Impact of FDI on Indian Pharmaceutical Sector

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ABSTRACT

Foreign Direct Investment (FDI) has played a vital role in the process of Globalization. It is opinioned that it has a positive as well as negative impact on our country. The study will investigate the role and impact of FDI on India and specifically examine the Pharmaceutical Sector. The study will be of Exploratory and Analytical nature and will mainly scan the secondary data. Till now, the study of review of literature revealed that it has significantly improved the economy and has a spillover effect on Pharmaceutical Sector. The paper focuses on the brief background of FDI and Pharmaceutical Sector in India. It further states the current FDI Policy in regard to Pharmaceutical Sector and recent developments. The paper finally concludes the findings.

INTRODUCTION

According to World Bank, “India is the world’s fourth-largest economy with 1.2 billion people, GDP growth rate of 7.4 percent and Inflation of 6.4 percent (2014). India’s recent overall growth and development has been the most significant achievement. Over the six and half decades since Independence, the country has brought about a landmark agricultural evolution that has transformed the nation from chronic dependence on grain imports into a global agricultural powerhouse that is now a new exporter of food. Life expectancy has more than doubled, literacy rate had quadrupled, health conditions have improved, and a sizeable middle class emerged. India is now home to globally recognized companies in pharmaceuticals and steel and information and space technologies, and a growing voice on the international stage that is more in keeping with its enormous size and potential. India will soon have a largest and richest workforce the world has ever seen.”

India has already marked its presence as the fastest growing economy along with the large young workforce. It is among top 10 fastest growing economies for the inbound investments. But the condition of India was not always the same.

Prior to 1991, India was a Mixed Economy and suffered from huge fiscal and revenue deficits. In October 1990, World Bank’s Report advocated a 20 percent devaluation of rupee to correct the balance of payments problem. In 1991, the country experienced the Gulf War and the downfall of the erstwhile Soviet Union which further worsened the situation. Thus, Narasimha Rao and Manmohan Singh set out redeem for crisis and proposed the New Economic Policy, 1991.

In beginning of July 1991, Economy started shifted to Mixed Economy with equal control and opportunities for Private enterprises as New Economic Policy introduced Liberalisation, Privatisation and Globalisation (LPG) as major economic reforms. Primary objective of this model was to make the economy of India the fastest developing economy on the globe with capabilities that help it to match up with the biggest economies in the world, i.e., the Developed Economies.

Foreign Direct Investment is the outcome of New Economic Policy- LPG. Even though, history of foreign investment in India can be traced back with the establishment of East India Company of Britain. British capital came into India during colonial period. British companies set up their units in the sectors which suited their economic and business interest like mining sector etc. Before independence major amount of foreign investment came from British Companies.

Foreign Direct Investment (FDI) is a medium through which the foreign companies and residents of one country (defined as home country) acquire ownership of assets of a firm in another country (defined as host country).

There are two types of investment strategy followed by Foreign Investors- it can either be ‘Greenfield’ or ‘Brownfield’.

- **Greenfield Investment** is a form of FDI where a parent company starts a new venture in a foreign country by constructing new operational facilities from the ground up. In addition to building new facilities, most parent company also create new long term jobs in the foreign country by hiring new employees. It can be done by incorporating a new company under Companies Act, 2013 or as Joint Venture or Wholly-owned Subsidiary. An Indian Company may receive FDI through two routes, i.e., by Automatic Route or by Government Route with prior permission from Foreign Investment Promotion Board (as per the rules of Government)

- **Brownfield Investment** is a form of FDI where a company or government entity purchases or leases existing production facilities to launch a new production activity. It is basically done by Mergers and Acquisitions

As per Indian Brand Equity Foundation (IBEF), Foreign Direct Investment (FDI) is a major source of non-debt financial resource for economic development as well as critical driver of economic growth in India. Foreign company invests in India to take advantage of cheaper wages, special investment
privileges like tax exemptions etc. For India, it is one of the means to achieve technical know-how and generation of employment.

As per, National Council of Applied Economic Research (NCAER), FDI generate benefits through bringing in non-debt barring foreign capital resources, technological upgrading, skill enhancement, new employment, spillovers and allocative efficiency effects. It is expected to create positive outcome even though it may generate negative effects on the host economy. The cost through the host economy can arise from the market power of large firms and their associated ability to generate high profits.

Indian Pharmaceutical Sector accounts for about 2.4% percent of the global pharmaceutical industry in terms of value and 10% in terms of volume with a expected CAGR of 15.92%. It is one of the most developed industries. Indian drugs are exported to more than 200 countries with US as the major importer. India is the largest provider of generic drugs globally accounting to 20% of global export in terms of volume.

The Paper examines the brief background of Pharmaceutical sector in India, current FDI Policy, FDI flows and recent developments by the government in Pharma sector.

**REVIEW OF LITERATURE**

- **Vyas, Narayan & Ramanathan (2012)** elucidated in their article ‘Determinants of Mergers and Acquisitions in Indian Pharmaceutical Industry’ that firms which have excess capacity and high R&D investments rely on M&A to restructure & consolidate their position in the industry. It also revealed that small firms attract less M&A.

- **Reddy (2013)** in the article ‘Foreign Direct Investments in Pharmaceutical Industry’ concluded that FDI inflows are below than target, expenditure towards R&D should be raised and academic collaborations should be done for drug development.

- **Rajeshwar and Akliladeshwari (2015)** revealed in their article ‘Sector-Wise Foreign Direct Investment Inflows Into India’ that maximum FDI has taken place in the service sector including financial and non-financial services, telecommunication, information technology, hotel and tourism. Mauritius is the top nation to invest in service sector followed by UK and Singapore.

- **Sahoo (2004)** investigated in his thesis named ‘An Analysis of the Impact of Foreign Direct Investment on the Indian Economy’ the trends, growth and patterns of FDI inflows and determinants of FDI along with their impact at macro and sectoral level. The study stated that at macro level, FDI has a positive relationship in economic growth in India. At sectoral level FDI in major sectors has a positive impact in increasing the output, labour, productivities and exports but the major sectors have little variation in overall impact.

- **Bergman (2006)** examined in her thesis named ‘FDI and spillover effects in the Indian Pharmaceutical Industry’ determinants- Competition, Demonstration and Imitation Effect, Transfer of Technology and R&D. Investment in human capital and labour turnover and Industrial Management Skills. The study states that there is positive impact from FDI in Pharmaceutical industry but the results of the study varied. As regression analysis stated that there is positive relation in FDI and productivity while Correlation doesn’t. It also mentioned that it is important for the state to provide sound economic environment and public policies to benefit from FDI.

  - **Parliamentary Standing Committee (2013)** reports on ‘FDI in Pharmaceutical Sector’ key observations are:
    - To establish a suitable mechanism to track nature of FDI
    - Foreign Pharma Company can enter and do similar business and provide benefit of business experience and R&D base
    - Competition Commission of India (CCI) play active role to make medicine by MNC and local companies are available to people at large
    - Foreign investors must bring Active Pharmaceutical Ingredient (API) manufacturing from basic stage
    - FDI in brown field Pharma sector has encroached on our generic base and adversely affected industry like export performance, access and affordability of medicines, domination on small and medium Pharma companies, undue demand, pressure by TRIPS etc.
    - Revive and re-strength PSU’s

- **Corporate Catalyst India Pvt. Ltd.(2014)** in a report ‘Pharmaceutical Industry in India’ elucidated that drug companies are declining productivity of in house R&D, patent expiration of number of blockbuster drugs, increasing legal and regulatory concern, and pricing issue.

- **McKinsey & Company** in a report ‘Indian Pharma 2020: Propelling access and acceptance, realising true potential’ summarized that healthcare sector is experiencing discontinuous development, industry structure in pharmaceutical sector has changed and traditional sources of growth are making the room for the new ones. Pricing controls and economic slowdown effects the investments and depress the markets.

- **UK Trade and Investment** analyzed the potential of Pharmaceutical and Biotechnology sector in the document tiled ‘Sector Briefing: Biotechnology and Pharmaceutical Opportunities in India’ and described how UK can positively impact in India’s growth in generic medicines, increase in clinic trials and help in boosting research and development.

**OBJECTIVE OF THE STUDY**

The paper uses an exploratory research technique based on past literature from respective journals, reports, newspapers and magazines covering wide collection of academic literature on implications of FDI on Pharmaceutical Sector. According to the objectives of the study, the research design is of descriptive in nature. Available secondary data was extensively used for the study. The objectives of the study are:

- To study the history and background of Foreign Direct Investment and Indian Pharmaceutical Sector.
To assess the current policy and condition of FDI in respect of Indian Pharma
To analyze the recent developments planned by government for Pharma sector

PHARMACEUTICAL SECTOR- A BRIEF

Indian Pharmaceutical Industry is third largest in terms of volume and thirteenth largest in terms of value in the world. Technologically strong and totally self reliant, the Pharmaceutical industry in India has low costs of production, low Research & Development (R&D), innovative scientific manpower, strength of National Laboratories and increasing Balance of Trade (BOT). It is ranked as world class in terms of Technology, quality and range of medicines manufactured.

As per Invest India, Pharma sector is valued at approximately US $12.26 billion as per industry estimates. The industry is growing @ 10-11% per annum on compounded growth rate basis. Although total turnover of the industry is estimated at 21.04 billion, about 65% of this revenue is from exports. It spends around 18% of the revenue on Research & Development (R&D) activities. Additionally, India’s clinical research industry is estimated to be a US $2.2 billion opportunity by 2012, due to low R&D costs and a talent pool. Through the introduction of a system of product patents since 2005, Indian Industry has today become a very worldwide exporter of high quality generic drugs to US, Germany, France, Russia, UK etc.

Some of the major Indian private companies are Alembic Chemicals, Aurobindo Pharma, Amnabal Sharabhai Limited, Cadila Healthcare, Cipla, Dr. Reddy’s, IPCA Laboratories, Kopran, Lupin Labs, Lyka Labs, Nicholas Piramal, Matrix Laboratories, Orchid Chemical and Pharmaceuticals, Sun Pharmaceuticals, Ranbaxy Laboratories, Torrent Pharma, TTK Healthcare, Unichem Labs and Wockhardt. The foreign companies in India include Abbott India, Astra Zeneca India, Aventis Pharma India, Burrough-Wellcome, Glaxo SmithKline, Merck India, Novartis, Pfizer Limited and Wyeth Ledele India.

As per Indian Brand Equity Foundation (IBEF), Pharma industry is expected to grow over 15 per cent per annum between 2015 and 2020. It will outperform the global pharma industry, which is set to grow at an annual rate of 5 per cent between the same period. The market is expected to grow to US$ 55 billion by 2020, thereby emerging as the sixth largest pharmaceutical market globally by absolute size. Branded generics dominate the pharmaceuticals market, constituting nearly 80 per cent of the market share (in terms of revenues).

CURRENT FDI POLICY AND CONDITION

Indian Government is very proactive for boosting growth and investment in Pharmaceutical industry. It allows 100 percent FDI under automatic route in Drugs and Pharmaceutical Sector (except Recombinant DNA Technology) in Greenfield Investment. Government route, i.e., through FIPB is required in case of Brownfield Investment beyond 74%.

The Indian pharmaceuticals market increased at a CAGR of 17.46 per cent during 2005-16 with the market increasing from US$ 6 billion in 2005 to US$ 36.7 billion in 2016 and is expected to expand at a CAGR of 15.92 per cent to US$ 55 billion by 2020. By 2020, India is likely to be among the top three pharmaceutical markets by incremental growth and sixth largest market globally in absolute size. India’s cost of production is significantly lower than that of the US and almost half of that of Europe. It gives a competitive edge to India over others.

India has also maintained its lead over China in pharmaceutical exports with a year-on-year growth of 11.44 per cent to US$ 12.91 billion in FY 2015-16, according to data from the Ministry of Commerce and Industry. In addition, Indian pharmaceutical exports are poised to grow between 8-10 per cent in FY 2016-17. Imports of pharmaceutical products rose marginally by 0.80 per cent year-on-year to US$ 1,641.15 million.

Overall drug approvals given by the US Food and Drug Administration (USFDA) to Indian companies have nearly doubled to 201 in FY 2015-16 from 109 in FY 2014-15. The country accounts for around 30 per cent (by volume) and about 10 per cent (value) in the US$ 70-80 billion US generics market.

India’s biotechnology industry comprising bio-pharmaceuticals, bio-services, bio-agriculture, bio-industry and bioinformatics is expected grow at an average growth rate of around 30 per cent a year and reach US$ 100 billion by 2025. Biopharma, comprising vaccines, therapeutics and diagnostics, is the largest sub-sector contributing nearly 62 per cent of the total revenues at Rs 12,600 crore (US$ 1.89 billion).

The amount of FDI Equity Inflow in Drugs and Pharmaceuticals was US$ 738.39 million during April, 2015 to February, 2016 (1.97% of All India). The drugs and pharmaceuticals sector attracted cumulative FDI inflows worth US$ 14.53 billion between April 2000 and December 2016, according to data released by the Department of Industrial Policy and Promotion (DIPP).

RECENT DEVELOPMENTS BY GOVERNMENT

The Government of India unveiled 'Pharma Vision 2020' aimed at making India a global leader in end-to-end drug manufacture. Approval time for new facilities has been reduced to boost investments. Further, the government introduced mechanisms such as the Drug Price Control Order and the National Pharmaceutical Pricing Authority to deal with the issue of affordability and availability of medicines. Mr Ananth Kumar, Union Minister of Chemicals and Petrochemicals, has announced setting up of chemical hubs across the country, early environment clearances in existing clusters, adequate infrastructure, and establishment of a Central Institute of Chemical Engineering and Technology.

Some of the major initiatives taken by the government to promote the pharmaceutical sector in India are as follows:

- The Government of India plans to set up around eight mini drug-testing laboratories across major ports and airports in the country, which is expected to improve the drug regulatory system and infrastructure facilities by monitoring the standards of imported and exported drugs and reduce the overall time spent on quality assessment.

- India is expected to rank among the top five global pharmaceutical innovation hubs by 2020, based on Government of India's decision to allow 50 per cent public funding in the pharmaceuticals sector through its Public Private Partnership (PPP) model.
• Indian Pharmaceutical Association (IPA), the professional association of pharmaceutical companies in India, plans to prepare data integrity guidelines which will help to measure and benchmark the quality of Indian companies with global peers.

• The Government of India plans to incentivise bulk drug manufacturers, including both state-run and private companies, to encourage ‘Make in India’ programme and reduce dependence on imports of Active Pharmaceutical Ingredients (API), nearly 85 per cent of which come from China.

• The Department of Pharmaceuticals has set up an inter-ministerial co-ordination committee, which would periodically review, coordinate and facilitate the resolution of the issues and constraints faced by the Indian pharmaceutical companies.

• The Department of Pharmaceuticals has planned to launch a venture capital fund of Rs 1,000 crore (US$ 149.11 million) to support start-ups in the research and development in the pharmaceutical and biotech industry.

CONCLUSION

The Indian Pharmaceutical Industry is positively impacted by FDI as it not only made India self reliant but also a net exporter of generic medicines. Pharmaceutical Sector recorded a spectacular growth since 1991, better technology, management and marketing skills, advancement in Research and Development etc. It has a negative impact too as FDI enter into Pharmaceutical sector mainly through Merger and Acquisitions rather than Green Field Investment, facing serious threats in competition, abuse and exploitation of Product Patent Protection etc. But there is a scope of immense growth, outsourcing in the field of R&D and manufacturing is the next best event. Spiraling costs, expiring patents, low R&D cost and market dynamics are driving the Multi National Corporations (MNCs) to outsource both manufacturing and R&D.

The Indian pharmaceutical market size is expected to grow to US$ 100 billion by 2025, driven by increasing consumer spending, rapid urbanisation, and raising healthcare expenses among others. Going forward, better growth in domestic sales would also depend on the ability of companies to align their product portfolio towards chronic therapies for diseases such as cardiovascular, anti-diabetes, anti-depressants and anti-cancers that are on the rise.

The Indian government has taken many steps to reduce costs and bring down healthcare expenses. Speedy introduction of generic drugs into the market has remained in focus and is expected to benefit the Indian pharmaceutical companies. In addition, the thrust on rural health programmes, lifesaving drugs and preventive vaccines also augurs well for the pharmaceutical companies.

Thus it can be concluded that that the positive effect offset the negatives, thus providing the net economic benefits to the host economies.

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