



**BUSINESS AND MANAGEMENT
CASE STUDY: N-PHARMA**

For use in May and November 2010

INSTRUCTIONS TO CANDIDATES

- Case study booklet required for Higher Level Paper 1 and Standard Level Paper 1 Business and Management examinations.

N-PHARMA

N-Pharma is one of the biggest multinational companies (MNC) operating in the pharmaceutical industry. It employs over 30 000 people globally. The corporate headquarters are in Tsukuba Science City near Tokyo in Japan.

History

5 *N-Pharma* was founded in 1973 by Yukio Nakamura, a Japanese chemist. It began as a small laboratory in a suburb of Tokyo employing nine members of staff. It was set up as a private limited company. In common with most other start-ups, poor cash flow meant that the early years were financially challenging. Costs were high as Yukio was developing a new type of painkiller, Pharmax, which was launched in 1977 to widespread acclaim. From this point, sales rose rapidly and high profits enabled Yukio to expand his business. Within three years, 10 the number of people employed by *N-Pharma* grew from 9 to 200 employees. Throughout this period of expansion, a key feature of Yukio's management philosophy was to maintain close relationships with suppliers.

Since 1980, the business has continued to grow. A combination of strong demand in the mid 1980s and a period of economic boom in Japan enabled *N-Pharma* to expand within the Pacific Rim. 15 In 1986 a subsidiary was established in Seattle, United States (USA), followed by another in Canberra (Australia) two years later. *N-Pharma* has also opened smaller subsidiaries in other countries such as Canada, Mexico, Chile, Vietnam, South Korea and New Zealand. Subsidiaries are responsible for both production and distribution of *N-Pharma* drugs in their national markets, as well as research and development (R&D).

Product development

20 In the pharmaceutical industry, R&D departments have a critical role in ensuring successful innovation. New product development can lead to competitive advantage, business growth, higher profits and therefore shareholder satisfaction. However, R&D is a long and expensive process: it could take more than 17 years from the discovery of a new drug to its launch onto the market (Appendix 1). The process of approval involves significant testing to 25 ensure the safety of the drugs. This takes longer than in other industries, which is why all new drugs, once commercialized, tend to be expensive. Once production begins, quality assurance and quality control are vital to ensure the continuing safety of the drugs.

Marketing

When *N-Pharma* sets the prices of its drugs, it must cover not only the costs of production and distribution, but also the costs of past R&D. Pricing is usually cost-based, although some other
30 factors may be taken into account, for example the price of competitors' drugs. Pharmaceutical companies do not normally use market-based pricing strategies of penetration or skimming.

N-Pharma has a portfolio of drugs at different stages of their product life cycle, for example:

- Pharmax is still very important for the company. It has a share of around one-third of the market for painkillers in Japan and the USA. That figure has been stable for the last 10 years.
35 Although the market is saturated and growing very slowly, this painkiller is a well-established product. Following the expiry of the original patent, competitors are now starting to produce cheaper substitutes.
- A range of drugs was launched in the early 2000s. One of them, Pharmaflo, is designed to prevent heart attacks; it already has a high 15% share in a market that is still growing rapidly.
40 On the other hand, some other *N-Pharma* drugs are performing quite poorly; such as the Pharmaslim line of products for weight control. The market for anti-obesity drugs is growing rapidly. It is very competitive and gaining market share is proving more difficult than anticipated.
- In 2009, *N-Pharma* launched a new anti-aging drug called Pharmatics. Thanks to significant
45 introductory marketing efforts, with both above the line and below the line promotion, the first sales results were satisfactory. It is, however, too early to tell whether present sales will be maintained.

Although launching a new drug is a complex marketing activity, *N-Pharma* has a key strength: its well-established brand name has been maintained by aggressive advertising in
50 specialist magazines. *N-Pharma's* logo is present on all its products; its family branding has attracted considerable brand loyalty. Market research shows that most adults across East Asia recognize *N-Pharma* labels and regard them as a mark of quality and safety.

N-Pharma drugs are trusted but are expensive. In periods of economic difficulties, many people prefer to buy generic drugs*, which are cheaper. Yukio has calculated that the demand for some
55 of *N-Pharma's* products is income elastic.

* generic drugs: as opposed to branded drugs, generic drugs are produced and sold without patent protection

Managing human resources in a multinational company

N-Pharma has attempted to introduce the same tall organizational structure in all its subsidiaries. However, this uniform approach to hierarchical organization has not proved appropriate as it ignores cultural differences between some of the countries where *N-Pharma* operates.

60 In Canada for instance, employees have repeatedly stated that they want more delegation
and a wider span of control. The Canadian subsidiary has recently suffered lower levels of
productivity compared to other *N-Pharma* subsidiaries. In this current financial year, it has
even traded at a loss. Several managers have been unable to improve productivity, so Yukio has
appointed Susan James as chief executive officer (CEO) in Canada to return the subsidiary to
65 profitability in the coming financial year. Susan has dismissed requests for greater empowerment.
Although morale has deteriorated and strike action has been threatened by the union, she
refuses to change her leadership style. She has the support of the rest of her management team.
The problems have been exacerbated by her inability to communicate and by the tall
hierarchical structure. With negotiations and collective bargaining now in process,
Susan understands that employees may be left demotivated and that productivity might suffer.
70 She knows that Canadian employees respond well to financial motivation, so her solution to the
problems is to redirect some of her R&D budget to her human resources (HR) department in
order to implement performance-related pay (PRP).

In Australia the *N-Pharma* CEO, Laura Davies, is facing different issues. Unlike Canada,
employees in Australia do not have problems with long chains of command. Instead they want
75 changes in employment patterns and practices in order to suit their lifestyle and to have a better
work/life balance. Many have questioned the appropriateness of traditional working hours;
they have been arguing for flexitime and teleworking. Absenteeism has become a key issue for
Laura and has impacted on workforce planning. *N-Pharma* employees in Australia are not
motivated by financial incentives as they already have a high standard of living. Laura Davies
80 anticipates, therefore, that the Australian employees of *N-Pharma* will respond positively to
non-financial rewards and these will improve employees' job satisfaction, motivation and
productivity.

Current issues: *N-Pharma* in the media

Since 1980, *N-Pharma* has been a public limited company with its shares traded on the
Tokyo Stock Exchange. Shareholders have traditionally been happy to invest in *N-Pharma*,
85 regarding the shares as a relatively risk-free, safe investment. However, many have recently
expressed concerns about the way *N-Pharma's* public image has been tarnished by some events
and problems.

In 2008, one of *N-Pharma*'s laboratories found itself at the centre of a controversy reported by the world's media. Its scientists were conducting research on the effects of a new drug and as part of the testing, they carried out experiments on animals. Many of these animals suffered a painful death. A "whistleblower"* alerted the authorities because the standard regulations and benchmarks that were supposed to ensure the care of animals were not followed. Unannounced, veterinary inspectors visited the premises and wrote a damaging report. The document was leaked to journalists and this started a "media frenzy" with headlines such as "Animals tortured at *N-Pharma* lab" and "*N-Pharma* lab of shame". Animal rights activists vandalised several laboratories as well as the Tsukuba headquarters; Yukio Nakamura himself received letters threatening him and his family. The weight of public opinion worldwide was against *N-Pharma*, even though a costly public relations exercise reduced the impact to a certain extent.

Following the negative publicity, *N-Pharma* tightened its procedures and created a new post of "director of corporate social responsibility". The person appointed to the position was Tadashi Agi, a professor of business ethics at the National University of Tsukuba. Tadashi is now writing a "Charter of Ethics", setting ethical objectives for the company. He intends to use a Kaizen approach to change the corporate culture and encourage ethical practices in all departments. He is making extensive use of information and communication technology (ICT) to communicate his ethical vision to internal and external stakeholders. He also plans to carry out social and environmental audits.

Accounts and finance

Although *N-Pharma* has large financial reserves and could theoretically withstand any financial instability including an economic recession, the board of directors is aware that financial markets are volatile.

The USA subsidiary of *N-Pharma* recently had a liquidity problem and as a form of crisis management the Tsukuba headquarters had to intervene to provide some extra short-term capital. The board of directors of *N-Pharma* sent Suzuko Tanaka, one of the Japanese financial auditors, to Seattle to enquire about the problem. Although Suzuko found that the financial information was not up-to-date she managed to collect some data (Appendix 2).

* whistleblower: an employee who reveals wrongdoing within an organization

The future: external growth and strategic options

In October 2008, in one week alone, the value of *N-Pharma* shares dropped by 25%. Although the market recovered, *N-Pharma* remains vulnerable to takeover.

120 The board of directors of *N-Pharma* is considering several strategic options for the future growth of *N-Pharma*. As part of this consideration Yukio has provided the board with a range of economic data and forecasts (Appendix 3).

Option 1: Market development in Europe

N-Pharma does not commercialize any of its drugs in Europe yet; it has three possible routes into the European market:

- 125 (a) Through direct entry. If *N-Pharma* wants to get its branded drugs known across Europe, where customers have strong brand loyalty towards products they already know, this strategy would require an investment of 75 000 million yen in communication, promotion and advertising.
- 130 (b) Through the acquisition of several small pharmaceutical companies based in Europe. The takeovers would require an investment of 100 000 million yen but would ensure access to national markets as well as economies of scale. However, if another recession hits Europe, those smaller companies could be cheaper to buy.
- 135 (c) Through a joint venture with *R-Taylor*, the European market leader in drugs distribution. *N-Pharma* would gain access to new customers, whilst *R-Taylor* would benefit from successful R&D activities. The cost of the joint venture is estimated at 75 000 million yen. Such a large scale joint venture would need prior approval from the European Union Commission. The legislation is too strict at the moment although this might change in the next couple of years.

Option 2: Market penetration within China

140 *N-Pharma* already sells some of its drugs in China, especially through business-to-business (B2B) operations with private clinics and it could take advantage of the rapid economic development and increasing life expectancy in China. *N-Pharma* could set up a major centre in Beijing; this would cost 50 000 million yen and give access to the largest market in the world. Some members of the board of directors have a number of concerns, such as:

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- the patent legislation is not enforced so strictly in China (some Chinese competitors could rapidly copy some of *N-Pharma*'s drugs and sell them at a lower price)
 - the quality control procedures are not as tight in China (*N-Pharma* drugs manufactured in China may not be of the same quality as the ones produced in other countries)
 - the historic disagreements between the two countries (political changes in China could have a negative impact on the *N-Pharma* subsidiary).

Option 3: Diversification

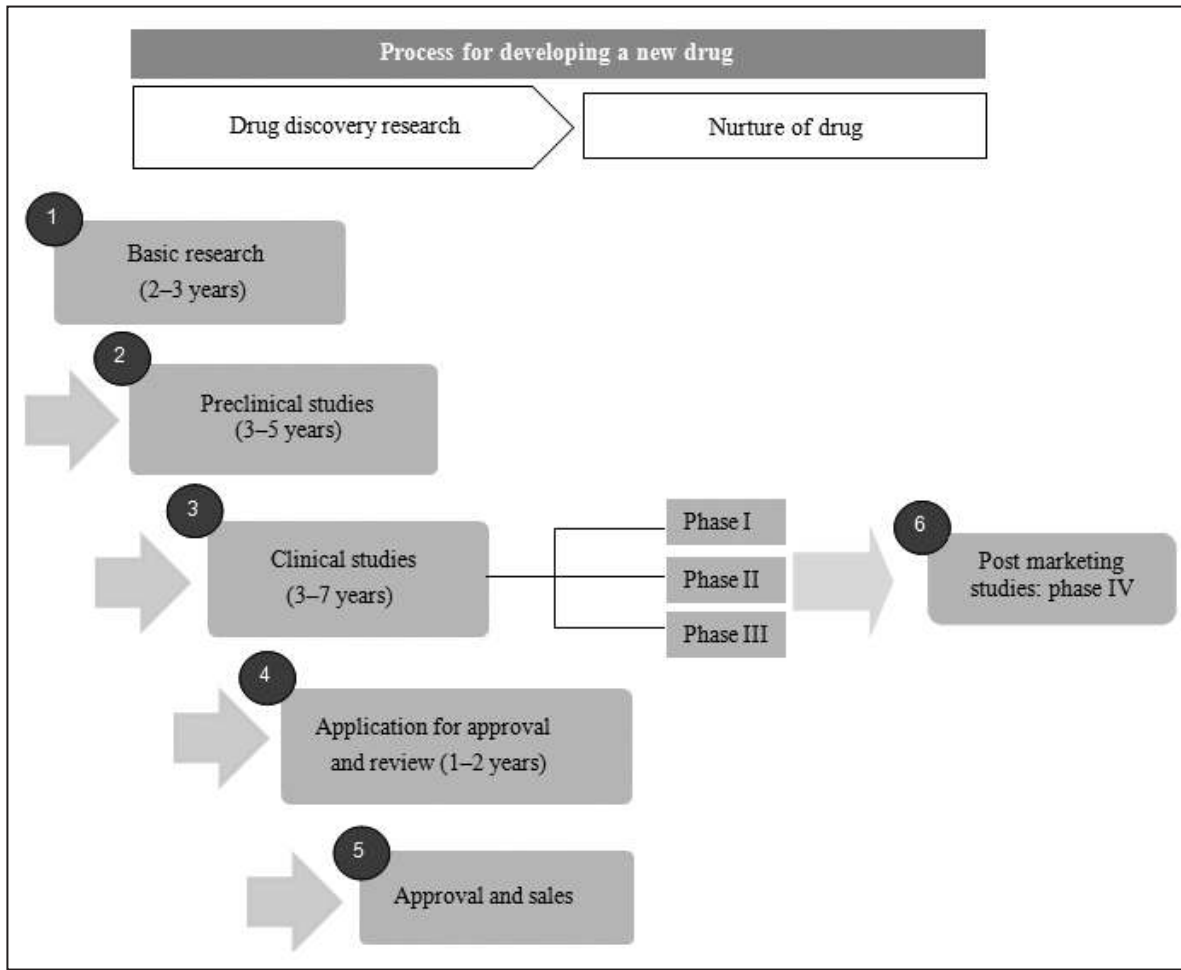
150 Some members of the board of directors believe that as part of their new ethical stance *N-Pharma* ought to widen its portfolio of products to include animal welfare. At the moment, *N-Pharma* only offers drugs for humans, but the veterinary market is booming. The market for animal drugs could represent the future of *N-Pharma*. As there is a strong element of risk, a strategic approach could be a merger with *Anigam*, one of the world specialists in animal drugs. *Anigam* is well established in the USA and Europe, but not in Asia.

Additional terms not in the Guide

Direct entry

Diversification

Appendix 1: Research and development in the pharmaceutical industry



[Source: <http://www.eisai.co.jp/eir/eindividual/eknowledge.html>, March 2009]

Appendix 2: Data collected by Suzuko Tanaka at the USA subsidiary of N-Pharma

(US\$m)	2008	2009
Cash	190	60
Creditors	620	630
Debtors	310	350
Short-term borrowing	115	230
Stock	250	356

Appendix 3: Economic data as at January 2010

	2007	2008	2009	2010 (forecast)	2011 (forecast)
Global conditions					
World trade volume (% change from previous year)	7.5	6.2	-2.1	4.0	6.0
Interest rates (%)	5.2	3.2	1.7	2.0	3.5
Real GDP growth (% change from previous year)					
World	3.7	2.5	-0.9	2.0	3.0
Japan	2.1	0.5	-0.1	0.5	0.6
China	11.9	9.4	7.5	7.5	9.5
Europe	2.6	1.1	-0.6	1.0	1.3
Consumer price inflation (% change from previous year)					
Japan	-0.6	-0.5	-1.4	-1.8	-1.2
China	5.2	8.7	-1.6	-0.5	0.1
Europe	3.2	4.1	1.1	1.7	2.4
Population (million)					
Japan	127.6	127.7	127.8	127.8	128.1
China	1311.8	1319.9	1325.4	1330.6	1380.8
Euro area	318.7	325.6	335.7	345.6	354.2

[Source: adapted from *World Bank Global Prospects 2009*, March 2009]

Companies, products, or individuals named in this case study are fictitious and any similarities with actual entities are purely coincidental.