, what was the mandate that was given to you as new CEO of the company – including your objectives and strategy?

Darnitsa has been a private family company since the time of Ukraine's independence, when my father became the manager of the company. In 2009 it was decided by the board that I would become the CEO of Darnitsa, heading the operational aspect of the business, and my father would remain as a lead scientist overlooking the R&D activities of the company. My father is a scientist by training and until today he is a lead faculty at the Medical Science Academy. I have been working at Darnitsa for 15 years and began my career here as low-level manager, slowly moving up the ranks until I became CEO.

The reason why we have made such changes to our management stems from the fact that we wished to restructure our business to make it as professional and competitive as possible. At some point we realized that the Ukrainian pharmaceutical companies, while very powerful in the local market, are not interesting for big pharma for a number of reasons.

The first reason regards the legislative framework of Ukraine's pharmaceutical sector, which is not clearly defined and at the same level as those in developed markets. Over the last couple of years the situation has been improving greatly, with the State Administration of Ukraine of Medicinal Products headed by Mr. Solovyov, taking a very aggressive stance to reform the regulatory legislation. Proof of these renewed efforts is Ukraine's accession to PIC/S in January 2011. At the moment this work is still in progress, but we expect that within the next two years our state

regulator will be successful in raising the national standards according to those used in Europe.

Another factor why Ukraine remains an unattractive market for big pharma is due to the country's low expenditure per capita on medicines. There is also the issue of currency risk and the large amount of imported medicines in Ukraine, which represent about 70% of the total market's value. Furthermore, I am not so optimistic about the growth of the market or its current size. Some market research companies estimate that Ukraine's pharmaceutical sector today is valued at US$3 billion and that it will grow 16% this year, however I am not so optimistic about these figures. Having conducted our own research, we find that the numbers are actually lower and that the total market value actually stands closer to US$2.6 billion and that real market growth is approximately 11%. For 2012, they recently released figures estimating growth at 17%, however we remain a lot more conservative in our forecasts as we expect that total growth will only reach 8%, as long as there is not a dramatic devaluation of our local currency.

Finally, the last cause behind our restructuring is related to our own internal ambitions for the next two years and how we see ourselves in the market. During the last four years there have been rumors that Ukrainian manufacturers were of high interest to foreign pharmaceutical companies in terms of M&A activities. This does not reflect the reality of the situation though.

When big pharma looks into acquiring a company locally, their main objective is to make the merger or acquisition as quickly and smooth as possible. To achieve this it would require that both companies, local and foreign, have similar business processes and internal procedures that can easily be aligned to create a single structure. The problem in Ukraine is that pharmaceutical companies are not used to working according to Western standards of management, and even the mentality of business is entirely different. Most top and middle-level managers in local companies don't even speak English and the owners of these companies are on average above 60 years old and still think along the lines of a soviet mentality. Furthermore, Ukrainian companies generally have a culture of only hiring people within their own ranks, which means that starting from the base level, all employees will already have this same culture ingrained because there is minimal external talent being brought in. When you take this into account and think that this scenario would be attractive for big pharma, I don't think it is very plausible. This is why I have taken it up on myself to reform our company and turn it into an enterprise that would be competitive according to international standards.

What defines Darnitsa's strategic focus today?

The Ukrainian pharmaceutical market is also characterized by its high fragmentation, not only in manufacturing, but also in distribution and retail. This makes it extremely difficult for us to gain market share in terms of the value of the market. Ultimately, the most important indicator then becomes a company's market share in terms of units, because this represents the real demand by the customer. This is why we have decided to focus on increasing the number of units sold rather than on our market share and this is what will be driving our internal framework until the end 2016. Between 2010 and 2011 we were focusing on preserving our current market share in terms of units, which stands between 12-13%. Until 2016 we aim to reach 18%. Darnitsa has always been a company aimed at the Ukrainian market. Nevertheless we export some of our products that for the last 5 years have represented between 7-12% of our turnover.

What have you accomplished so far and where do you stand today with your efforts to reform Darnitsa?

Over the last two years my goal has been to break this soviet culture within the company and even change the processes that my father had instituted here at Darnitsa. At the end of the day business is business and I have to do what is in the best interest for the company, even if personally this has been the greatest challenge for me. No other Ukrainian company has begun such a process of reform within their ranks and surely it will be the most difficult task for them when the time arrives. We have found that Ukrainian employees are resistant to change, and most of them are even afraid to learn how to work with new technologies, such as computer networks and smartphones. In general, the commercial and marketing departments of a Ukrainian company are the most modern and open-minded and there is a discrepancy between these personnel and those in the rest of the company. It would be a waste of time to try and force people to change, which is why I have decided to renew approximately 50% of the staff at Darnitsa and to attract external talent.

Unlike most national companies, who tend to think about their future on a very short-term basis, Darnitsa works under a 6-year strategic plan. We are only in our second year of such a plan and I would say that still at the fundamental level of the changes we wish to make. This means that we have still not engaged the higher-level personnel that we absolutely need to achieve our objectives. This is particularly true for our R&D department where overhauled our staff to harmonize our generic technology standards with those of the rest of the world. It has taken us one year to attract the specialists for this, when it usually only takes about half the time. Currently we are in the pre-formation of our marketing and commercial team and I expect to hire at least two new top managers within these departments this year.

Up until 2011 Darnitsa was focused on finishing its CAPEX project that essentially transformed our plant from an old soviet factory into a modern pharmaceutical production site. The project was developed together with a Swiss company in 2000 and it has taken us 11 years to complete. In parallel to the CAPEX plans we have also been restructuring our finances in order to become a debt-free company, which is where we stand today. This required that we learn how to be audited by international auditing companies like PWC, and to make all of our structures and processes fully transparent. This will also assist us to implement our new CAPEX project that will focus on improving our technology for products aimed at the hospital sector. Furthermore, implementing such processes is also in line with our aim to become an attractive partner for other pharmaceutical companies.

How have you managed to attract the right talent to Darnitsa and to retain those employees that are still valuable to you?

I am convinced that the people we will have to attract to Darnitsa are those that have worked in international pharmaceutical companies and have expertise in operating under their standards. We are now considering making such a move, not only in Ukraine but also in Russia, and we are ready to take the risk. Overall these people will be Slavic but they will have an American or European background, as I do not think we are ready to engage foreigners to have them work in our company.

With so many ongoing changes is your final aim to sell streamline the company so that it may be bought out by big pharma?

We are not looking to sell our company any time soon. Ukraine offers great opportunities as a market and we wish to be here at that time when those will be fully developed so that we may capitalize on them. This includes opportunities in the average prices of products sold in Ukraine compares to the prices in neighboring markets, as well as the possibility to launch new products that are in our pipeline. Without a doubt, local players that are well-organized have the greatest resources to grow in the coming years. Ukraine has yet to see the next stage of its development, and only then will big pharma truly become interested in this market. Our philosophy is that we would like to be the most attractive partner for such companies when the time arrives and this is what I would like to achieve until then.

What defines the ideal partner for Darnitsa?

There is not one specific company that we are looking at, but I believe there a handful of companies that will truly be interested in collaborating with us and in growing their presence in the

Ukrainian market. This includes global companies such as TEVA, the largest American generic companies and important regional players, such as Gedeon Richter, Polpharma and KRKA. Our objective is to prepare Darnitsa for when such players enter the market in full force and will need a local partner such as ourselves – transparent and offering potential generic products that are aimed at the low and mid-level price segments. Global generic companies, such as Novartis, are already considered to be at the high-priced segment in Ukraine, so we still differentiate our products by producing at the same quality for lower prices. Today the average price for a medicine is 7-8UAH and we only expect that this market will become most interesting for global companies when the average price reaches 12UAH. Speaking about the large Eastern European generic manufacturers, they are all focused on export markets, such as Ukraine, which means that they are vulnerable. Considering the strength of our local industry I believe that in the future, such regional player will be pushed out of the market as we build the strengths of our national companies.

Would the introduction of a reimbursement system be the final push for this new stage of Ukraine's pharmaceutical sector?

Indeed there is currently no reimbursement system in Ukraine and the only state funding for medicines is provided for specific diseases, such as HIV, oncology, diabetes, etc. For the past 15 years there have been conversations about introducing a reimbursement system, and while I do not want to be a pessimist, I do not believe that this will happen anytime soon. The ultimate reason is that the state lacks the necessary funds for this, and there are other priorities, such as the debt of pension funds, that will be taken care before a reimbursement system. The sad reality is that our population is already used to paying for their medical expenses out of their pockets, and I do not think that this will change anytime soon. Perhaps in the five years we will have some partial reimbursement for the lowest income segment of the population and only for major and chronic diseases. For this reason we have also expanded our product portfolio for primary care that will in the future address this demand on behalf of the government.

What could we expect from Darnitsa and Ukraine in the next five years then?

If everything goes as planned, our family will still be heading Darnitsa but with a greater percentage of young and talented personnel. I also expect that we will have achieved an 18-20% market share in terms of units sold in the country. This will be the company that has established an important 3-5 year partnership with big pharma, in contract manufacturing, packaging or co-marketing. I wish to have my personnel be very educated in the practices of western companies and this will be achieved through such a partnership. In five years we might have also expanded our production facilities and maybe even began to explore the biosimilar sector, even though this

would represent a colossal investment for us.

Do you have a final piece of advice to foreigners coming into the Ukrainian pharmaceutical market?

This is a very interesting market in terms of the opportunities it presents, but today it is too early for managers of the great pharmaceutical companies to come to Ukraine as it is still only a market of US$3 billion. To those companies that wish to grow through acquisitions, make sure that you are present here today so that you can learn how the market functions and what you need to do in order to be successful. In order to save time I recommend that this be done through collaboration with local manufacturers. Finally, no one should fear the Ukrainian market, especially because our regulations are evolving very quickly and improving every year.

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