China Today: Pharmaceutical Distribution in China

The country strives to modernize its distribution logistics as thousands of small companies compete for profits

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China today represents a $15-billion market for pharmaceutical products. China’s pharmaceutical industry has been expanding at about 20% over the past five years. It has been predicted that China will become the world’s fifth largest single pharmaceutical market by 2010. With such a fast-growing market segment and a huge population, simply getting pharmaceuticals to the patients and healthcare providers is becoming a daunting task. Biopharmaceuticals distributors face the same challenge, with the added complications associated with cold-chain management, shelf-life, and product stability.

China is entering its 11th Five-Year Plan, the national economic development guidance which roadmaps the country’s overall development in the five years between 2006 and 2010. The ongoing reforms in its healthcare system are creating a significant impact on pharmaceutical pricing and distribution. According to our recent study, Advances in Biopharmaceutical Technology in China (Society for Industrial Microbiology and BioPlan Associates), Chinese pharmaceutical distributors are struggling to survive harsh competition (Table 1) and are looking for business opportunities that will enhance their profitability. Over the past decade, there have been 19 waves of drug price cuts, and the government has launched nationwide drug bidding programs since 2000. These programs have considerably lowered gross profits within the drug distribution segment. As China opens its pharma distribution industry to foreign players, the question on most distributors’ minds is survival.

"China’s further integration with the global economy, the internationalizing of domestic markets, and the advancements of reforms in pharmaceutical, healthcare, and medical insurance systems has brought China's 50-year-old traditional pharmaceutical distributing mode to an end," said Jin Qian, chairman of Shanghai Pharmaceutical Co. "The Chinese pharma distribution industry must experience a rebirth before it gains new life."

PHARMACEUTICAL DISTRIBUTION

Chinese pharmaceutical distributors have an arduous task of supplying to 1.3 billion people residing over 9.6 million square kilometers. Distributing pharmaceuticals to more than 700 million people located in rural areas is especially difficult. In China, the term medicines broadly includes all products used in the diagnosis, treatment, or prevention of diseases. Drug distribution was rigorously controlled by the Chinese government. To ensure this control, state-owned distributors have monopolized the drug distribution sector for many years. Consequently, the expansion of Chinese pharmaceutical distributors has closely linked to the evolution of the country’s pharmaceutical distribution framework.

DEVELOPMENT HISTORY

China’s pharmaceutical distribution has undergone three stages of development: the planned economy stage,
the reform and open stage, and the market-oriented stage.

**Planned Economy Stage (1950–1979)**

Before China opened its door to the outside world, the government applied rigorous central power policies to rule the country. The state adopted a highly centralized drug distribution management system under this "planned economy." During this period, pharmaceutical products were strictly allocated and transferred through three levels of drug wholesale distributors. The first-level drug wholesalers, which were called "medical and pharmaceutical purchase and supply stations," were under direct supervision of the central government. The second-level wholesale stations were supervised by provincial or municipal authorities, and the third-level wholesalers were managed by local governments. At the planned economy stage, all Chinese distributors were state-owned. The government controlled the price differences between wholesalers. The price difference between the drug manufacturers and the first-level wholesalers was not allowed to exceed 5%. The price difference between the first-level and the second-level wholesalers ranged from 5% to 8%, and the price difference between the second-level wholesalers and hospitals or pharmacies was up to 15%. In total, the overall price difference from producer to pharmacy or hospital ranged from 25% to 28%.

**Reform and Open Stage (1980–1989)**

China began major economic reforms and gradually opened its door to the world in 1978. The pharmaceutical distribution structure in China evolved significantly at that time, moving from an introverted structure to a more open system. It also became more decentralized. During this period, as China began to have more market-driven economy policies, the rigid three-level drug distribution pattern was gradually abandoned. Drug distribution channels increased and manufacturers had some freedom to choose their distributors. At this stage, the market demand for pharmaceutical products also began to increase dramatically, and the market became more of a seller's market. This reduced competition among distributors as both the pharmaceutical industry and distributing businesses in China experienced rapid growth.

**Market-Oriented Stage (1990–present)**

In the early 1990s, China’s pharmaceutical industrial environment began to undergo tremendous changes. Domestic pharmaceutical production grew dramatically while numerous imported drugs began to enter the Chinese market. China’s pharmaceutical market changed from a seller's to a buyer's market. Meanwhile, the number of distributors and retailers continued to increase. Many large state-owned distributing companies were restructured and transformed to public shareholding enterprises. Some of these companies managed to get listed on Hong Kong or domestic Chinese stock exchange markets. The total number of distributors soared from 2,500 in the 1980s to more than 16,000 in the 1990s. Mergers and acquisitions among Chinese distributors began to take place in the early 1990s and have increased over time. In general, the most successful distributors today are the ones that adopt strategies for pharmaceutical logistics that emphasize expansion, large scale distribution, and modernization.

Although China has not fully modernized, and is still undergoing reform and restructuring, the country is on the way to developing an organized, efficient, and cost-effective pharmaceutical distribution framework in conformity with international standards.

**CURRENT DISTRIBUTION SITUATION IN CHINA**

In 2004, after a nationwide "Good Supply Practice" (GSP) certification campaign, the number of drug wholesalers dropped from 16,000 to 7,445. Today, there are over 200,000 pharmacies across China and private owned enterprises are becoming a strong force in China's pharmaceutical distribution sector. State-supported pharmaceutical logistics and electronic trade systems have been put into operation in many cities. Since pharmaceutical distribution in China was opened to the world in 2003, several foreign distributors have entered the Chinese market.

Despite these advances, the industry is dominated by small companies. In terms of sales revenue, only 10 wholesalers have exceeded 1 billion RMB ($127 million) and just a handful have exceeded 5 billion RMB ($635 million). The revenue of the largest chain pharmacy is 500 million RMB ($63 million). However, the total market share of the three largest Chinese distributors (China National Pharmaceutical Group Corporation, Shanghai Pharmaceutical Co., Ltd., and China Jointown Group) in 2005 was only 17%. This is a small figure compared with that of the three leading distributors in the US, which account for 90% of the US domestic market.

The majority (80%) of Chinese drug distributors can be characterized as small. This has resulted in a relatively unhealthy competitive environment, where multiple firms are competing for small market shares. The average gross profit of China's drug distributing companies has been dropping and is now at 8%, with net profit declining to around 0.5%. This trend is expected to continue. In some cases, as zero net profit is reached, pharmaceutical distributors will seek opportunities to become product agents, where they will make profits by earning commissions and discounts from the manufacturers.
Table 2 lists the top 10 pharmaceutical distributors in China. In April 2005, five distributors—Shanghai Pharmaceutical Co., Guangzhou Pharmaceutical Corp., Chongqing Medicine Co., Beijing Pharmaceutical Co., and Tianjin Taiping Group—officially formed the "China Pharmaceutical Commercial Economic Alliance," which was an important event in the Chinese pharmaceutical community. Meanwhile, Sinopharm Medicine Holding Co., the major branch company of Sinopharm, was planning a merger with the Tianjing Taiping Group to expand its business network and compete with the alliance. All these activities indicate that the Chinese distribution system expects a major restructuring or large-scale merger and acquisition.

MODERN PHARMACEUTICAL LOGISTICS IN CHINA

Modern logistics management is still in the nascent stage in China. The first modern pharmaceutical logistics center was built by Beijing Pharmaceutical Group Co., Ltd., and started operations in Beijing in March 2004. The center introduced advanced logistics equipment and technologies from Siemens Dematic Co. Since then, numerous logistics centers have been established or begun construction in several major cities including Shanghai, Guangzhou, Luoyang, Shenyang, Changsha, and Lanzhou.

The government has been making efforts to encourage Chinese drug distributors to develop new logistics systems, and also has provided financial support to help major distributors modify their traditional system and build a modern logistics system.

FOREIGN-INVESTED DISTRIBUTORS IN CHINA

In 2003, to comply with the agreement between China and the World Trade Organization, China's pharmaceutical distribution field partially opened to foreign companies. It completely opened up in 2005. Several foreign-owned or joint-venture drug distributors were established in China in 2003.

In December 2003, the first Sino-foreign joint-venture pharmaceutical distributor, China Zuellig Xinxing Pharmaceutical Co., Ltd., was established by the Swiss company Zuellig Pharma and the China Xinxing Group, with a total investment of 120 million RMB ($15 million).

In September 2005, China Ministry of Commerce and Trade approved the acquisition by a US company, Beijing Med-Pharm Corporation (BMP), of a Chinese drug distributor, Wanwei Corporation based in Beijing. BMP became the first wholly foreign-owned pharmaceutical distributor in China.

In October 2005, a wholly-Japanese owned drug wholesale company completed its registration in Guangzhou, China. The company started operations in January 2006.

MAJOR CHALLENGES

Following its long and complicated history, the Chinese pharmaceutical distribution sector now faces major challenges. These include:

- The current operation mode of most distributors is not in line with the requirements of modern distribution, especially with regard to scale and automation.
- Many distributors lack logistics management knowledge and talented managerial professionals.
- Macro regulation and control from the government is limited.
- Profits today are at very low levels.
- The existence of a large number of undersized distributors has caused malignant competition and chaotic growth, which has resulted in higher costs, lower profits, and conflicts over limited market shares.
- Many distributors have limited market development and service capabilities.

FUTURE TRENDS

Chinese pharmaceutical distributors are growing in the following directions:

- Scale-up to achieve economies of scale required for economic performance
- Merging with domestic and foreign-owned companies
- Narrowing their focus to specific geographic, market, or healthcare areas
- Enhancing modern logistics management.

China's domestic pharmaceutical industry growth is exploding. With 26% growth and $55.8 billion in sales in 2005, the future looks bright. However, systemic planning will be required. In the future, Chinese healthcare
policy makers and pharmaceutical distributors will continue to grapple with the monumental responsibility and task of supplying 1.3 billion people with medicines, diagnostics, and services. They will continue to play an indispensable role in fueling the expansion of China's pharmaceutical industry.

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REFERENCES


3. Official data released by SFDA Southern Institute of Medicinal Economy. Pharmaceutical industry sales include chemical synthetic medicines, traditional Chinese medicines, biologics, medical devices, hygiene materials, etc.