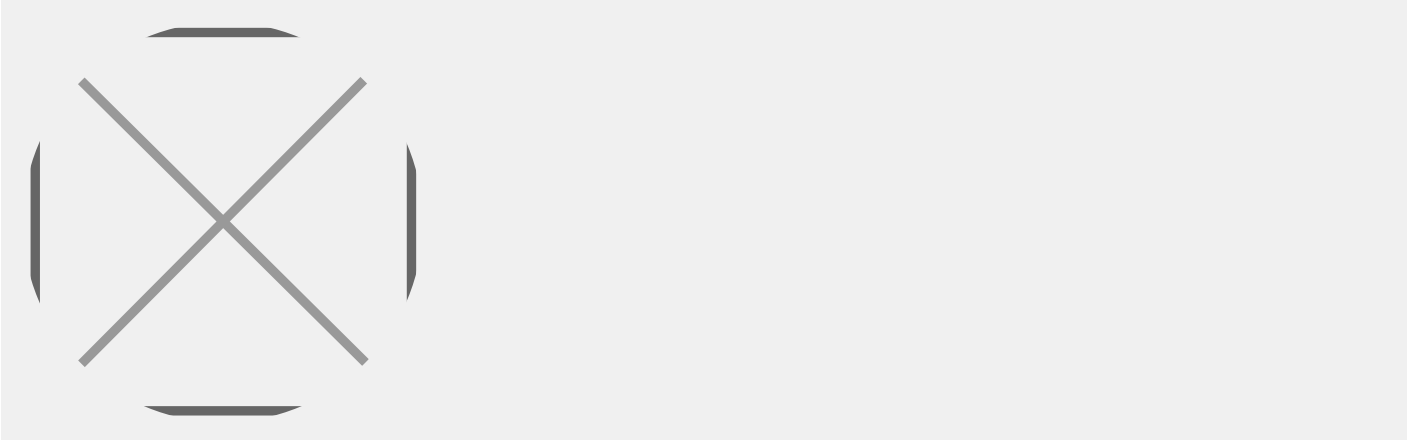
Interview with Jostein Davidsen, President, Nycomed Russia-CIS



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Nycomed is currently constructing a Greenfield plant in the Yaroslavl region, at an investment of 75-80Mn EUR. Last time we met in 2006, many foreign companies viewed local production as strategically and economically unattractive. What have been the evolutions in the market that have made construction of a Russian facility more attractive today?

In the last few years, the policy in the country has changed. The strategy for healthcare and social development has changed. In the government's Pharma 2020 plan, localization is a key objective. According to the plan, by 2020, 50% of the products sold on this market should be locally manufactured. Currently there are certain preferences for local products, but I believe these are short-term protectionist measures.

Also, there has been a clear change in what it means to be a 'local product'. Before, it was defensible that, for example, local packaging would be enough to garner local status. This has changed. The ongoing trend or discussion is to label full-cycle production as that which produces the defined strategic 'local' medicines. This means production of substances—APIs. I think this will be very difficult to fulfill: to attract foreign companies to produce their APIs in Russia. It is quite unlikely that they will do that here. But secondary production—this, companies will do. Tableting, ampuling, sterile liquid filling, and this type of activity. Which, actually, will be a very big step ahead for this market.

But you do have a strategic list in Russia of 57 products, which was approved by the Government in mid 2010. These are products of strategic importance to the Russian patient. By 2015, these products will only be purchased if they are produced under full-scale manufacturing in Russia. Of course, very many international companies have their products on this list and some are even patented products. Therefore the question is: how can patented products be manufactured here unless the companies manufacture them themselves?

So there are some open questions, of course, the conditions in the marketplace and the focus of the Government has changed. This has made us take this decision more quickly, or rather, to decide that now is the right time to go ahead. The decision was taken in light of the framework of operation that is developing in this market today—a framework that will endure, we assume, in the future.

Do you feel that the government is forcing your hand? As you note, they are announcing strategies to stop buying as many imported products under the reimbursement programs, they are announcing protectionist preferences for locally produced medicines, etc. Are they offering any real economic incentives as well?

At the end of the day, it is up to you to decide what you want to do with your business; the government cannot force us to build facilities here. For us, what is important is that emerging markets—not only Russia specifically—have a huge part in Nycomed's global revenues. They have a huge part today, and will play an increasing role in the next five years. For Nycomed, as a group, emerging markets comprised 39% of sales last year, led by Russia and Brazil. That is very significant!

Individual companies will have individual approaches regarding how to move forward in such extremely strategic markets. For us, we did this not because we feel there is a forceful message from authorities saying "if you want to have success in Russia, then you better do this." We did this because we have many high-volume retail products here that are not dependant on the essential drug list, not dependant on reimbursement, not dependant on state procurement, etc. etc. Our products are dependent on the demand of the market.

So we can defend our investment in the factory independent of any government procurement strategies. It is purely something we need to fulfill the demand of the market and provide for product availability, logistic streamlining, and efficacy. Also we need to make these products more affordable, by gaining a different cost structure within the country.

Politically speaking, to make such an investment and to provide two-three hundred working places in a Russian region, makes you a very important partner of the region itself, as we are in Yaroslavl. It makes you a very important partner for the federal authorities, because this investment is in line

with their thinking.

But it was not ultimately a deciding factor for Nycomed to invest 80Mn EUR in plant, because we 'need to.' No, we made this decision based on an absolutely concrete business plan. Because you cannot have any guarantees! There is no state in the world that can guarantee you, say, more added value, or more business, or more state procurement, if you set up a plant. They will tell you that if you want to invest in the country—please, go ahead! Buy the land, build the plant, and produce your products. But they cannot guarantee your success. What the government wants, and I agree with them, is high-quality medicine at affordable prices. That is the key, for any budget holder.

Let us consider a bit more the government's strategy and the overall environment that they are creating for healthcare. You mentioned, of course, Pharma 2020. When we spoke with you in 2006, the push for modernization was just beginning. Now, there are clear goals in place—although we will wait to see how they are implemented. As a foreign company, are you satisfied with the direction the healthcare system is taking at present and what challenges do you see?

I think, first of all, that Russian healthcare policymakers, get too much negative criticism. This criticism is unfair. The complexity of what we are dealing with is immense! In Russia we have 85 regions and we have a technology problem. A technology transfer problem that must be developed and adapted: communication, the internet, communication-sharing, etc.

It is complex! You go to a polyclinic and an attendant comes with your file in the same binder that it was in when you were there 15 years ago. You ask them, when will they move to an electronic system? And they will tell you that it is very difficult. How can they even keep your data protected like this? You do not see this in any Western country. But the solution is not easily implemented.

A second issue is that Russia is still spending something like four percent of GDP on healthcare—which is very low compared to Western Europe where healthcare spending is between seven and ten percent. The focus on healthcare, from the collapse of the Soviet Union until three or four years ago, has been tremendously low.

Now, what we are seeing, over these last three or four years, is both positive and negative. The negative is that as Russia increasingly focuses on its healthcare industry, we the industry are, little bit the "bad guys.' The healthcare industry globally has a difficult time—price pressures, litigation cases, compliance, etc. Nobody wants to pay higher prices for medicine and therefore, as businesses, we are castigated. This industry, worldwide, used to be very well-received and very reputable; this has changed because the policymaker changed it. This is also happening in Russia. It is not specific to Russia, but it is happening as Russian policymakers begin to increasingly scrutinize our activities. Here also, there is a demand for better prices, affordable medicines,

compliance, etc. And they want to make a better framework for this. I fully understand them and this process is positive long term for the entire healthcare system in Russia.

We cannot scream and protest that our business lives are changing; that things are getting more difficult for us. No—we have to adapt. Of course, not everything is exceptionally transparent, and maybe some decisions are implemented too quickly, so you do not have time to do your proper homework. There are times when you go home on Friday, and everything seems absolutely perfect in terms of the business and its projects. Monday morning, you get a call, and suddenly things have changed dramatically. This is how it is.

The question is always to measure predictability. One of the issues for investors here is the predictability of the money that the government will put into healthcare, into reimbursement, into increasing the share of healthcare spending GDP, and into modernization.

But I have to say that, looking at this from a positive point of view, there is a focus on healthcare now! There is a focus on dramatically changing lifestyle. There is a focus on decreasing the prevalence of things like smoking-related deaths, COPD diseases, pulmonologic diseases, alcoholism, unhealthy eating, etc. This is a huge cost burden for the society! These are simple calculations for the government, when they look at it.

Reimbursement is also under development. Because this is still a retail market—something like 65-70 percent of the market is dominated by retail sales. 60-70 percent is generics, so it is still a generic market. The access to highly innovative medicine is still not distributed on a level that may be compared to the Western world; partly because there is a huge gap in funding for reimbursement.

There is a long way to go. But by looking at all of this you can see that being here as a healthcare company these are all only upsides. These are all growth opportunities.

In our 2006 interview you noted that you have been able to be so successful here because Nycomed's Russian product portfolio is very specialized to the needs of this market. In 2011, as specialty care sectors have grown, as the reimbursement programs have evolved, as Russian tastes have evolved—how have you attuned your sales strategy?

If you look at the top ten companies in Russia, many of them have a partially outdated product portfolio. If you look at the top ten medicines, many of them similarly, are outdated. Although they play an important role in Russia, many of these products are no longer sold in Western Europe or the U.S. They are sold here by tradition and doctors are still very conservative about changing therapy recommendations. Many companies have perhaps 25 percent of their business coming from products that they sold in Soviet times!

But it is changing. That is quite clear. For Nycomed, we have 50% of our total business coming from in-licensed products; from partner products. We just established, and kicked off this year, a joint venture with GE Healthcare Medical Diagnostics, which for Nycomed, as a medium-sized company, is a very big image booster. We are very proud that GE chose Nycomed as a partner. It is a flag for us. We also have a very close collaboration with Biogen Idec for MS products.

Nycomed is more and more moving into an innovative portfolio. Of course, this furthers our objective to be more strongly present in the reimbursement programs, when they really take speed.

Again, most of the business of Nycomed is still in retail and we are very small in the Seven Nosologies program. We now focus all of our in-licensing activities on innovative, patented products that should be part of the reimbursement programs in the future. And also from our own portfolio, we have Daxas, which is an example of a new, innovative COPD drug developed by Nycomed, which we will bring to the Russian market. We have great expectations for Daxas in Russia. There is a particularly high prevalence of COPD—spurred, as I have mentioned, by the country's smoking problem.

Do you agree that company's superlative market knowledge is the reason why the group is able to so successfully gain partners and help them increase their global penetration?

If you are looking for a partner, you always want to know who they are. We have a good track record. The first in-licensing deal I did was in 2001, with Merck KGaA. When they pulled out of this market in 2001, they were looking for a partner to take over their portfolio and part of their structure here. We entered into a tender process and we won the rights. At that time the business with Merck was just a few million dollars. Over the course of 10 years, we developed this portfolio to what is now close to a 150Mn EUR business.

In the early 2000s—in the early post-crisis after the collapse of the economy in 1998-99—very many companies had no interest in entering this market; they found it corrupt, non-compliant, or just generally unattractive. So we worked extremely hard from the early 2000s until 2005 to get in-licensing partners. We established a framework where we do the job for you. We develop the business for you and maybe from there you take on the business yourself when the market conditions and the business platform are there. That has been a successful model, and we have been building on success after success. Today, we have about 10 big partners, which represent 50% of our revenues.

Of course, the other reason that we had to work hard for in-licensing partners is that Nycomed globally did not have a particularly large R&D pipeline. At the time, the global in-licensing deals of Nycomed were more sophisticated and more suited to highly developed markets. In the middle of 2000, those partnerships were not suited to the conditions in Russia. We were looking for more adaptable solutions to the market.

In the last three or four years it has become more and more difficult to get partners because everybody wants to be here now! We see also that when we have five or seven year contracts, once they end, some of our partners would like to go in and establish their own subsidiaries, since we have done such a good job in developing a platform for them. Conditions have changed and the outlook is much different. It is much more difficult now to get new partners for exclusive representation in Russia.

But you seem to be doing quite well in this respect nonetheless.

Yes, we are. We signed two big deals last year and we have a fantastic partnership pipeline. I cannot speak on it, as they have not yet signed off, but we have very promising term sheet negotiations with several key partners. Our business development team is doing a fantastic job and I am impressed about their professionalism. We are a team. I am also myself much involved together with our alliance management in promoting and telling our success story.

One aspect of your role in Russia is to sell pharmaceuticals and develop your business. Another aspect is to develop this market. The ultimate goal of Pharma 2020 is to encourage local science and R&D. In Yaroslavl, you are involved in the development of a pharmaceutical cluster and Nycomed is going to have a training program for specialists to work in GMP-certified facilities. What do you feel the role of a globally-experienced company like Nycomed is in developing the Russian market?

The main interest of Russia is not to attract multinational companies to set up production facilities; it is to set up R&D, innovation centers, collaborations with Russian science for the development of molecules. The main interest of Russia is to return to the strong tradition of R&D that permeated Soviet times.

Of course Nycomed is also thinking in this direction. We have plans to establish a Nycomed Innovation Center, where we are going to conduct pre-clinical work and it could also be a center for screening interesting molecules. So in this sense we see a switch, partly, from other global Nycomed centers, to emerging markets where company growth is coming from.

This kind of thinking is part of the Yaroslavl concept. It is not enough to simply set up a production facility, plant your flag, and do sales and marketing. Conducting technology transfer for R&D, and activities in that vein, is the higher goal.

Do you feel that conditions in Russia are right for you to bring this kind of science here?

Historically, for the last 20 years, Russian companies have offered many quite creative molecules for our scrutiny, and for the scrutiny of other multinationals. We often had a very negative perception before we even looked at them—Russian science has lately had an image problem.

But looking at the larger history of Russian science, this country long had a formidable base. Why can't this come back? We have Skolkovo, now, as an example: it has a Silicon Valley-style model. There we will have many large American companies, like Microsoft. This can perhaps also drive the creation of some pharma clusters at Skolkovo for innovation.

I believe Russia itself, as a market, is going to be a very significant place of doing business. For much of Big Pharma, emerging markets represent 30-40% of revenues, and this will perhaps increase. Beyond sales and marketing, multinationals here have to develop a new scope of thinking about this industry. Look at India—how developed India is becoming. Nycomed just opened up an API facility in Bombay.

As Russia evolves, so will Nycomed. You have quite an ambitious plan—you want to make upwards of 1Bn EUR in revenues within the next five years. Where do you think this growth will come from, and what will the company look like when it reaches the billion?

I think we will reach the billion quite a bit sooner than that actually! At least if we look at current company growth patterns. The growth will come from, first of all, the existing products. These will still make up about two-thirds of our projected revenues. But minimum, we will make 200 – 250Mn EUR in new products over the same period. Some of the new products have been launched this year and some others will be launched over the next few years. Our pipeline is very promising.

This company has been completely built on organic growth; No mergers, no acquisitions. Yes, the global Nycomed acquired Altana four or five years ago, but it had no impact on this market. In Russia, we have been able to grow through successful in-licensing, business development and sales of our own patented products.

You have personally been here almost as long as Nycomed has been in Russia and this affiliate is now the most successful in the company. What is left to accomplish?

That is a good question! For me personally, a chief accomplishment will be the completion of our factory in Yaroslavl and to get the first product manufactured in the facility. Then, I will feel that we are really local and that we have moved quite far ahead by setting up a GMP-compliant pharmaceutical facility with a few hundred workers.

Where in Europe will it be more exciting than in Russia? The dynamics, the growth, the opportunities—they are here. We had a fantastic 2010 and the first quarter of 2011 looks extremely good. The billion Euros we planned to achieve by 2014 will be reached in advance of the mark. This is where it is happening!

But I think that if you do not continue to have a focus developing at a rapid clip, you run the risk of stagnation. Nycomed had the second-fastest growth after Sanofi-Aventis last year in Russia, and we were nearly equal. Nycomed was rated one of the top two or three companies in the CIS

republics and in Russia we were approximately seventh. Nycomed was fastest in prescription growth. Now, we have the Yaroslavl plant nearly finished and the innovation center will most likely go into development as well. Nycomed Russia-CIS also has a significant pipeline. Therefore, my challenge now is to continue to change Nycomed for the better and to continue to develop its business model to sustain growth. This is an enormous challenge.

I am looking very, very attentively at the current business model and discerning what needs to be done to adapt to the new changes in the marketplace and to maintain growth. It is important—not only in this country, but perhaps especially in this country—to energize organizations frequently. If you do not give your colleagues significant new projects and challenges they will rest on their laurels. They will think everything is perfect because they are meeting budget targets, and so on. When that happens, you stop stretching targets and reaching for more. You fall a bit asleep. Therefore, you absolutely need to energize the organization.

Another issue that is enormously important is human talent. The problem now is that talent is decreasing in Russia. In the BRIC countries, Russia ranks lowest in attracting new talent and the educational level in Russia has worsened since the Soviet era. It is developing again, but it is still not what it used to be. Russia used to be one of the best in the world in an academic respect, but that has changed.

Noting these tendencies—when it is difficult to find outside talent—you need to build talent from the inside. I have seen, over the last two or three years specifically, that all of our new positions are filled from inside our organization. Therefore we have a very big focus on talent development, succession planning, and so on.

To be able to continue to do that, you need to make sure that you have the right business model in place and that you make the proper changes. You need to be sure that you have a talent pool that sees that this company is moving forward and that this company is developing. Employees need to see that they can have a career here and reach leadership positions.

It is not only the products that have made Nycomed so successful in Russia. We do have exellent products, but it is the people that make the difference. Yes, it is also: the structure, it is our set-up, it is our functionality, it is the coverage we have. But it is the people that make the difference! Employees are pretty stable at Nycomed and we have a small turnover—especially in top and middle management. We see middle management getting older or better to say more mature, but constantly developing their management competencies, which is proven fact looking at the company’s year on year performance. We have a good balanced management team in Nycomed Russia. I am very proud of my team. They are doing such a great job.

What would you like you final message to be, on behalf of Nycomed Russia?

I would love to see the Russian population proud of, and happy with, the available healthcare services in their country. I sincerely hope that healthcare will be the number one priority of the Russian government—not only in terms of money spending, but policy making, training, professional salaries, etc.

We are getting there. There are a lot of positive steps in this direction. One example is that today, it is nearly impossible to recruit a sales rep that comes from a medical university because they all want professional medical careers. Salaries in medicine are significantly higher. Only three or four years ago 80 or 90 percent of the sales force for the Russian pharmaceutical industry was comprised of medical doctors. That is changing because medical doctors do not want to work for the pharmaceutical industry—they want to go work professionally. This, I think, is an excellent example of where the country is headed. The industry should not fill up their offices with medical doctors! Doctors should work in hospitals and policlinics, and we should not take the best students from medical universities. Instead, companies should sponsor, as Nycomed does, the best candidates for scholarship programs so they are able to continue, financially, to obtain more education and specialization.

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