

## CHAPTER 1

### INTRODUCTION

The main factor affecting the attractiveness of Asia is in the market itself. Asia boasts half the world's hospitals, one third of the world's doctors and two-fifths of the world's pharmacists. It is a huge lucrative healthcare market to be explored. With nine consecutive years of strong growth, Malaysia has become an attractive market for pharmaceutical companies. With an estimated market worth RM900 million (Malaysian Business, 1996), there has been a dramatic increase in the demand of industrial distributors, especially by new entrants. With the consistent growth of the economy, people are becoming wealthier and with improved standard of living, the consumers are shifting their attitude toward better quality medical care. With increasing disposable income, coupled with higher awareness on healthcare, there is an attractive pharmaceutical market to be explored (Vandermolen, 1995). For most of the foreign pharmaceutical companies, the main business is the patent drugs and the main target customers are the doctors. At the end of 1995, there are 9,504 registered doctors in the country and it is expected to increase to 33,500 by the year 2020 (News Straits Times, 1996). With the increasing number of doctors, effective distribution is definitely crucial for a profitable business. From the marketing point of view, fast distribution system also will make the availability of drugs to reach all big and small towns through out the country. It is made even more challenging when the marketing of drugs is highly regulated by law. An efficient and effective distributor is required beside all the creative marketing tactics employed by managers.

Industrial distributor is an important element in marketing distribution strategy, especially for foreign international company. The process of developing an appropriate channel of distribution is a complex task for industrial marketer. In fact, one of the important part of marketing mix which is neglected most of the time is distribution. The importance of distribution of goods from producers to end users can costs more than US\$400 billion a year, or 20 percent of United State Gross National Product (Stern and El-Ansary, 1982). Some organizations who sell in foreign market simply do not have the task of managing distribution within those markets. For these companies, the survival or death of the company depends on the decision on the method of market entry. This is especially true when the target market is unjustifiable. In Japan, the distribution channel is very long, this is important because it needs to distribute to the large population in the shortest time possible. The whole system is very complex, with cost of goods going through as many as six intermediaries. This lengthy distribution channel causes Japan to have exorbitant prices --- US\$20 for a bottle of aspirin, US\$72 for a package of golf balls (Thornton, 1994).

The very first step in managing foreign distribution is to identify the firm's goals in the foreign market. The marketing program, including distribution, is a means toward achieving those goals. Then, the company must identify the specific tasks to be performed by the channel in that market. What role is the channel expected to play - inventory, promotion, credit extension, physical distribution, service? Lastly, the marketer must try to match this job description with the channel possibilities available in the market. Seldom there will be a perfect match between the firm's specifications and what is available in the market. A lot of factors are

beyond the control of the marketer, so compromise will often be necessary.

Several channel options are available to enter a market. These methods basically can be categorized into direct or indirect channels. In Malaysia, foreign pharmaceutical companies usually choose the indirect channel through the appointment of a local distributor. Distributor here is referred to as an organization which is responsible for order processing, warehousing, product delivery, payment collection and sometimes including some marketing and administrative activities. Many time, it is being called the logistic management. There are more than twenty pharmaceutical distributors in Malaysia. Some are very established and distribute a wide range of products for many multinational pharmaceutical companies. The number of physical distributors has increased over the year. The puzzle here is why certain pharmaceutical company prefers a particular distributor. On what basis the distributor being rated. Given the importance of physical distributors in marketing drugs, this study is designed to find out what criteria and the relevant importance of each criteria in the selection process. The knowledge of this study can be used later as the basis for further distributor's improvement and also to create a quality distributorship in the future.

The flow of products from manufacturers to end users involve cost. Correct distributor selection can reduce two types of cost. Firstly, *visible distribution costs* such as direct warehousing, transportation, and materials costs as well as indirect costs associated with interest on capital invested in inventory spoilage and obsolescence, and property taxes on inventories and warehouses. Another challenge of channel management is on *hidden costs* including lost profit

opportunities due to failure to ship the product on time and stock out resulting in brand switching, sources of supply, or stores, cancelled orders, and customer dissatisfaction. The hidden costs are somehow inherent in the service provided by the distributor (Stern and El-Ansary, 1982).

The success in export markets will depend largely on the performance of the independent distributors it uses in the host countries. The main question to ask is, "How can we get the distributor to do a good job for us?" The key is to make the relationship continually rewarding to the distributors as well as to the international marketer. In most cases, the agreement between marketer and distributor later on is considered downstream decision, the most important is in its selection. Therefore, the criteria used is extremely important, because it will determine the success or failure of the relationship.

Careful specification of what is wanted from the distributor will help a firm choose the most suitable candidate. Not all distributor will help a firm choose the most suitable candidate. Not all distributor candidates in a country will match a firm's specifications equally well.

## **BACKGROUND INFORMATION**

Presently, there are about 300 pharmaceutical companies in Malaysia sharing a piece of cake worth RM900 millions which include prescription drugs as well as vitamins. In 1995, the

market grew in the region of 14 percent (Malaysian Business, 1996). Majority of these companies are generic manufacturers, importers and agents. The word *generic* means the product produced is no longer protected by patent right by the original producer, for example, Panadol is the original paracetamol preparation produced by Beringer and a generic version can be found produced by local manufacturers. Out of a total of about 300 companies, only 56 have manufacturing licenses, of which 11 are multinational and 47 local.

As of May 31st 1994, there are 519 retail pharmacies and 2455 drugstores/medical hall. There are 7434 doctors in Malaysia as of October 1993 and the number of doctors have increased to 9504 in December 1995. Most of these pharmacies and doctors situated in west coast of Peninsula Malaysia. The highest number of doctors are situated in Wilayah Persekutuan, followed by Selangor, Perak, Johor and Pulau Pinang (MPTMA, 1994). For any pharmaceutical company to reach all of them is a very difficult task, especially for small new entrants where the high operating cost is unjustifiable by their small turnover. In certain cases, the use of distributor is the only alternative as setting up of a subsidiary is unjustifiable.

There are more than 17 physical distributors for pharmaceutical company (17 distributors are registered with Malaysian Pharmaceutical Trade and Manufacturers Association, MPTMA). The major big distributor include Zuellig Pharma, Diethelm, Summit Co., Antah Pharma, Sime Darby and Waleta Malaysia. One of the largest distributor is Zuellig Pharma. The main strength of Zuellig Pharma is that it has nine branches (Kuala Lumpur, Penang, Johor Bahru, Ipoh, Kota Bahru, Kuching, Kota Kinabalu, Singapore and Brunei) and two small bases (Melaka and

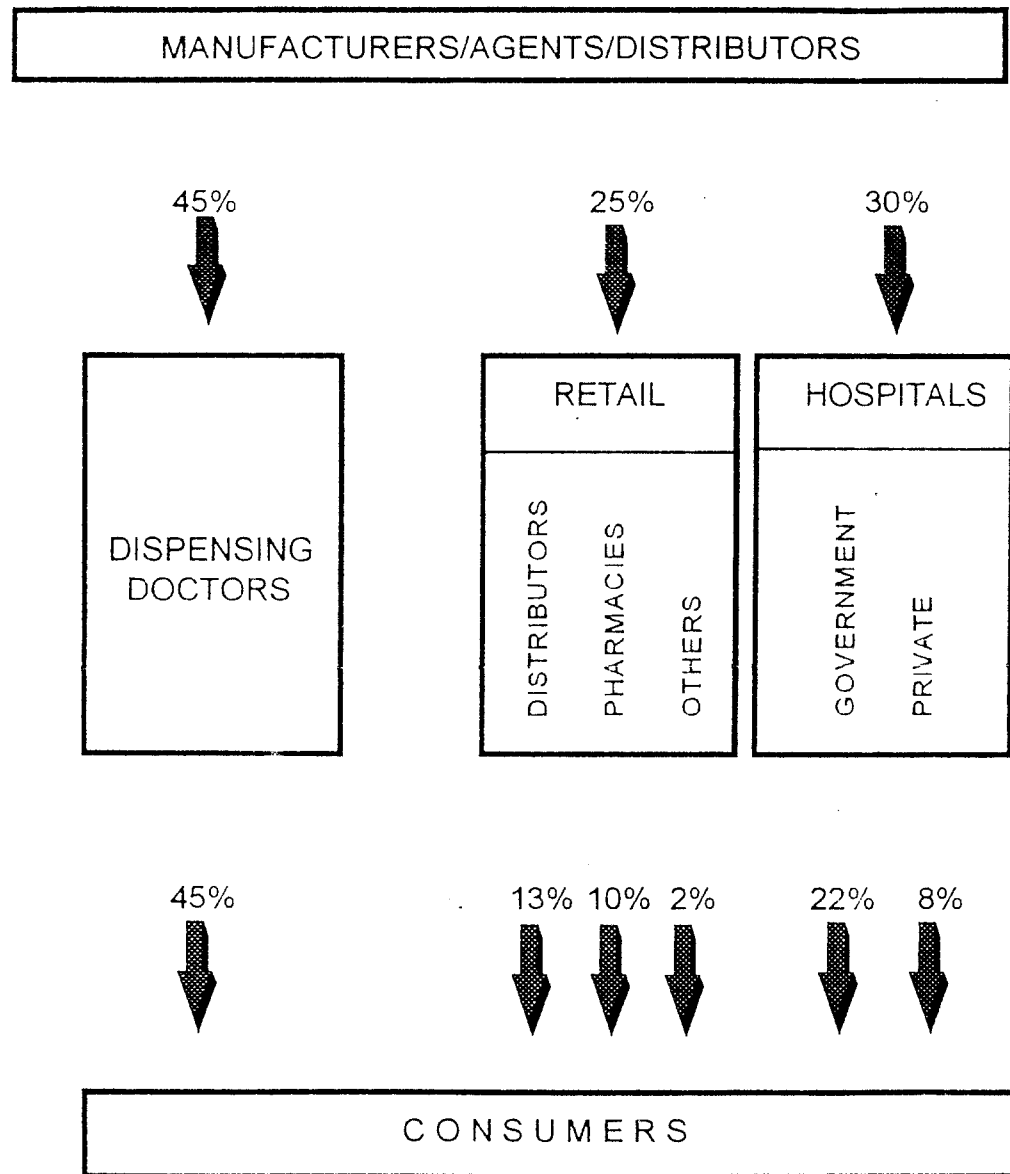
Kuantan). Zuellig was established over 40 years ago in Malaysia. Above 90 % of the products can be delivered within 24 hours in urban areas, and 75 % by in-house personnel. Zuellig has a total of 33 sales representatives, 41 product advisors and 14 customer relations officers in the country. The company covers a total 6796 accounts ranging from government hospitals, private hospitals, clinics, pharmacies, medical halls, supermarkets, mini markets, wholesalers, dental clinics, veterinary clinics, laboratories and tendering agents (Zuellig Pharma, 1996). Not all distributors have the advantages like Zuellig Pharma. According to industry sources, some distributors only have less than 10 sales representatives covering the whole Malaysia, but it is surprising that some principal companies still appointing this smaller distributors as the sole physical distributor and survive with a profitable business.

## **INDUSTRY SITUATION**

In Malaysia, the flow of pharmaceuticals from its manufacturers to end users can exist in different ways. The following flow chart (FIGURE 1) will give an overall picture.

FIGURE 1 :

FLOW OF PHARMACEUTICAL BUSINESS IN MALAYSIA, JANUARY TO JUNE, 1994



Source : MPTMA Basic Industrial Data, 1994 page 29.

Supply of drugs to government hospitals have to go through bumiputera tendering agent. Bumiputera tendering agents are organizations setup as an intermediary between private pharmaceutical companies and government hospitals. All businesses between pharmaceutical companies and government hospitals have to go through these agents. They are considered an important part of the whole distribution system since the government is the single largest purchaser in the country. In 1994, the former National Pharmaceutical and Medical Store had been privatized to become Remedi Pharmaceutical Sdn. Bhd. Since then, the importance of the bumiputera agent has diminished, especially for drugs. With the creation of Remedi Pharmaceutical Sdn. Bhd., all essential drugs should be purchased by government hospitals through them. Unless the items required is not in Remedi's list of essential drugs, the government hospitals can purchase through the bumiputera agent. The question here is, will the existing physical distributor continue to exist bearing in mind Remedi will be managed as profit center, nothing can stop them for being a physical distributor themselves through direct contact with potential foreign new pharmaceutical company. Therefore, there is a need to reassess the requirement or the criteria used by pharmaceutical company to select a distributor. Hopefully this study can be used to assure the continued survival of the local distributor especially the smaller ones.

Recently, a new type of healthcare organization has emerged and caused some controversial discussion among healthcare professionals. They are the Health Maintenance Organization (HMO). Under the system proposed by HMO, HMO will acts as an agent to

provide managed healthcare to companies, their employees and families. Employers will not need to deal directly with medical practitioners, insurance companies and employees, the HMO system will take care of all the relevant parties. According to managers from pharmaceutical companies, they think HMO are expected to play an important role too in the distribution of drugs in the future.

Another emerging trend in the distribution is mail ordering service. Customers can order drugs through mail order, the service is presently offered by some retail pharmacy chain. Although the idea is innovative, most of the pharmaceutical managers think this service is still at its infancy stage and is not expected to make a major impact in drugs distribution.

Three types of function can be performed by a distributor, product management, promotion and sales and distribution. Depending on the principal, certain functions can be performed by the principal company itself. Product management includes market research, product registration and marketing planning. Promotion and sales include promotion, sales and product training, merchandising and sales and order taking. Distribution includes importation, warehousing, inventory control, order processing, shipping & delivery and payment collection. New entrants usually appoint a distributor for all the functions without having a representative from the headquarter based in the host country. Bigger and more established companies, usually perform the sales and promotion themselves and leaving the logistics to the distributor. This happens because principal companies usually prefer to do the promotion themselves as they can have a higher level of control over information flow. Marketing, advertising and promotional

activities are governed by Medicines (Advertisement and Sale) Act (Revised) 1983 where trade names of pharmaceutical products are not allowed in consumer press - either advertisements or in editorial material. Owning own sales force will make sure the correct information are distributed ethically to the market without violating the act.

There is no study in Malaysia to classified and categorized the kind of function performed by distributors but generally understood by the industry that the progress of the whole system can be summarized in the following flow chart (FIGURE 2). One should always remember that there is no clear cut of this progression as the distribution system is rather complex. For example, a pharmaceutical may performs some form of product management and also some level of promotion.

FIGURE 2 : PROGRESS OF DISTRIBUTION SYSTEM

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	<u>DISTRIBUTOR</u>	<u>PRINCIPAL</u>
Stage 1	Product Management	
	Sales & Promotion	none
	Distribution	
	I	
Stage 2	Product Management	Sales & Promotion
	Distribution	
	I	

FIGURE 2 : (CONTINUED)

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Stage 3	Distribution	Product Management Sales & Promotion
		1
Stage 4	none	Product Management Sales & Promotion Distribution

where,

<u>Product Management</u>	<u>Sales and Promotion</u>	<u>Distribution</u>
Market Research	Promotion	Importation
Product Registration	Sales and Product Training	Warehousing
Marketing Planning	Sales & Order Taking	Inventory Control
		Shipping & Delivery
		Payment Collection

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When introducing a new product to a foreign market, manufacturers must decide if the product should be marketed mainly by company salesforce and distribution divisions or by outside sales agents and distributors. In Malaysia, new entrants usually will use distributor's

salesforce but for more well established company, they always have their own salesforce. Having own salesforce provide few advantages such as higher salesforce commitment, better control, faster customer feedback and more focus on marketing objective. When the business slowly grows, own sales force will be employed and leaving the physical work to the distributor. This is followed by reduction in distributorship margin. And if the business continues to be profitable, Malaysia incorporated firm will be established. At this point, the function of the distributor will be reduced to logistic management only. Not many company actually reach this final stage. Most of the company are still using a physical distributor.

## **OBJECTIVE**

There are numerous studies carried out to study the selection criteria for a distributors. Clasen (1991), Shipley et al (1989), Shipley (1988), Moore (1987), William (1987), Cavusgil (1987) and Grand (1986), but none of the studies was to study the distribution of pharmaceuticals or medical equipments. For example, Gordon et al (1991) studies on electrical contractors choose distributors.

In Malaysia, no such study had ever been carried out. As such, a study would be of interest both to the distributors and the companies using the distributors in pharmaceutical industry in Malaysia.

The major aim of this study is to access the criteria used by international pharmaceutical companies when selecting a distributor in Malaysia. Beside looking at the selection criteria, the another aim is to look at the relative importance of these criteria. It is hopefully the result of this study can be used later by distributors to reevaluate their company advantages and disadvantages. Perhaps it can be used as a basis to further improvement.

Finally, this study is also aim to contribute some understanding towards the selection criteria in the study of marketing.