Since Zuellig Pharma established itself in South Korea over a decade ago, the company has enjoyed an eventful and successful time in the country. Starting out as the first overseas distributor to enter the country’s pharmaceutical sector, Zuellig Pharma has shown that its adherence to world-class standards and first-rate facilities have provided the platform from which to soar, with 60% of the top 20 international manufacturers’ sales in Korea now passing through the company. This article looks at the prospects ahead for Korea’s healthcare sector and Zuellig Pharma’s future direction within the country.

Background
The evolution of the Republic of Korea into a highly developed industrial nation and OECD member is among the most impressive economic changes of recent times. High education levels, strong investment in research and development, and industrial complexes and free trade zones that successfully attract investments from both domestic and overseas companies are all part of the country’s strategy for continued success and prosperity.

Korea has a developed infrastructure of transportation and energy sources to support economic growth. Free Trade Agreements with the US (under discussion) and the EU (ratified in 2011) should provide the framework to further increase the competitive advantage of export-dependent Korean industry in two of its main markets. Proximity to China, the region’s fastest growing market, and a favorable exchange rate for the won versus other currencies has also improved the position of its key industries and contributed to a quick rebound from the global financial crisis.

However, the strength of the Korean economy is also its weakness. The country depends heavily on the primary and secondary sectors, which contribute over 40% to its economy, in comparison with other major OECD countries where the maximum is 25%. This economic structure makes Korea prone to competition from developing countries, namely China which is gradually stepping up the value chain by investing in its own resources and applying policies to encourage knowledge and technology transfer.

The dominant and most famous Korean national champions are found in various industries, such as automotive (Hyundai/Kia), ship-building (Hyundai/Samsung), steel and construction (Doosan/Posco), and consumer electronics (LG/Samsung).

While the ratio of employment in a specific sector tends to contribute in equal parts to GDP for most OECD countries, Korea’s tertiary sector contributes approximately 55% to GDP, while employing over 65% of the workforce. This imbalance reflects the economic and political focus on manufacturing. The highly fragmented service sector remains relatively untouched by the conglomerates so far and most attempts at consolidation are subject to fierce political disputes. As a result, there are no Korean companies among global service sector giants.

Korea is following an active policy to increase its political weight. In holding the G20 summit in 2010, the country was the first in Asia to host the international event. The country has also attracted a number of international events in sports (Football World Cup 2002 Korea/Japan) and been the venue of various conventions and fairs.

Healthcare environment
Korea maintains a National Health Insurance (NHI) system which provides coverage to most of the population. The insurance relies on partial self-payment
The question remains whether the distribution model in Korea will move toward more direct access or remain in its current form as a wholesale model from patients. Since 2000 when separation of prescribing and dispensing was introduced, prescription drugs are sold exclusively at pharmacies and clinics. A law prohibits Korean hospitals being run as for-profit organizations. As a consequence, hospitals focus on the domestic market and do not have any share in international medical tourism. Exceptions are the derma and beauty industries, which have flourished in recent years, attracting large numbers of customers from the Asian region.

With a population of 48 million and GDP per capita of US$20,000, Korea spends 6.75% of GDP on health (2010), out of which 16.7% is spent on pharmaceuticals. Pharmaceutical sales reached US$13 billion in 2010, with 35% sold by multinationals and 65% by local manufacturers. Local manufacturers mainly produce small molecule ETC and OTC products, while multinationals have the major market share in innovative products with patent protection and large molecule products, such as biologics. Local manufacturing has flourished due to a reimbursement policy that prices generic products at around 80% of the original product.

Domestic pharmaceutical manufacturers cater for most of the demand for OTC drugs, which contributes less than 20% to total pharmaceutical sales. With a market share below 15%, few international manufacturers invest in the competitive and saturated OTC market. That said, attention has been given to recent new market entries such as Reckitt Benckiser which has successfully launched several OTC and consumer health brands. With limited OTC reclassification currently under approval to allow retail sales, the sector is drawing further attention and more investment from multinationals can be expected.

Supply chain
Most pharmaceutical products are sold to healthcare providers through wholesalers. A large wholesaling industry developed after the separation of prescribing and dispensing, with 1,800 wholesalers managing the distribution of drugs at the peak. Wholesalers maintain strong relationships with their customers and differentiate their service mainly through covering different geographic areas. No wholesaler covers more than 7% of the total market even today. This situation requires manufacturers to maintain internal teams for administration and day-to-day management of multiple wholesaler accounts.

Clinical trial destination
South Korea is one of the top destinations for clinical trials in Asia and has attracted considerable investment in research and development from major multinational pharmaceutical manufacturers. Korea has established a network of clinical trial centers throughout the country. The centers enable sponsors to conduct trials in an ideal environment. The government body tasked with coordinating and driving clinical trial development is the Korea National Enterprise for Clinical Trials, or KoNECT.

The number of trials in Korea has increased 18% annually since 2005, with a total of 439 trials conducted in 2010. In addition, the Investigational New Drug (IND) approval time for Phase 1 studies has recently been reduced to 14 days. Such measures aim to increase Korea’s share of early phase studies.

Zuellig Pharma Korea, in cooperation with Zuellig Pharma Specialty Solutions Group, is actively supporting the industry by offering depot management and a delivery service that covers 100% of trial sites and utilizes a dedicated team and infrastructure.

Growth of biosimilars
South Korea sees the healthcare sector as strategically important for economic success and is pursuing growth through an active industrial policy. One key focus is biosimilars, generic versions of off-patent biological products. These generics are expected to show strong future growth due to their assistance with the country’s efforts to curb healthcare expenses. For Korea, the healthcare industry also provides the opportunity to move its economy away from labor-intensive manufacturing toward a more balanced sector mix. As major investment is necessary to build up the required infrastructure, mostly large Korean conglomerates with sufficient free cash flow, or local chemical companies in alliance with foreign partners, have invested in the field to date.

- Co-operative agreement between Celltrion and Hospira to develop and market biosimilars under development (2009).
- Announcement of strategic partnership between Samsung and Quintiles to form a joint venture for manufacturing biosimilar drugs (2011). The first biosimilar products are expected to move into retail sales from 2013.
- Biosimilar drug cooperation between MSD and Hanwha Chemical Corp, worth US$720 million (2011).

<table>
<thead>
<tr>
<th>Zuellig Pharma Korea services by industry</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Services/Industries</strong></td>
</tr>
<tr>
<td>Distribution Service</td>
</tr>
<tr>
<td>Pick &amp; Pack Service</td>
</tr>
<tr>
<td>Import/Bonded Warehousing Service</td>
</tr>
<tr>
<td>Contract Sales Force (Detailing &amp; Merchandizing)</td>
</tr>
<tr>
<td>IT Solutions (Business intelligence, Mobile Ordering Tools, B2B Platform)</td>
</tr>
</tbody>
</table>

| Domestic pharmaceutical manufacturers cater for most of the demand for OTC drugs, which contributes less than 20% to total pharmaceutical sales. | 12 | 13 |
Challenges for manufacturers
Most manufacturers in Korea have seen continuous double-digit growth during the past 10 years. But in 2011, many of these companies expect single-digit revenue growth. The pressure on revenues is linked to several NHI efforts to curb healthcare expenses. Major issues for multinational manufacturers include:

**Low purchase price**
The NHI has started an initiative to reduce drug costs through price reductions on insurance prices of drugs. While drugs have traditionally been sold to hospitals at the medical insurance price, hospitals now have an incentive to negotiate a lower purchase price and retain some of the price reduction. The NHI will adjust medical insurance prices based on actual transaction prices paid.

**Generic substitution threat**
Pressure to substitute original medicines with cheaper generics is mounting as the NHI's deficit increases. Prescriptions from doctors are typically issued by brand name, unlike other countries where prescriptions by ingredient leave the choice of the brand subject to the dispensing pharmacist's decision.

**Shortage of collaterals**
Multinational manufacturers require their sales to wholesalers to be 100% collateralized. An insufficient amount of collateral limits sales growth and requires manufacturers to continuously negotiate business terms with wholesalers.

**Supply chain and channel costs**
Korean regulations require imported products to be stored in a manufacturer's dedicated import warehouse before being transferred into a Korea Good Storage Practice commercial area after completion of quality control tests and import administration procedures. The requirement regarding a dedicated import warehouse is unique in Korea and limits potential economies of scale from warehousing. Together with trade margins to wholesalers, the cost of delivering products to channels is significantly higher than other Asian markets.

The wholesaler industry shares most of the challenges of manufacturers. As a key service, wholesalers take on a financing role by accepting payment terms from hospitals up to 280 days, which leaves them vulnerable to interest rate fluctuations. Wholesalers are highly leveraged through short-term debt and several bankruptcies during the global financial crisis have shown that unexpected drops in sales can disturb the financial balance of even large wholesalers.

These challenges in conjunction with recently implemented minimum warehouse space requirements and the change of marketing practices accelerates the erosion of profitability and shows a clear path toward consolidation in the wholesaler industry, which today still runs on significant over-capacity.

Zuellig Pharma in Korea
The complexity related to the large number of wholesalers provided the trigger for Zuellig Pharma's entry into the market, creating a joint venture with several multinational manufacturers. As the country's first overseas distributor, Zuellig Pharma quickly built up strong relations with both principals and a range of selected local wholesalers. Today, Zuellig Pharma handles 60% of sales.
Import Warehouse Pick & Pack: a manufacturer’s import warehouse is set up within Zuellig Pharma’s distribution center with the entire operation, including bonded warehousing and relabeling, managed by Zuellig Pharma within one single facility. This service is used by pharmaceutical, medical device and vaccine manufacturers. As well as warehousing, Zuellig Pharma manages the delivery of products to indirect or direct accounts. The most recent service established offers next-day delivery of temperature-sensitive vaccines to over 3,500 direct accounts (clinics) throughout Korea.

- IT Solutions & Business Intelligence Reports: to increase the productivity of principals’ sales teams and automation of order processing, the mobile ordering solution “eZRx Mobile” is available to principals on iPads or smart phones which send orders directly to Zuellig Pharma’s enterprise resource planning system. Zuellig Pharma also runs the user-friendly web-ordering platform “eZRx” for B2B, which provides customers with the opportunity to order directly through the internet, a major and fast-growing distribution channel in Korea.
- Distribution: includes warehousing, order processing and delivery with invoicing/accounts receivable & collateral management. Zuellig Pharma has coverage of all major hospitals and pharmacies by selling prescription products directly through its sales force, or through a network of 170 partner wholesalers.
- Distribution with Detailing/Merchandizing: a principal’s products are sold by Zuellig Pharma’s multi-line team or an exclusive sales force under Zuellig Pharma. Sales representatives perform sales calls to pharmacies for OTC products, conduct merchandizing activities and manage transactions with pharmacies.
- Clinical Trial Depot Management: Korea is a major clinical trial hub in Asia and attracts a large number of studies due to its developed infrastructure and favorable regulation. Through Zuellig Pharma’s Specialty Solutions Group, Zuellig Pharma offers depot management services for regional and local trials conducted in Korea.
- Business Intelligence: ZPK Insights, a business intelligence system, enables principals to create a 360-degree view of their business by combining sales to different wholesalers into one report. The system allows customization of a principal’s requests and can analyze sales numbers and trends at a high level of granularity.

**Outlook**
Zuellig Pharma’s wide-ranging portfolio allows the company to customize its services to principals. The successful establishment of this portfolio demonstrates that Zuellig Pharma has contributed to the change in the distribution landscape of the pharmaceutical industry during the past decade.

The question remains whether the distribution model in Korea will move toward more direct access, or remain in its current form as a wholesale model. The global tendency to increase manufacturers’ productivity by reducing channel costs points toward a change.

However, in Korea relationships between hospitals, pharmacies and wholesalers have been strong historically and still are. Long payment terms and additional services provided by wholesalers to hospitals, that is, stock management, remain a hurdle for manufacturers to access hospitals directly. For pharmacies, product assortment and delivery frequency are key criteria in their decision to select a supplier. This requires distributors to maintain a nationwide infrastructure of branches and warehouses.

The government’s determination to implement the new healthcare regulations has put pressure on the existing wholesaler model and requires all stakeholders in the healthcare industry to review and redefine their strategy.

Either way, Zuellig Pharma is well positioned to address the needs of principals in Korea and looks forward to continuing a long-term partnership with the South Korean healthcare industry in which Zuellig Pharma can contribute by applying its core values of trust, quality, transparency and innovation.