MANAGING DRUG COSTS - CHALLENGE TO THE INDUSTRY

BY

SAM I. OHUABUNWA

REGIONAL MANAGER (WEST AFRICA) / MANAGING DIRECTOR

PFIZER PRODUCTS PLC.

Ikeja, Lagos.

INTRODUCTION

The Chairman of the symposium, President of the Pharmaceutical Society of Nigeria, fellows of the PSN, distinguished colleagues, ladies and gentlemen, I am pleased to be requested to present this paper at this conference.

The theme of the conference - "The Challenges of Rising Healthcare cost in Nigeria" is a very contemporary one. All over the world, a lot of attention is currently being focused on the rising cost of healthcare. Today, several Governments of the world especially in Bill Clinton's USA - containment of healthcare costs is top on the agenda. Several measures including medicare, medicaid, managed healthcare and the evolution of Health Management Organisations (HMOs) are now being taken. The Pharmaceutical industry is particularly disturbed by the prospects of price controls (direct or indirect) - a situation which hitherto has been an anathema in the free market capitalist America. I am therefore pleased that Pharmacists themselves are taking the initiative to draw attention to this problem even before government begins to take any concrete action to curb the rise.

In the African scene and specifically in Nigeria, the matter calls for even greater focus. Whereas the overall government allocation for healthcare in Nigeria and indeed most of Africa is on the decline (chronically less than 5% of the annual budget as proposed by WHO, the burden on the individual consumer is rising in reverse proportion. The impact is felt by those who pay directly for their healthcare costs and that will be over 60% of Nigerians and the institutions that offer free medical care services to their employees. The pressure is getting so much that some individuals unable to cope are returning to traditional medicine and to quack doctors and chemists. Even the governments that used to offer free services in the General Hospitals have gone commercial.

HEALTHCARE COSTS

Often, it is assumed that in discussing healthcare costs, drugs or medicines is the main issue. This is not true. Expressed as a percentage of GDP, the spending on Pharmaceuticals does not significantly exceed one percentage of total healthcare spending, the proportion ranges from 6% and averages at around 10% (see table).

PHARMACEUTICAL CONSUMPTION

COUNTRY	PER CAPITA($1990 PPP)	% GDP(1990)	%CHE(1990)
Canada	136	0.7	7.6
France	160	1.0	11.4
Germany	143	0.8	10.4
Italy	132	1.0	13.4
Japan	194	1.0	15.1
Netherlands	84	0.5	6.3
N Zealand	70	0.8	10.6
Spain	87	0.9	13.8
Sweden	66	0.5	5.5
UK	77	0.6	9.2
USA	201	0.9	7.6
Average	123	0.8	10.1

The figures for Nigeria are difficult to compute due to the paucity of data, but they may not be significantly different from these and represent only a fraction of the total cost whereas doctors' consultation fees, hospitalisation costs, investigation costs, nursing care costs, costs of utilities take the rest 90%. However, it must be admitted that in situations, where there is a high degree of self medication, then the cost of drugs or medicines become a major component of the healthcare costs.

DRUGS : COST DRIVERS

It is incontrovertible fact that the cost of drugs are rising steeply and many of them are getting beyond the reach of the proverbial 'common man'. This has become a major source of worry for the pharmaceutical industry. As I have said somewhere else, there is an element of 'charity' in the business of drug manufacturing. Beyond the desire to make money, a genuine wish to remove the pain and alleviate the suffering of the sick constitute a significant driving force for those scientists and companies that toil and invest to discover breakthrough drugs. It therefore becomes frustrating if you realise that after all these efforts, people who really need the drugs are unable to obtain them because of costs. To enable us appreciate the real cost drivers, it may be helpful to take a look at the cost components of a typical drug manufacturing company in Nigeria:

COST OF MATERIALS	% CONTENT
Bulk	53.8
Raw	7.8
Packaging	27.9
SUB TOTAL	89.5
OVERHEAD COSTS	
Payroll and other Allowances	4.9
Other Expenses	5.6
SUB TOTAL	10.5
TOTAL	100.00

From the above analysis it can be seen that 90% of the costs are from materials.

In view of the fact that the Pharmaceutical raw materials and indeed a number of the finished Pharmaceutical products have to be imported due to the very poor availability of primary manufacturing, we all have to depend on foreign exchange. Therefore the major driving force for the increasing cost of drugs is the continuous depreciation of the exchange rate of the Naira against the major international currencies. The matter is even worsened by the fact that the forex even at the poor exchange value is not easily available. Both factors lead to cost push inflation and represent the dominant factors in pushing up the cost of drugs in Nigeria.

The other critical factor impacting on prices of drugs is the high interest rate. Many banks now ask up to 70% interest rate and that is where you can find those that even have the cash to lend. We all know what the finance houses ask - 120% or more (before the bubble burst). When therefore one borrows at this rate to buy forex at the ridiculous rate of $1 to N45·00 or £1 to N65·00, it is little wonder that prices of drugs are high. Most times, the matter is complicated by the long importation lead times placed by all kinds of inspections and reports and a couple of times, new regulations and policies. And when the goods finally arrive, it is either that the port workers are on strike or the clearing agents are.

In Nigeria, the cost of labour is very cheap and as can be seen from the analysis above, costs of labour is only 5% of the total cost of the products and therefore cannot be a significant cost driver.

Times were, when companies had 25% or more of their net sales as net income. But increasing cost of sales, high interest payments and taxation has drastically reduced these. Many companies today are unable to even have 10% of sales as net income despite the special 3rd world prices. This drastically reduced return on investment is the motivating factor for the recent spates of deinvestments and sell offs we have seen in the Pharmaceutical industry. It therefore becomes a major challenge for the Pharmaceutical Industry to sustain investment in this country.

FACING THE CHALLENGES

It is clear that if we must check the rising cost of drugs and in consequence hold down the overall rise in healthcare costs, we must find a way of arresting the unending devaluation of the Naira. I cannot sincerely tell you this is easy but it is a sine qua non. Secondly, the government must take the initiative to make special allocation of forex to the Pharmaceutical Industry for the importation of raw materials. Mr. Chairman, dear colleagues, this year only about 11% of the total foreign exchange needs of the industry has been allocated in the weekly forex market. Even companies who wish to buy the mix blend cannot find to buy. Let me use this opportunity to warn that if the government does not take any action in the next couple of weeks, I am afraid that we shall soon return to the era of product shortages with its attendant social consequences which include increased drug adulteration, faking and the resultant mortality and morbility.

To remove the pressure on working capital for Pharmaceutical practice, the government should set up a special fund - the "Pharmaceutical Fund" to cater for this sector of the economy. Beyond the critical necessities like air and water which have been given to us free by the merciful Almighty God, medicines are the second most important and universal need after food. We have several banks like the Nigerian Agricultural and Credit Bank, Credit and Cooperative Banks, DFRRI, NERFUND, NALDA and several schemes for assisting agriculture in Nigeria. We must institute similar financing schemes for assisting the pharmaceutical industry to promote raw materials development and primary manufacturing. The traditional banks and sources of finance are too concerned with short lending and short term high profits to bother with investments that return on the long term. The Industry continues to face the challenge of high tariffs on raw and packaging materials. When the extended SAP relief terminates at the end of this year, tariffs on raw materials will climb to 20% and those on some packaging materials like bottles and Aluminium foil and gelatin capsules remain prohibitive, up to 60% in some cases. These are additional elements in pushing up costs of drugs. If Government intends to take the health of our people seriously, it should entirely abolish tariff on Pharmaceutical raw materials.

Beyond these efforts which rest primarily on the government, the Pharmaceutical Industry is making a lot of efforts to contain the price of drugs.

Firstly, There is an unwritten code to take smaller margins as I had referred to earlier on. For most companies today, a net income of 10% of sales is what they live on instead of the 25% and above in the 80's.

Secondly, there are different Cost Improvement Programs (CIPs) being executed in the companies. Some of these range from processes and methods of manufacture to give better yields to new formulation or use of alternative excipients to reduce cost. The QA departments of Pharmaceutical companies are actually working on these cost improvement schemes.

Thirdly, as it is happening all over the world, the Nigerian Pharmaceutical companies are restructuring with the objective of becoming more efficient and cutting costs. On a global basis this involves the rationalisation of production facilities and the discontinuation of unprofitable lines. At times, it involves personnel engineering and loss of jobs. This is a painful aspect of cost saving but becomes imperative if we must manage the rising cost of drugs, Local fabrication of engineering spare parts and refurbishing of old equipment are on-going efforts to manage costs. Outright purchase of new equipment is difficult and where it is possible adds to increasing cost as depreciation becomes high.

The Industry is also working under the umbrella of PMG/ MAN to bargain for local materials so as to obtain volume discounts which impact favourably on costs. This cooperation is being extended to the search for local Pharmaceutical grade starch and sugar amongst other items.

Also, the Industry is intensifying its lobby to persuade government to accelerate the development of the Petrochemical industry to the stage where basic starting blocs for Industrial Pharmaceutical synthesis can be obtained locally, thereby reducing our dependence on importation of raw materials which will drastically reduce the cost of drugs, since most of the pressure on the price is externally driven.

CONCLUSION

Mr. Chairman, colleagues, the issue of rising healthcare costs and the challenges posed by this has become a major obsession in the world today. And rightly so. Governments all over the world are seriously grappling with the problems. I am not quite sure if our own governments are yet prepared to face the matter, but I am pleased that our Society and the pharmacists are focusing on this.

Whereas Pharmaceuticals as a group constitute only a fraction of the cost of healthcare in the world, that fraction is still significant. And in Nigeria, the significance is enhanced because of the high degree of self medication. As far as cost of drugs is concerned, the twin issues of .he Naira exchange rate and the availability of foreign exchange coupled with the high interst rates must be addressed by government if we must contain the rising cost of Pharmaceuticals. Every possible incentive must be given to motivate local primary manufacturing to reduce our reliance on importation and make drugs locally available and affordable.

Finally, let me thank the President in Council and the onference planning committee for giving me the opportunity to put across the pharmaceutical Industry view on this vexed issue. I wish all of us a successful and enjoyable IBADAN '93.

Stay blessed.

A PRESENTATION AT THE SYMPOSIUM OF THE 66TH ANNUAL CONFERENCE OF THE PHARMACEUTICAL SOCIETY OF NIGERIA , HOLDING AT IBADAN NOVEMBER 2 - 5, 1993