Interview with Eric Zwisler, CEO of Zuellig Pharma Asia Pacific, Zuellig Pharma Asia Pacific

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You started the Chinese operations and have been working in the country for many years but recently moved up to running all operations in Asia Pacific. Are you still closely involved with what's happening in China?

I started the operations in China almost 16 years ago, and I started them from scratch. Thus my professional home has been here in China. I know the people and the operations intimately, and I have a very warm place in my heart for what goes on in China. I also come back to Shanghai often because my family lives here. Moreover, China is an increasingly important part of the group, and thus from a management point of view, it deserves more attention. This is with full recognition of the space that Elsie Lim needs as a new Chief Executive in China, so I do keep my hands off. It's a complex relationship.

Zuellig Pharma's operations in China are quite young as compared to many other markets in Asia. How important is China for overall Asian operations?

China is extremely strategic for Zuellig Pharma, as with all multinational companies focusing on emerging markets as a growth engine. The country is a major growth market for everyone in Asia. Our business has been growing at a CAGR of over 40% for the past decade. The difference in the business model in China as compared to the rest of Asia is that the country requires significant working capital investment to engage in the distribution business. Thus it is important as a growth driver of Group profitability as well as an increasing destination for the Group's investment.

Do you engage in cross selling and sign regional distributions deals, or are your activities segmented, country-by-country?

We do not engage in cross selling. The history of the business is that it has been country by country. All country level deals include restrictions on cross selling. The business model in most Asian countries is different from Europe, the US, or Japan. It's not a wholesale model, but rather an exclusive distribution model, where a multinational manufacturer gives us rights to distribute their products in a given market. However, as our business has grown, and we have relationships in multiple countries with the same manufacturer, those contracts and commercial discussions tend to be packaged together.

You entered the Chinese market before you could have a fully owned subsidiary by providing distribution services. I can imagine you had to jump through a number of hoops to build that business. What was the biggest challenge you faced in the early years in China?

The biggest challenge was licensing. From 1993 to 2003, we had no legal right in China to buy or sell one box of any kind of pharmaceutical product. The basic ability to engage in the business was a critical aspect in those years. In the first 10 years, the business was concentrated on importing products and operating through the bonded zone in Waigaoqiao in Pudong. There were no restrictions on the handling and sale of pharmaceutical products in the zone, but once those products left the zone they needed to go through a completely Chinese distribution system. We managed to enter the market by variously working with partners, shadow managing the business, and providing distribution services, but not invoicing, in the market to support this system. This operation allowed us a decade to get to know the market and build relationships, and for the Chinese authorities to get to know us. When the opportunity came for an investment, we were in a preferred position.

When people talk about distribution in the Chinese market, the first thing that often comes to their lips is massive fragmentation. But the market is now moving through a period of consolidation. How do you see this consolidation unfolding?

I don't think China will develop any differently as compared to the rest of the world. Of course, there are some factors that do make China somewhat different: China has a large population and geographic spread, remnants of a planned economy, and an authoritarian regime. However, the economic reality and drivers of distribution are the same as other countries. There will be consolidation, the strong will get stronger, and there will be an emergence of a few big players.

This process has been going on for at least a decade. The top ten wholesalers now account for 35% of the market. Some of the big groups such as Sinopharm and Shanghai Pharma have ownership of a network of wholesalers around the country. However, they are in a lengthy integration process and aren't yet operating as a single company. Nonetheless, if you looked at the number of distributors ten years ago and the number today, you would see a dramatic change. I don't know precisely how long it will to take, but I think it will take at least another 5 to 10 years for consolidation to pull the market together.

Local companies do have certain advantages such as a long history in the market and strong relationships. As a multinational company, how are you offsetting those local advantages?

When markets are inefficient, relationships are important. When markets are more efficient, relationships become less important because the markets become more systematic, professional, and objective in the way they operate. The trend is moving towards the diminution of the importance of relationships in the course of business. Obviously, as long as you have two people, you will always have a relationship, and there is no way to avoid that. However, the importance of relationships in producing economic advantages and guiding decision-making will decrease. That said, relationships are still important in China today and particularly at the hospital level and in local wholesaling. One can't deny local companies' 40 or 50 years of experience and service to the industry. On the other hand, Zuellig Pharma has many strengths as a very large group with a long history of direct distribution systems, quality approaches to the market, efficiencies, high service levels, transparency and trust – these are the strengths that we have to play on in the market while we simultaneously develop relationships and commercial contacts to drive our business.
It may be a bit controversial, but I think the importance of relationships in this market is overstated. Relationships are a protective barrier to avoid change and a method of maintaining control in the market. We tackle business issues in a very straightforward way. If local companies use 70% relationship and 30% content, we use 70% content and 30% relationship, and we are just as successful. The competitive balance resides in how quickly we can develop the local content and position, versus how quickly local companies improve services and management of operations. This is the essential long-term competitive landscape.

One way that you have been working to enhance local content has been through acquisition. You are buying strong client facing organizations and relationships, while infusing them with advanced technology, management and infrastructure. How are you managing the transition for people who come from small Chinese distributors that were operating in a very atypical environment, who have suddenly now become a part of Zuellig Pharma?

Wholesaling is a very local and customer-client focused business and that is one of the strengths that we look for in buying a company. We look for a strong hospital network and hospital relationships, and then fill in the financial backing, a product pipeline, and technical and operations management support. The first issue is targeting the right companies. Available companies range from the smallest, greenfield, paper companies, across the spectrum to the large, historically main channel State companies. When you look at bigger companies you get more market impact, but you also get more integration problems. When you look at smaller companies there is smaller impact, but integration is easier and there are fewer internal complications, such as hidden financial or u resource issues. So it is important to play in a place where you can get the most of the best and avoid the most of the worst. Those companies tend to be small and medium sized companies that are privately owned, having either already reformed their capital structures or led by strong individual manager/owners. That has been our focus, though we do certainly have an appetite for larger companies if they meet basic business requirements for M&A deals.
It is also important to maintain the forward facing part of the business, which is what makes the acquisition valuable. That often includes general management, sales forces and people who know customers. We go in and clean what needs to be cleaned, because there is always something that needs to be taken care of, and then we start building management, hardware, services infrastructure, and product pipeline with management support.
We have gone through this process about five times now, and it takes about a year to complete the procedure. Integration begins to take place before the formal takeover, once we've made legal commitments to integrate and pending approval. In this period we engage in formal shadow management and planning such that when we start on day one, there has been a tremendous amount of pre-work already completed.

Zuellig Pharma is well known for being particularly adept at implementing technology and IT to facilitate the delivery process and deliver data. I would imagine that tools used in China aren't quite cutting edge. Which technologies and tools would you say have been the most useful and made the biggest impact in China?

The level of technology implementation in China is actually very high. There isn't a history of technological generations and legacy systems, so we can skip generations. For example, China is more wireless than other more developed markets. So, contrary to what you might think, the technology that we have put in place here to meet the market needs is quite advanced. This is due to the size and applicability of the data in the business. China has a complexity of data that isn't seen in smaller markets, and we need very modern business intelligence tools to parse that data. China is geographically large with widely dispersed population centers, requiring electronic means of transmitting orders that are integrated into central ERP systems. It makes no sense to be handling tens of thousands of orders by fax machine or telephone. There are a number of platforms including mobile phone and PDA enabled solutions and various internet and B to B solutions. One of the applications we have here is intercity, integrated 2-8 degree cold chain shipping with real-time internet based GPS tracking and remote temperature control for each truck. That way we can remotely monitor the location of a truck coming from for example Guangzhou to Shanghai and check whether it is on the approved route, and whether the temperature needs adjustment. You don’t need these kinds of systems in many other markets, so I think the application of technology in China can be even richer than in other markets. We also operate an extensive range of business lines in China, from 3PL healthcare and services all the way to first level and second level distribution, so we have a very wide range of requirements.

Some multinational companies are looking at increasing penetration into lower tier cities and Western regions of the country. How are you looking to facilitate and accommodate that?

Multinational companies have been widely penetrating China for some time. Everyone is in Urumqi and areas in the West. China has 665 cities, and we supply directly to over 400 of those cities, which is a fairly good estimate of what a broad based multinational companies’ distribution would look like. Four hundred cities is deep penetration, reaching tertiary and fourth tier cities. There are two issues when it comes to penetration levels. First, is the smaller urban areas, and second is transition from larger urban areas to surrounding suburban outlets.

The healthcare reform is focused on community health centers, which is part of the challenge in moving into those areas. Two or three years ago, the desire was to move into rural areas and then as now, the question is whether there is a viable market. Multinational products are not the lowest price on the market, and this is still an issue in the community health centers. For the multinationals, the community health market is more reachable in the big urban areas. We reach it through our existing distribution network, or through wholesalers when we don’t have local subsidiaries. The health outlets suffer a common problem in the healthcare industry, which is the question of who finances and pays for the services. For a pharmaceutical distributor or wholesaler, the issue is ‘when am I going to get my money?’ And also the high cost of servicing a very diverse, low volume network. Across the board, this is not exactly, as they say in Chinese, ‘a piece of fatty meat.’ This is a bone kind of market. There is quite a balancing act in terms of the speed of development of the community health center market and the ability to serve this market.

What have been the commercial results for Zuellig Pharma in 2008 and what is your outlook for 2009?

We continue to grow strongly in China and we have a very large and significant business in the country. We are certainly one of the top ten in China and have been growing at over 40% a year, since 2000 and we expect the business to continue to grow at that rate.

What is the five-year plan in terms of strategic developments in the Chinese market?

The heart of the strategy for Zuellig Pharma will be continued acquisitions and the growth of the local wholesale business. These acquisitions are very important to us and are the cornerstone of our strategy. They further facilitate working with suppliers to develop low cost, efficient, customer focused solutions. We will continue to operate in our current channels and across the range of existing products, which include prescription pharmaceuticals, non-prescription healthcare products, vaccines, and medical device and diagnostics as well as local wholesaling and first level sales to wholesalers.

What advice would you give to a manager coming to China today to set up new operations?

All the large and medium sized multinationals are already in China. Thus we are talking about companies of a smaller scale. The issue here is that the market is very, very competitive and the cost of entry in China is quite high. The time to market for registration and reimbursement, the scope and scale of sales forces needed, and learning to navigate in a complicated operating environment all contribute to a high barrier to entry. Partnering and working with appropriate people is probably the way to go. There are a number ways to ease into the market. It is important to pay close attention to what will make you successful here, which is marketing, sales, and government relations. Then work with people to provide everything else from administrative to legal to outsourcing. Take a multiphase approach on entering the market and focus resources on where they will make an impact. Go deep, not broad, and that includes geographical focus in the market. Be prepared that anything you do in China will take twice as long as you think, be twice as hard, and cost twice as much. There is a long learning curve in this market, and it takes time to get down that corporate learning curve. You are not going to make money for five or seven years, and it is going to be a bit of a challenge. You need to have commitment, persistence, and top level executive or board backing to enter the Chinese market. I wouldn’t approach it in an incremental fashion, or take the ‘let’s try’ approach. You need to come into this market with a clear idea of what you’re doing, and with a precise plan to accomplish your goals.

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