International Journal of Innovative Research in Management Studies (IJIRMS)
ISSN (Online): 2455-7188
Volume 1 | Issue 2 | March 2016

RECENT TRENDS OF OVERSEAS GROWTH IN THE PHARMACEUTICAL INDUSTRY

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ABSTRACT

While India has become an attractive destination for foreign capital, the country is also becoming a significant source of outflows. Many Indian enterprises view outward investments as an important dimension of their corporate strategies. The India's Pharmaceutical sector is exploring this opportunity and going for the investment abroad through the means of mergers and acquisitions, takeovers, expansion, green filed investment, strategic alliance, etc. The Pharmaceutical industry has grown from mere US$ 0.3 billion turnover in 1980 to about US$ 21.73 billion in 2009-10 and is expected to grow at a CAGR of 23.9 percent to reach US$ 55 billion by 2020. (Corporate Catalyst India Pvt. Ltd, Pharmaceutical Industry in India, 2015). The country now ranks 3rd in terms of volume of production (10 per cent of global share) and 14th largest by value (1.5 per cent of global share). One reason for lower value share is the lowest cost of drugs in India ranging from 5 per cent to 50 per cent less as compared to developed countries. The current study discusses the trends in India's FDI outflow by the mode of acquisition in Pharmaceutical Industry over the period of last 10 years from 2001 to 2011 and to identify the driving factors in this industry. The analysis is based on the number of foreign investment made by the Indian Pharmaceutical Industries. The paper is based on Dunning's Eclectic Paradigm to study the impact of ownership, location and internalization variables on foreign investment from India in the Industry. The paper also discuss the policy changes that has made impact on FDI outflow from India in the last decade. An analysis has been performed regarding the intent of entry, geographic location and other variables considered in the study.

Key words: Pharmaceutical Industry, FDI outflow, Acquisition, Indian MNEs

1. INTRODUCTION

Globalization is widely seen as a dominating phenomenon of current century encompassing worldwide integration of financial systems, trade liberalization, deregulation and market opening resulting in a global market and patterns of industrial development. In last few decades it is evident that firms and institutions from peripheral countries or developing world are making sustained and deliberate effort to take advantage of the new opportunities. The rise of East Asia followed by growth in China and India has led to emergence of new breed of MNEs from these countries. By the end of 2004 China emerged as fifth largest outward direct foreign investor with a total US $ 37 billion and was the third largest exporter after Germany and the US (Child and Rodrigues, 2005). In 2014, Chinese outward direct investment (ODI) entered a new stage, with more Chinese companies investing in more industries in more countries. According to the Ministry of Commerce of the People's Republic of China (MOFCOM), non-financial ODI in 2014 reached US$102.9 billion, an annual increase of 14.1 percent (China Outlook 2015). Similarly albeit on a smaller scale in the last decade Indian economy saw a dramatic growth in overseas investment by the Indian industry. The firms from latecomer countries are making inroads in sectors such as manufacturing (steel and pharmaceuticals) and services (IT) and trading as well as high technology sectors like semi-conductors. Some of the firms such as Infosys, Lenovo, Ranbaxy and Espat are now competing at a global level.

The Indian pharmaceutical sector has come a long way, being almost non-existent before 1970 to a prominent provider of healthcare products, meeting almost 95 percent (Changing role of pharmacists: Indian scenario, Express Pharma, 2012) of the country's pharmaceuticals needs. The Industry today is in the front rank of India's science-based industries with wide ranging capabilities in the complex field of drug manufacture and technology. It ranks very high in the third world, in terms of technology, quality and range of medicines manufactured. From simple headache pills to sophisticated antibiotics and complex cardiac compounds, almost every type of medicine is now made indigenously.

The Indian Pharmaceutical sector is highly fragmented with more than 20,000 registered units with severe price competition and government price control. It has expanded drastically in the last two decades. There are about 250 large units that control 70 per cent of the market with market leader holding nearly 7 per cent of the market share and about 8000 Small Scale Units together which form the core of the pharmaceutical industry in India (including 5 Central Public Sector Units). These units produce the complete range of pharmaceutical formulations, i.e., medicines ready for consumption by patients and about 350 bulk drugs, i.e., chemicals having therapeutic value and used for production of pharmaceutical formulations. (Pharmaceutical

Industry in India, July 2015) Following the de-licensing of the pharmaceutical industry, industrial licensing for most of the drugs and pharmaceutical products has been done away with. Manufacturers are free to produce any drug duly approved by the Drug Control Authority. Technologically strong and totally self-reliant, the pharmaceutical industry in India has low costs of production, low R&D costs, innovative scientific manpower, strength of national laboratories and an increasing balance of trade.

The Indian pharmaceutical industry is one of the developing world's largest and most developed, ranking 3rd in the world in terms of production volume and 14th in terms of value. According to the data published by the department of pharmaceuticals, Ministry of chemicals and fertilizers the annual turnover of the Indian Pharmaceutical Industry is estimated to be about Rs. 128044.291Crores during the year 2013-14. The share of export of Drugs, Pharmaceuticals and Fine Chemicals is Rs. 63293.912Crores. Over, the last 30 years, India's pharmaceutical industry has evolved from almost on existent to a world leader in the production of high quality generic drugs. India has garnered a worldwide reputation for producing high quality, low cost generic drugs.

2. REVIEW OF LITERATURE

The first wave MNEs from the developing world documented by authors such as Kumar and McLeod (1981) and Lall (1983) succeeded as international players despite many difficulties. Their success was due as much to the difficulties encountered at home as to the incentives driving internationalization. One of the most salient features of first wave MNE activity is the direction and motivation of FDI compared to western MNEs. Much empirical work on first MNEs indicated strong and marked trend investments in neighbouring and other countries which were at a similar or earlier stage of their development. Prominent first wave countries such as India, Philippines, Argentina and Columbia did not show any significant increase in either the level of the total outward FDI, nor a significant shift towards developed country hosts. Initial analysis of second wave of MNEs reveals that overseas move of firms in the second wave is a result of the 'pull factors' that are drawing firms into global connections unlike 'push factors' that drove firms as standalone players in the first wave (Mathews, 2006). Dunning et al., (1997) suggest that in the case of second wave of MNEs from East-Asian countries such as Taiwan and Korea were subsidized by governments with government policy interacting with firm strategies.

The rise of second wave MNEs from emerging countries is less driven by cost factors per se, but more by a search for markets and technological innovations to compete successfully in the global economy (Yueng, 2000). The sudden appearance of the second wave of firms and their capacity to create competitive positions to existing incumbents has raised interesting questions as they are not simply occupying space vacated by incumbents instead in many cases they are creating new economic space by their organizational and strategic innovation. Thus the changes in the world economy, specifically its globally interlinked character is responsible for driving the new approaches to and patterns of internationalization in firms from peripheral countries. Therefore Mathews (2006) suggests that existing theories and framework of internationalization have failed to capture organization and strategic innovations adopted by developing country MNEs for new modes of internationalization.

In this context the Indian pharmaceutical industry provides an ideal case to investigate approaches and motives of second wave MNEs firms from developing countries. From the beginning of the 1990s, the Indian government started liberalization by removing restrictions on trade such as regulations on FDI and opened Indian market to overseas firms. As a result of liberalization policy Indian economy witnessed dramatic growth, changes in domestic market and firm activities specifically in relation to overseas expansion strategies. The growth of overseas investment is been characterized by significant changes in location and sectorial distribution. In the 1990s the majority of investments have originated from the service sector and were increasingly developed country-oriented with majority ownership in most cases.

A trend analysis shows that the level of outward FDI from India has increased manifold since 1999-2000. The level of net outward FDI flows (on BoP basis), however, recorded a sharp uptrend at US$ 74.3 billion during the second half of 2000s (2005-06 to 2009-10) as compared to US$ 8.2 billion in the first half of 2000s (2000-01 to 2004-05). Outward FDI from India has mainly been by way of equities and loans. According to UNCTAD’s World Investment Report 2011, based on the magnitude of FDI outflows, India was placed 21st in the world. In terms of value of net purchases5 (*i.e*., cross border acquisition deals) by Indian companies in 2010, India was placed fifth in the World after the US, Canada, Japan and China.

The global pharmaceutical market seems to be showing signs of recovery with several positive factors projected for the period 2014-2018. Global spending on medicines is expected to reach US$ 1.3 trillion by 2018, representing a compounded annual growth rate (CAGR) varying between 5-6% on a constant currency basis for the forecast period of 2014-2018. This is slightly higher than the 5.2% growth rate recorded over the past five years. (Dr. Reddy's Annual Report 2015)

3. REGULATORY FRAMEWORK

As part of the new policy emphasis, relaxation of restrictions on overseas investment began in 1992. The first step was to introduce an automatic route for overseas investment up to $4 million. The authority for approval of proposals up to $15 million was vested in the Reserve Bank of India, but proposals of more than $15 million still had to be approved by the Minister of Finance. Regulatory changes in India have also been a strong contributor to the observed increase in investment outflow from India, especially the year 2000 onwards. Some of the key policy changes which have impacted investment outflow from India are:

- In March 2002 and December 2002, the annual limit on overseas investment has been raised to $100 million (up from $50 million) and the limit for direct investments in South Asian Association for Regional Cooperation countries (excluding Pakistan) and Myanmar has been raised to $150 million (up from $75 million); for Rupee investments in Nepal and Bhutan the limit has been raised to Rs. 700 crores (up from Rs. 350 crores) under the automatic route by Reserve Bank of India.
- In March 2003 Reserve Bank of India Permitted Indian companies to make overseas investments by market purchases of foreign exchange without prior approval of the Reserve Bank of India up to 100% of their net worth; up from the previous limit of 50%. An Indian company with a proven track-record is allowed to invest up to 100% of its net worth within the overall limit of $100 million by way of market purchases for investment in a foreign entity engaged in any bona fide business activity starting fiscal year 2003-2004. The provision restricting overseas investments in the same activity as its core activity at home of the Indian

company are removed. Listed Indian companies, residents and mutual funds are permitted to invest abroad in companies listed on a recognized stock exchange and in company which has the shareholding of at least 10% in an Indian company listed on a recognized stock exchange in India.

- In January 2004, the Reserve Bank of India further relaxed the monetary ceiling on Indian companies' investment abroad. With effect from fiscal year 2003-2004, Indian companies can invest up to 100% of their net worth without any separate monetary ceiling even if the investment exceeds the $100 million ceiling previously imposed. Furthermore, Indian companies can now invest or make acquisitions abroad in areas unrelated to their business at home.
- In 2005, banks were permitted to lend money to Indian companies for acquisition of equity in overseas joint ventures, wholly owned subsidiaries or in other overseas companies as strategic investment.
- In 2006, the automatic route of disinvestments was further liberalized. Indian companies are now permitted to disinvest without prior approval of the RBI in select categories. To encourage large and important exporters, proprietary/unregistered partnership firms have been allowed to set up a JV/WOS outside Indian with the prior approval of RBI.
- In 2007, the ceiling of investment by Indian entities was revised from 100 per cent of the net worth to 200 per cent of the net worth of the investing company under the automatic route of overseas investment. The limit of 200 per cent of the net worth of the Indian party was enhanced to 300 per cent of the net worth in June 2007 under automatic route (200 per cent in case of revisited partnership firms). In September 2007, this was further enhanced to 400 per cent of the net worth of the Indian party.
- In 2014 the Union Cabinet chaired by the Prime Minister, Shri Narendra Modi, today gave its approval to amend the existing Foreign Direct Investment (FDI) policy in the Pharmaceutical Sector to create carve out for medical devices. As per the extant FDI policy for pharmaceuticals sector, FDI up to 100% is permitted subject to specified conditions. While FDI for green-field projects is under automatic route, brown-field projects are placed under government route. The Policy on the pharmaceutical sector covers 'medical devices' since this area is not separately covered.

4. RESEARCH DESIGN

A researcher is guided by the maxim that which discoveries cannot be planned (Tripathi, 2002). The research design of present study has been explained on the basis of following essential steps:

4.1 RESEARCH OBJECTIVES:

The review of literature has raised the following research questions:

Q1. What are the strategies adopted by the Indian Pharmaceutical companies to make investment in other countries?

Q2. What criteria companies follow for making investment in other countries?

4.2 SAMPLE DESIGN:

The judgmental sampling has been used in this study since the researcher had used his own knowledge and professional expertise for selecting the companies. Pharmaceutical industry is one of the major overseas investor. These four companies have been selected on the basis on their performance in overseas investment.

4.3 DATA COLLECTION:

The secondary sources of information had been used to collect the data. The information about these companies had been obtained from the company websites, annual reports, press releases and data bases such as CMIE. The data has been collected for the period of 10 years from 2001-2011. The data of 97 instances of overseas investment of these four companies had been taken for the study.

4.4 DATA ANALYSIS: The content analysis technique has been use for data analysis purpose. This had been used as the findings have been made on the basis of analysis of Government reports, Company’s annual reports, company manuals, websites, etc.

4.5 PERIOD OF STUDY:

The data has been collected for a period of 10 years ie 2001 to 2011.

5. DATA ANALYSIS

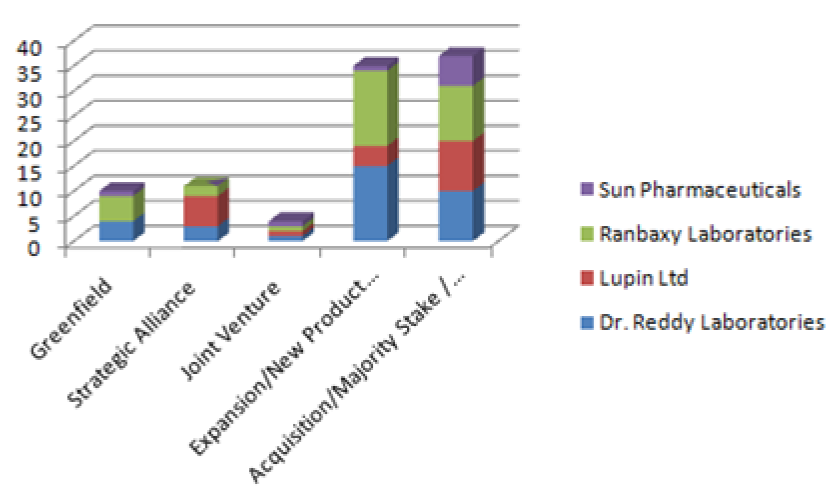
5.1 MODE OF ENTRY

Table I Modes of entry of Indian Pharmaceutical Companies

	Greenfield	Strategic Alliance	Joint Venture	Expansion/New Product launch	Acquisition / Majority Stake/ Minority Stake	Total
Dr. Reddy Laboratories	04	03	01	15 (13 after 2009 crises)	10	33
Lupin Ltd	00	06	01	04	10	21
Ranbaxy Laboratories	05	02	01	15 (08 are after 2008 crises)	11	34
Sun Pharma.	01	00	01	01	06	09
Total	10	11	04	35	37	97
Percentage	9.7%	10.67%	3.88%	33.95%	35.89%	100%

The Indian pharmaceutical companies going for investment abroad have got the options like Greenfield investment, strategic alliance, joint venture, Expansion / New product launch, Acquisition / Majority stake / Minority stake etc. through which they can enter in target country. In our study 97 instances of overseas investment by the pharmaceutical companies had been taken. From the data given in table 1 it is clear that Indian companies are following the route of acquisition / Majority stake / Minority stake and Expansion / new product launch.

Figure I Mode of entry in the target country



From the data collected on the mode of entry by the four major Indian pharmaceutical companies in the past ten years, it can be concluded that around 35.89 % of the overseas investment by these companies has been in the form of Acquisitions, 33.95% is done through expansion or new product launch, followed by the strategic alliance i.e. 10.67%. The Greenfield investment is just 9.7% of the total investment made by the top four pharmaceutical companies in the period of four years. The figure 2 depicts the same picture i.e. the major overseas investment is in the form of acquisition and expansion / new product launch.

5.2 INCOME OF TARGET COUNTRY

On income basis, the target countries are classified into three categories (Based on the World Bank classification of economies, November 2011):

- Low income: Low-income countries are those with GNI per capita of $1,005 or less.
- Lower middle income: The Lower- middle income countries are those with GNI per capita of $1,006–3,975.
- Upper middle income: the upper middle-income countries are those with GNI per capita of $3,976–12,275.
- High Income: The high-income countries are those with GNI per capita of $12,276 or more.
- Based on the above classification, India is categorized as a low middle-income country. The countries are categorized on the basis of this income band for the purpose of the study. The 97 instances of overseas investment made by the 4 Indian pharmaceutical firms in the last 10 years is classified on the basis of this income band (World Bank classification of economies, November 2011). The data is as shown in Table 2. The overall results are also summarized in Figure 2.

Table II Classification of Overseas Investment on country's Income basis

	High Income	Upper Middle Income	Lower Middle Income	Low Income	Total
Dr. Reddy Laboratories	27	03	03	00	33
Lupin Ltd	16	1	04	00	21
Ranbaxy Laboratories	24	05	05	00	34

Sun Pharmaceuticals	09	00	00	00	09
Total	76	09	12	00	97
Percentage	78.35%	9.27%	12.37%	00%	100%

The table II shows that out of the 97 instances of overseas investment by the 4 pharmaceutical companies 76 has been to the countries having high Gross National Income. No instance of overseas investment has been seen in the low income countries it is because these countries have low per capita expenditure.

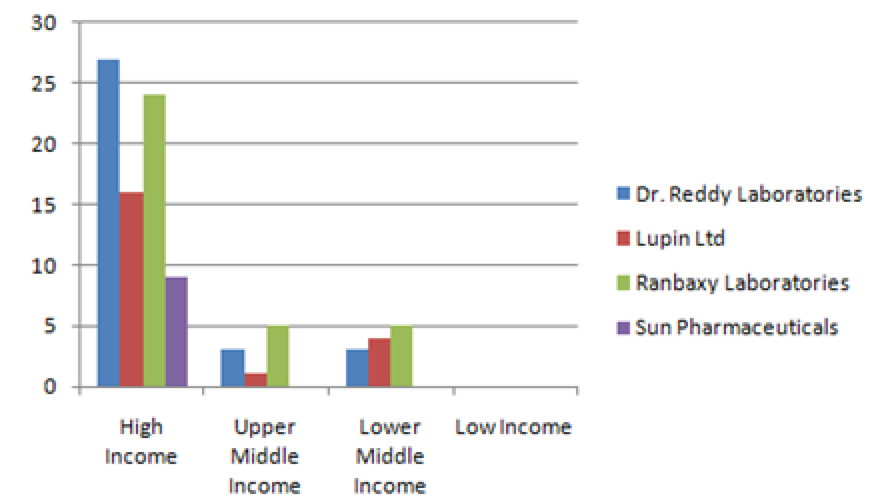


Figure II Classification of overseas investment on country's Income basis

Figure II shows that most of the foreign investment from India has been to countries with high income (GNI). As seen in Table 2, high-income countries account for 78.35% of the total foreign investment from India by the top four pharmaceutical companies. Reason of top pharmaceuticals FDI outflow towards High income Countries is higher as, per capita expenditure in the medical care is more than other countries, so there is adequate scope and opportunities available for these Indian companies.

6. CONCLUSION

On the basis of the data collected of the top four Indian pharmaceutical companies it can be concluded that Indian companies are mainly adopting the route of acquisition with 37 instances out of the 97 instances and Expansion/New Product launch route with 35 instances. Companies follow this route because it is easy to acquire a running business rather than to have a Green field investment where they have to do every activity from the very beginning. Greenfield form of overseas investment is lowest by the Indian pharmaceutical companies which accounted for just 9.7 % of the total overseas investment. The companies do not follow this form of foreign direct investment as a parent company has to start a new venture in a foreign country by constructing new operational facilities from the ground up. It is easy to acquire an existing company rather to establish a new company. In addition to building new facilities, most parent companies also create new long-term jobs in the foreign country by hiring new employees. The companies also do not often go for the strategic alliance and joint venture because often these do not continue for a longer term. So the options left available with the companies is the acquisition, expansion and launching of new product route where long-term continuity and survival is possible. It is always easy to acquire a running business rather to establish a new business.

The majority of the overseas investment is going to the countries falling in the high income group. These countries have got the high Gross national income and the per capita expenditure on medical facilities is also high in these countries. This provides abundant of opportunities to the companies of the developing nations like India, which are competent enough in all aspects and have comparative advantage of low cost medicines.

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