

**Egypt's Pharmaceutical Sector**  
**Survival and Development Strategy Report**  
**Incorporating Results and Conclusions Of Review Activity**

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## **Overall Approach**

The strongest period of growth in Egypt's pharmaceutical manufacturing capabilities was in the 1980s and early 1990s. Since this period there has been increasing stagnation and a decline in international competitiveness. The main reason for this situation has been an over-emphasis in applying a defensive economic policy to the sector, which has become increasingly out-of-date. The key objective of the policy, as applied in Egypt, has been to keep prices of pharmaceutical products as low as possible, at the same time as maximising the level of domestic manufacture. The policy has been successful in meeting its objectives with prices being maintained at low levels and 75% of domestic consumption of dosage products manufactured domestically.

## **Impact Of Defensive Economic Policy**

There have been a number of negative impacts of applying the defensive economic policy:

- Egypt still relies on most of the input materials for producing synthetic dosage products being imported.
- The value of pharmaceutical exports in 2002 was \$ 41.2 mn. With imports of \$ 430 mn, there was a negative trade balance of \$ 388.8 mn.
- The countries with worse trade balances than Egypt in 2002 were: UAE (\$ 467 mn); South Africa (\$ 528 mn); Algeria (\$ 544 mn); Saudi Arabia (\$ 944 mn); and Turkey (\$ 1,391 mn), but Jordan achieved a positive trade balance of \$ 34.5 mn which demonstrates what is possible.
- Egypt is in 7<sup>th</sup> place for regional export performance with \$ 41.2 mn in 2002 behind: Israel \$ 901 mn; Jordan \$ 198 mn; Turkey \$ 142 mn; UAE \$ 92 mn; Cyprus \$ 71 mn; and South Africa \$ 58 mn.
- Egypt's exports of pharmaceutical products increased by only 4.8% from 1998 – 2002, compared to: 537% for Iran; 309% for Saudi Arabia; 134% for Israel; 80% for Cyprus; 44% for Turkey; 41% for Jordan; and 34% for Morocco. Egypt was in the top five regional exporters in 1998.
- Using a trade performance indicator of export value expressed as a percentage of import values, Egypt is in 8<sup>th</sup> position, behind: Israel; Jordan; Cyprus; UAE; Morocco; Malta; and South Africa.

In conclusion the defensive economic policy may have been successful in controlling imports, but it has also acted as a significant constraint on the development of exports.

## **Sector Orientation**

A key outcome of applying the defensive economic policy is that Egypt's Pharmaceutical Sector is domestically oriented and has been suffering from poor trading performance for a number of years. Multi-national companies manufacturing in Egypt are incurring net losses at an average of 4% of turnover. Indigenous generics and public enterprise manufacturers are maintaining profit levels, but only through cutting costs on marketing and sales, and on product development. Such cost cutting cannot be sustainable in the medium to longer-term without undermining the future of these companies.

One of the most significant outcomes of the domestic orientation is the manufacturers produce a wide range of products and have not adopted the international trend towards increasing product specialisation. This effect can be seen in Egypt's export performance with export sales in 21 different product areas. All regional countries that are more successful exporters than Egypt concentrate their exporting efforts in one, or a limited number of product areas. The percentage of total export sales accounted for by one product area is: 99% for Cyprus; 95% for Israel; 89% for Jordan; 81% for Malta; 79% for UAE; 76% for Iran; 75% for Morocco; 59% for South Africa; 53% for Turkey; compared to 51% for Egypt.

### **Manufacturing Costs**

Material inputs represent a higher proportion of manufacturing costs in Egypt, at 80%, than their international equivalents, where these costs are 60%. The result of this situation is that the advantage of lower manufacturing expenses, energy costs and administrative costs in Egypt are lost.

The following table compares the product cost structures of indigenous and international manufacturers operating in Egypt, with their international equivalents.

<b>Cost Heading</b>	<b>Indigenous Manufacturers In Egypt</b>	<b>International Manufacturers In Egypt</b>	<b>Manufacturers Outside Egypt</b>
Cost of sales	78%	68%	48%
Sales and marketing	5%	18%	32%
R&D	2%	3%	5%
Other costs	6%	6%	1%
Taxes	1%	1%	3%
Profit after interest	8%	-4%	11%
Total	100%	100%	100%

Comparing international manufacturers operating in Egypt to such companies manufacturing outside Egypt, the key points are:

- Cost of sales at 68% of total product costs, compared to 48% outside Egypt.
- Expenditure on marketing and sales 18%, compared to 32% outside Egypt.
- 3% allocated to research and development, compared to 5% outside Egypt.

The comparisons between indigenous manufacturers and their international competitors are even more striking, with the key points being:

- Cost of sales at 78% of total product costs, compared to 48% outside Egypt.
- Expenditure on marketing and sales 5%, compared to 32% outside Egypt.
- 2% allocated to research and development, compared to 5% outside Egypt.

Not only is Egypt giving away its competitive advantage in low manufacturing costs, but it has become a high cost location in which to manufacture pharmaceutical products. The result is a squeezing of margins and lower budgets allocated to marketing and sales and product development. This not a sustainable position for the domestic manufacturing sector, but it also provides a partial explanation for the poor export performance. The above cost comparisons provide evidence as to why Egypt's Pharmaceutical Sector is losing its competitive position.

Recent reductions in import tariffs will help the above situation, but it is our view that the higher input material costs are also due to a number of sector structural issues, including:

- Purchasing these materials through import agents, or joint venture partners, rather than purchasing business-to-business.
- The wide range of products being produced results in relatively small orders being placed.
- Cash flow problems result in purchases being made on an as required basis, rather than to longer-term contracts.

### **Manufacturing Capabilities**

None of the manufacturers covered by the company review are operating to current Good Manufacturing Practice (cGMP) and none have obtained manufacturing accreditation from an internationally recognised inspection body, such as the FDA. This compares to India which has 126 approvals, or pending applications, of its manufacturing facilities with the FDA.

Having such accreditation is now a pre-requisite for selling dosage products into developed consumer markets in North America and Europe. The consequences of this situation are reflected in Egypt's export performance:

- A relatively high proportion of exports, 38.5%, are of bulk products, with only 61.5% in dosage form.
- Egypt's three largest exporting markets in 2002 were: Saudi Arabia at \$ 12.6 mn; Romania \$ 6.9 mn; and Sudan \$ 4.0 mn.

- MENA region is Egypt's largest exporting market taking 48.6% of exports in 2002, followed by: Eastern Europe 19.4%; Rest of Africa 14.1%; EU 13.9%; and others 4.0%.
- Egypt's exports to the EU in 2002, valued at \$ 5.6 mn, were split 91% bulk and 9% dosage products.

### **Pricing**

Product pricing has been one of the successes of Egypt's defensive economic policy, but the success can only be viewed within short-term healthcare objectives. The consequences of the pricing regime that has applied up to now are:

- Lack of profitability for the international manufacturers to justify investing in the next stage of development of the sector.
- Lack of incentive to export as importing countries take into account the prevailing prices in the country of export.
- Reduced levels of new product development which is a serious issue for Egypt's indigenous generic product manufacturers.
- Lack of resources to implement international market and sales development campaigns.
- Medications available in Egypt being restricted to off-protection products, which may either have more potent up-dated alternatives, or there are new innovative products that provide better results.

### **Policy Change**

With the imminent implementation of TRIPS there is a reduced role for defensive economic policies, as with open borders, there are less policy instruments available to protect domestic manufacturers from external competition. The fundamental issue in this context is the reduced international competitiveness of the sector. Companies that manufacture outside Egypt, with lower cost bases and efficiencies from product specialisation, are likely to be able to under-cut indigenous manufacturers to gain domestic market share.

A number of countries covered under the global review activity have already recognised the need for a change and have given greater emphasis to offensive economic policies to maximise the export sales of selected products. These countries now have multi-level strategies for developing their domestic pharmaceutical manufacturing sectors, around four main areas of activity:

- Applying bulk purchasing schemes to both material inputs for domestic manufacturers, and for dosage products, to keep prices as low as possible.
- Encouraging the manufacture of products still under-protection through joint ventures, strategic alliances, local manufacturing by multi-national companies.

- Purchasing domestically manufactured generic products, wherever these are available at low prices and have the same properties as alternative more expensive products.
- Identifying product areas, often based on domestically sourced natural materials, where these products offer genuine medical properties which are demonstrated through clinical trials. As such products can exploit the “grey” areas of TRIPS they have the potential to become new innovative products at a fraction of the development costs of new innovative synthetic products, but to benefit from product protection. National governments can use their healthcare systems to encourage the purchase of these products through issuing prescriptions favouring these products.

Egypt’s defensive economic policy has run its course and needs to be changed to an approach that gives greater emphasis to offensive economic policies, that will return the sector to its previous level of international competitiveness, and beyond. One of the key elements of the new offensive economic policy should be an accelerated increase in export sales.

### **Export Potential**

In 2002 the regional market (Cyprus, Malta, North Africa, Middle East and Rest of Africa) imported \$ 8.3 bn worth of pharmaceutical products. There are 17 product groups where the regional import values exceeded \$ 50 mn in 2002. Egypt had exports of over \$ 3 mn in three of these product areas during 2002. It has therefore been concluded that there is a short-term opportunity to increase export sales into the regional market without requiring an improvement in manufacturing capabilities. Exports into developed consumer markets will have to wait for manufacturing facilities to be accredited by international organisations, such as FDA.

The main points to be taken into account in preparing for an export development drive are:

- Activities to increase exports should be implemented within an overall programme of initiatives to improve the sector’s international competitiveness and performance. This is important for manufacturers to have confidence that improvements will be achieved across the sector, and will not be restricted to exporting activity.
- Current production capacities need to be increased, with the emphasis in the short to medium-term on increasing the number of shifts and personnel, rather than requiring investment in additional production facilities.
- Availability of working capital within indigenous manufacturers to finance the implementation of international market and sales development campaigns. This may require co-operation between indigenous manufacturers to achieve the required level of resources to break into new markets. It also needs to be recognised that many of these manufacturers are relatively new to exporting and may require to participate in business development programmes to prepare themselves for increased exporting performance.

## **Recommended Approach**

A key recommendation of this study, based on the results of the review activity, is that Egypt's pharmaceutical manufacturers and its national policy-makers, should move away from polarising the future of the sector on product pricing. This is a highly emotive issue, which has too many negative connotations, to provide the core of taking the sector forward to its next stage of development. It is recommended that there needs to be an open and transparent debate on how increased economic benefits can be most effectively delivered from Egypt's Pharmaceutical Sector to the national economy.

Product pricing should be introduced as an issue within the consideration of accepting changes to achieve increased economic benefits. Under this approach price increases could be justified if they result in sufficient additional economic benefits to offset the negative impact on domestic consumers and the government's healthcare budget.

The following are recommended to be the areas in which economic benefits should be assessed and debated as:

- Increased export performance of pharmaceutical products manufactured in Egypt.
- Reduction in imports of either input materials, or finished products into Egypt.
- Introduction of new products into the domestic market that have enhanced medical properties over products that are currently available and will save costs within Egypt's overall healthcare system.
- Manufacturing of new products domestically, either for domestic consumption, or also for export.
- Supply of essential products for Egypt's healthcare system that are subsidised internally to result in prices that are lower in Egypt, than apply internationally.
- Contracting of product development activities from Egyptian suppliers.
- Strengthening of research and development activities within Egypt.
- Joint ventures, or strategic alliances, with indigenous pharmaceutical manufacturers to: develop new products; manufacture new products under license; open new export markets; contribute to the overall strategic development of the sector.
- Invest in up-grading existing or establishing new manufacturing facilities in Egypt, or taking initiatives that will result in new investment being attracted into Egypt.

- Obtaining internationally recognised manufacturing approvals that will provide the basis of starting exports into developed consumer markets.

A package of changes to the framework within which the sector operates should be agreed based on a package of economic benefits to be delivered by the pharmaceutical manufacturers. In this report we cannot indicate what the changes should be or what should be implemented by way of economic benefits. This can only be achieved through dialogue between the pharmaceutical manufacturers and the Government of Egypt. Both sides would benefit from having a single representative body to lead the dialogue, but the process can start without this being in place. The role of this report has been to demonstrate that a change in policy towards Egypt's Pharmaceutical Sector is required and there is sufficient economic development potential to justify implementing the required changes.