

Future Growth Drivers & Obstacles Of The Chinese Pharmaceutical Outsourcing Industry

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Starting from almost scratch, the Chinese pharmaceutical outsourcing industry has grown markedly fast in recent years. The industry has successfully achieved an average annual growth rate of 48% in the past eight years and reached a market value of \$1.42 billion in 2008.

At present, it is composed of nearly 250 professional service providers, including about 50 multinational service companies that have facilities in China. Moreover, growing numbers of traditional Chinese pharma companies and R&D-oriented biotech companies also have joined the outsourcing industry as “part-time” service providers, as they are frequently approached by drug companies from all over the world for collaborations.

However, largely due to the financial crisis, the fast growth of this Chinese industry has been slowed significantly at present. The fierce domestic and international competition is another factor affecting its future growth potential. How this Chinese industry will likely develop in the future has become a common concern to many professionals. This article summarizes our in-depth analysis (from the research report “China Pharma Outsourcing Market By 2015” published by JZMed, Inc.) of the future growth potential and obstacles to growth of the Chinese pharmaceutical industry.

Growth Drivers

There are a number of positive growth factors, both internal and external, that will drive the Chinese pharmaceutical industry’s future growth.

a. Internal Drivers

The following internal factors make China a good place for outsourcing for a few more years:

Improved IP protection environment: Years of education and strengthening of law enforcement have significantly improved the IP protection situation in China. Many pharma and biotech companies that have recently dealt with Chinese companies agreed

with this statement. It is anticipated that the improvement in the image of China's IP protection will attract more outsourcing companies.

Improved service capability: In addition to the growing service experience over the years, increasing partnerships and alliances between Chinese CROs/CMOs and experienced multinational service providers are rapidly improving the overall service capability and competence of the Chinese pharmaceutical industry.

Government support: Pharma outsourcing is considered part of China's biotech industry which is considered a high-priority industry by the Chinese government for future development. Governments at various levels strongly encourage and support the development of this industry, including pledges of more financial investments and improvements in industry infrastructure.

b. External drivers

Externally, the current environment in the global pharmaceutical industry exerts more and more pressures on all drug companies. They are now forced to pursue more efficient, cost-effective, and productive ways to conduct their operations, whether R&D or manufacturing. Outsourcing has been proven to be one of the effective solutions for drug companies to quickly turn the situation around as it provides them with the desired efficiency, flexibility, and agility. Since China still possesses the combination of low cost and quality service, we believe the demands for outsourcing to China will still remain relatively strong in the foreseeable future.

Three Outsourcing Waves Driving Growth In China

Based on our studies, we believe there are three outsourcing waves that will drive the future growth of this Chinese industry. The first wave actually started a couple of years ago and has almost reached its peak at the present time. It consisted of major pharma and biotech companies taking advantage of China's low-cost labor to open up a potentially huge Chinese pharma market. While conducting a variety of outsourcing activities in China, almost all of these major companies have also been building their own R&D facilities there. Many of their China R&D centers have already reached decent sizes after constant expansions and are now fully operational. For example, GSK's R&D center in Shanghai was designed to accommodate 1,000 scientists and is already about half full.

The second wave of outsourcing is from those small and even midsize biotech companies that will be driven to China by the financial crisis. In the past, these

companies would not consider this option. But the current financial crisis has resulted in a significant investment shortage. From now on, those companies that are still in discovery or early development stages have to spend their R&D budget wisely. Thus, they will be forced to look for outsourcing resources in the low-cost regions, of which China will be one of their ideal choices. We believe this outsourcing wave is going to be realized soon.

The third wave that will gradually shape up in the next few years will be caused by the growing outsourcing demands of domestic Chinese companies. At present, the Chinese biotech industry is still in its infancy. However, it has gained growth momentum as more Chinese returnees are establishing R&D-oriented biotech companies. The government also encourages innovative research on new medicines and has pledged to provide more financial support. At present, many of these emerging biotech companies still lack the necessary experience, expertise, and facilities. Some of them are even intentionally set up as virtual or semivirtual companies. The readily available facilities at those China-based CROs/CMOs will be the best resources for these startups. The accessibility of these CROs and CMOs also creates a shortcut for these emerging companies so they can avoid building up fixed but necessary facilities themselves.

Obstacles To Growth

The Chinese pharma outsourcing industry is also going to face a number of challenges along its future development. In addition to competition from other developing countries, many issues on the domestic side will challenge all China-based service providers.

a. Fast-rising labor cost

Traditionally, one of the primary attractions of using China for pharma outsourcing has been low-cost labor. However, living expenses in many coastal cities such as Shanghai, Beijing, and Guangzhou have increased considerably in recent years, resulting in wages rising quickly in the Chinese outsourcing industry. This rapid increase in operational costs is one of the key issues China-based CROs and CMOs have to seriously address.

b. Abiding by the international rule of the game

In the past year or so, there were several incidents of quality breakdown associated with Chinese companies involved in the supply chain, which resulted in stricter control in regulation/inspection in the Western countries. The new policies implemented by the Western governments for all imported drug products (including APIs) will greatly curb the manner of raw material sourcing. To the Chinese companies that supply raw materials to Western pharma companies, this means strengthening quality control in their production

processes or raising inspection standards in their own supply chains. Companies that fail to do so or have no ability to reach the required level of quality control may face eviction from the business loop.

c. Competition from neighboring developing countries

At present, Chinese service providers face huge competition from their counterparts in other countries, in particular, India. Major pharma and biotech companies frequently choose Indian CROs for collaborations of more advanced R&D projects. They also incline to choose Indian CMOs for manufacturing of more complex APIs.

Other future potential competitors might come from other Asian countries, including Vietnam, Malaysia, and the Philippines. Although at present, pharma outsourcing in these countries has not become popular, these regions already have companies providing low-end services to Western pharma companies. Multinational service providers have also started moving to these countries to open subsidiaries/divisions there. For example, Progenix, a UK-based preclinical service CRO, recently opened a service branch in Malaysia's first life science park, Penang Science Park, located in Bukit Minyak. The U.S.-based CRO Kendle also recently opened a division in the Philippines. As time goes on, the service capabilities of many of these CROs and CMOs in these countries will gradually catch up in the foreseeable near future and eventually will become strong competitors to Chinese CROs and CMOs, as these countries have a lower cost advantage than China.

The China Outsourcing Forecast

We believe China's pharma outsourcing industry will continue to grow for a few more years but, at a much slower rate than before. We predict that in the following five to seven years, the Chinese pharma outsourcing industry will grow at an average annual rate of 29% and the industry will reach a market value of about \$8 billion by 2015.

About The Authors

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