

Logistics developments within the pharmaceutical industry



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ARTICLE Logistics developments within the
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1 LOGISTICS DEVELOPMENTS WITHIN THE PHARMACEUTICAL INDUSTRY

In comparison with pioneering sectors such as FMCG, retail and electronics, the pharma industry is somewhat behind when it comes to logistics developments like distribution network optimization and Sales & Operations Planning (S&OP).

However, change is inevitable, since various developments currently underway in the pharmaceutical industry are making the logistics situation increasingly complex. The most important of these developments are outlined below.

1.1 Reduction in logistics costs

At less than 2.5%, the contribution of logistics costs to Costs of Goods Sold (CoGS) has always been relatively low within the pharma sector, although this has mainly been due to the high capital intensity of medicines. Hence, there has never been a real financial need to look for ways of improving logistics efficiency.

Shorter patent terms and growing competition from cheaper generic medicines from the Far East are putting the high price of medicines under increasing pressure. As a result, pharma manufacturers are embarking on cost-saving programmes, focusing mainly on outsourcing their logistics activities and centralizing their warehouse operations for various countries.



1.2 From wholesale supplies to 'end customer' deliveries

In particular in smaller sales markets, it is standard practice for pharma manufacturers to sell through wholesalers rather than directly to customers (hospitals, pharmacies, retailers). Especially in countries with a low sales volume yet a high service level, wholesalers offer added value since their strong local network enables them to offer very short delivery times (often delivering to local pharmacies several times per day). In some countries (including Hungary and Finland) it is even mandatory to sell through wholesalers.

However, an increasing number of manufacturers are actively looking for ways in which they can sell to pharmacies or retailers directly and independently, not least in order to circumvent the wholesale margin which producers have to pay. This margin is largely based on the pharmacy purchase price (PPP). As prices rise, particularly for prescription medicines, so too do the margins, despite the fact that no extra logistics activities are necessary.

Furthermore, manufacturers are not happy about parallel imports¹ since these have a negative impact on their turnover.

¹ International flows of goods between wholesalers themselves which exploit differences in medicine prices between various countries.

1.3 Late stage customization

As a result of the large number of patents currently expiring within the pharmaceutical industry, there is a growing need for cash to finance the massive R&D investment involved in the race to develop a new blockbuster.

One way of freeing up cash is to reduce the inventory of finished product. This is no easy task in the pharma sector, where inventory levels of 6 months or more are commonplace. These high stock levels are caused primarily by the labour-intensive administrative procedures related to production batch registration and release.

Centralizing pharmaceutical warehouse operations opens up opportunities for late stage customization, or in other words for moving the push pull point further downstream. The first prerequisite for being able to manage late stage customization is an effective S&OP. However, the use of wholesalers in certain countries means that a manufacturer often lacks sufficient market transparency (inventory and sales data) for a reliable S&OP process.



1.4 Power struggle over who manages logistics in the pharma supply chain

Pharmaceutical wholesalers have diversified considerably in terms of the services they offer in recent years. While few of them have pan-European reach, they all carry considerable weight in their local markets. A wholesaler is often a business division of a pharmacy chain, or may operate as a pre-wholesaler – in other words, logistics service supplier – which makes them direct competitors of the likes of DHL, UPS and DSV. As a result, wholesalers' influence in the supply chain is increasing both upstream and downstream.

In order to protect their own market position, pharma manufacturers are eagerly looking for ways to weaken the wholesalers' position of power through logistics. One option is to move from a national logistics approach to a regional one, using just one pre-wholesaler for a number of countries. This helps a manufacturer to create more buying power without completely losing sight of local market needs.

In view of the wholesalers' various financial interests, however, this is a delicate process for manufacturers. In fact, many regional initiatives of this kind do not come to fruition because manufacturers are afraid of damaging commercial relationships with wholesalers/pharmacies by cancelling the logistics contract with their sister companies.

1.5 Tighter regulations in the form of Good Manufacturing Practice (GMP) and Good Distribution Practice (GDP)

GMP and GDP (good practices for manufacturing and distribution) are quality assurance systems which outline criteria relating to the purchase, receipt, storage and export of medicines. These regulations stipulate that manufacturing and warehouse operations must be designed so as to avoid cross contamination and mix-ups and must be inspected regularly. All of these procedures are laid down in what are known as SOPs (Standard Operating Procedures). All changes to the working principles and any deviations in the procedures followed are recorded.

This means that each warehouse facility and transport route has to be validated, qualified and documented. In addition, every time goods are to be transported (from factory to warehouse) a sample has to be taken and tested in the laboratory before the entire batch can be released – a process which can often take several weeks.

For these reasons, an increasing number of pharma manufacturers are striving for a less complex distribution structure (i.e. fewer warehouses) as a way of reducing the administrative costs and achieving greater logistical flexibility within the framework of the GMP and GDP regulations.

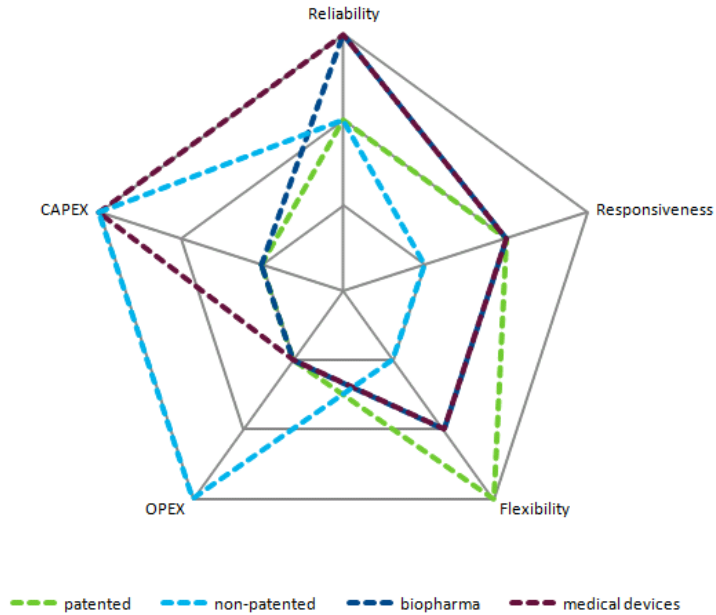
In many cases, however, the logistics solution is failing to materialize since the EU's anticipated new GDP regulations put the pharma industry at a distinct disadvantage, as follows:

- Storage of medicines for longer than 24 hours will be classed as an operation which needs qualifying and hence requires a relevant GDP licence. This means that each logistics hub will need to possess a GDP licence if it stores medicines over the weekend, for example, ready for transportation the following week.
- Regardless of the duration, a wholesaler licence will always be required for the storage of temperature-controlled medicines. This implies that every airport will have to apply for a wholesaler licence in order to be permitted to handle medicines in transit.
- Medicines destined for non-EU countries will be required to be kept physically separate from EU medicines. This will lead to very complex processes within a warehouse if, for example, a pallet is delivered containing a mix of products.

This is just a selection of the many developments within the pharmaceutical industry which will inevitably have to be translated into more contemporary logistics concepts. Depending on the type of medicine, reliability, flexibility and responsiveness currently remain the key reasons for deciding to optimize the logistics operation. Except for logistics relating to generic medicines, finance is still a relatively minor consideration.



Supply Chains performance attributes per pharma sector



In a world of pharma in which the need for logistics reform is so blatantly evident, it will still take some time before the awareness of logistics costs has trickled down to the other types of medicine.

For questions regarding this article, please contact Alain Beerens, beerens@groenewout.com or tel.: +31 6 5025 28 32.



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