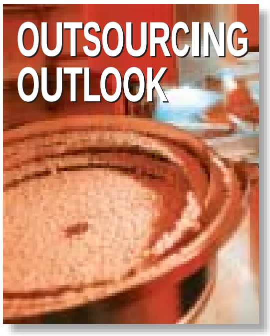

New Supply-Chain Dynamics

Create a Distribution Services Sector

Jim Miller

Distribution services are becoming an important part of the pharmaceutical contract services business. Their emergence is not so much the result of new players entering the industry, but rather of the transformation of the traditional wholesaling business model.

The new supply-chain structure was described by **Cardinal Health** CEO Robert Walter in his October 2003 quarterly earnings teleconference. According to Walter, the distribution business is moving away from its traditional model, in which a wholesaler such as Cardinal Health (Dublin, OH) or **AmerisourceBergen** (Chesterbrook, PA) buys products from the drug companies and resells them to pharmacies, making a profit on the markup between the purchase price and the sale price.

Pharmaceutical companies are finally getting the "supply-chain religion" that swept most manufacturing industries in the 1990s. As a result, contract manufacturers will have to operate in a more demanding environment in the future.

The major wholesalers have profited handsomely from this model by using their working capital to buy a large inventory of a drug just before a price increase and then selling off the inventory at the higher price. However, major pharmaceutical companies are finding that this model is an obstacle to their efforts to bring their supply-chain costs under control because it isolates manufacturers from the end-user demand for their products. Modern supply-chain management practices emphasize manufacturing to demand—rather than to forecast—with the aim of reducing the manufacturer's investment in inventories and forcing continuous improvement in manufacturing reliability and performance. Large wholesaler inventories represent a buffer that separates the pharmaceutical companies from actual product demand and frustrates efforts to make the supply chain more efficient.

Major pharmaceutical companies have been willing to take strong medicine to bring wholesaler inventories under control. The day before Walter's presentation, **Merck** (Whitehouse Station, NJ) announced that it would take a $700-million revenue hit in the fourth quarter of 2003 to reduce the amount of product inventory in its downstream supply chain and "moderate the fluctuations in sales currently caused by wholesaler investment buying." **Pfizer** (New York, NY) took a $300-million revenue hit in the second quarter of 2003 to bring down inventories of Pharmacia products from their preacquisition level of 2.1 months of sales to the Pfizer norm of one-half month of sales.

The new distribution business model will emphasize a fee-for-service relationship between the pharmaceutical company and the distributor. Distributors will receive a negotiated fee for storing the product, handling and fulfilling orders from pharmacies, and shipping the drug to the pharmacies. They expect to receive premium fees for higher-value services such as handling drugs that require maintenance of a cold chain or controlled substances requiring extra security.

The current major distributors, including AmerisourceBergen, Cardinal Health, and **McKesson (**San Francisco, CA**)**, have invested in highly efficient, automated distribution networks and are confident that their role in the supply chain is secure. They also see themselves as central players in the efforts to keep counterfeit and illegally imported drugs out of the supply chain. Still, the transition to a fee-for-service model may open the door to new players, especially companies such as UPS, Federal Express, and DHL that already play a role in the distribution of clinical-trial supplies and have built highly efficient global distribution networks that serve a variety of industries.

Another consequence of these developments in the pharmaceutical supply chain is that it will require contract manufacturers and packagers to develop new skills and capabilities to meet the demands of their clients. Contract manufacturers are accustomed to manufacturing to forecast, and manufacturing agreements typically include rolling forecasts that look forward as much as a year and lock in production volume on a quarterly basis. Major pharmaceutical companies may no longer be willing to guarantee use levels and are likely to expect contractors to respond quickly to real-time sales trends. Contract manufacturing organizations will

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need to invest in "just-in-time" manufacturing skills and infrastructure, including costly sophisticated enterprise resource planning systems and continuous improvement programs. Contract manufacturers and packagers also may have to offer capabilities that support sophisticated supply-chain practices, including product bar coding and radio frequency identification.

An interesting effect of the change in the distribution model is that it will enable wholesalers to free up billions of dollars of working capital that was tied up in product inventories. What wholesalers do with all that cash could significantly change the contractor landscape. Cardinal Health has been investing in the contract services and drug delivery sectors for some time and will continue to do so. The plans of Amerisource-Bergen and McKesson are less clear, although AmerisourceBergen made its first foray into contract manufacturing and packaging earlier this year with its acquisition of **Anderson Packaging** (Rockford, IL). The changes in pharmaceutical product distribution will trigger changes throughout the pharmaceutical supply-chain industry.

POMA's 2004 Annual Meeting

The Pharmaceutical Outsourcing Management Association (POMA) will hold its 2004 Annual Meeting in Charleston, South Carolina, 9–12 February. This year's program offers a look at where the industry is heading, results of recent studies by Standard & Poor's and the Tufts Center for the Study of Drug Development, and first-hand analyses of outsourcing problems and opportunities in Europe and Asia. A preconference program will offer training in "Facilitative Leadership" by Beth Yates of Interaction Associates. As usual, the schedule will include multiple opportunities for POMA members (who must be employees of pharmaceutical companies) to network with each other and with representatives of contract research and manufacturing companies that support POMA as patrons.

More program and registration information about the 2004 POMA Annual Meeting can be found at www.pomasite.com or by calling 908.301.1236. **PT**

FYI

Entries sought for activated carbon and packaging awards

The International Activated Carbon Conference (IACC) is seeking nominations for the Hall of Fame Award to be given at the 12th IACC in Mexico City, Mexico, on 1–2 March 2004 and at the 14th IACC in Pittsburgh, Pennsylvania, on 8–9 October 2004.

The Hall of Fame Award honors individuals who have made outstanding contributions to the advancement and development of the field of activated carbon in any of the following areas: new products, R&D, development, new test methods, teaching, implementation, and public awareness.

For more information about nomination procedures, contact Dr. Henry Nowicki, PACS Testing and Consulting Services, 409 Meade Dr., Coraopolis, PA 15108, tel. 724.457.6576, hnpacs@aol.com. www.pacslabs.com.

The Healthcare Compliance Packaging Council (HCPC) is seeking entries for the 2003 HPCP Compliance Package of the Year awards.

Qualifying packages must be in a unit-dose format; have at least one compliance-enhancing feature; have been commercially available in 2003; and not require drug products to be repackaged by patients. A panel of judges will score each entry on the basis of innovative design, unique features, and ability to increase pharmaceutical compliance.

The winning entrant will be asked to designate a school of packaging to receive $6000 in scholarship funds provided by Canon Communications and HCPC. Second and third place winners will each designate a school to receive $3000 in scholarship funds. Complete competition guidelines can be obtained online at www.unitdose.org or by calling the HCPC offices at 703.538.4030.