

A Tale of Three Countries

Eastern Europe is still an important emerging market for a considerable portion of the industry. But how does a company looking to expand eastwards select the most suitable country for a successful venture?

Martin Meyer at
Lodestone Management
Consultants

Image: Ian Harbison

An increasing number of companies are considering expanding their distribution network to include operations in eastern Europe, which is considered an emerging market for many in the pharmaceutical industry. Indeed, regulatory requirements are changing, and customers are becoming more demanding. To help improve customer service levels and reduce customer delivery times, many organisations are focusing on enhancing their distribution network. There are, however, many obstacles to successfully establishing an efficient and effective network in eastern Europe. While the methodology for distribution centre (DC) site selection may be the same as that used for analysis in western Europe, there are different factors to be considered, and these factors will have a different relative importance. For an overall distribution strategy, a balance must be reached between maintaining high levels of customer satisfaction and the overall cost of the distribution network.

Current Situation

Sales opportunities in central and south-eastern Europe are growing for many pharmaceutical companies. As this market is evolving, customer expectations are evolving with it. Customers are expecting higher customer service levels and increased supply flexibility. Regulatory conditions are also becoming more demanding and market sizes do not always justify the implementation of a local warehouse. Many pharmaceutical companies have developed a 'direct to pharmacy delivery' model to optimise traceability of their products and maintain product margins. Of course, the challenge of this model is dealing with long customer lead times.

A large number of companies are evaluating and establishing regional warehouses to increase flexibility to satisfy customer orders, reduce customer order lead times, and reduce the risk of out-of-stock situations. In addition, the challenge of warehouse site selection can be a complex process in western Europe. Factors to consider include the cost of

Above: Hungarian Parliament Building, Budapest

distribution from the warehouse and the volume of distribution, as well as site and transportation costs. When considering site location in eastern Europe, there are additional issues involved, which will have increased criticality.

Challenges

A client recently enlisted our help when faced with the business challenge of expanding their distribution network in eastern Europe. The goals of the project were to help them determine the relative importance of 25 factors regarding the location of the warehouse, to research each of these factors and to make recommendations for the location. A survey took place and the management team was interviewed, and the most critical factors were determined to be political climate, employment, wages and labour force, as well as overall transportation and logistics. Three countries were able to make a business case when considering the best location

for the warehouse: Hungary, Romania and Bulgaria. For each of the potential solutions, the following elements were considered:

- The economic and political stability of the country, including investment fitness and competitiveness
- Transport and logistics, including the road and rail infrastructure, border crossing conditions and possible government incentives for infrastructure development
- The employment and labour force, along with the employment/unemployment ratio, encompassing labour force availability and dynamics, as well as wages

The results of the analysis are summarised below.

Hungary

Political/Economic Situation

The country has undergone the relevant improvements in terms of stability and maturity. However, the recent changes in government and constitution bear new risks and concerns regarding investments.



Staffing

There are no major problems with staffing quality today, and it is not expected that there will be in the future, although costs and staff availability could be considered a minor issue.

Warehousing

Warehouse parks are still under development, but there is no major issue with warehousing space and quality. Furthermore, regional capacities are still developing.

Traffic

Most of the traffic problems are on the Budapest ring road. There is high traffic density from the north-west to Budapest. However, this is not considered to be a major obstacle to logistics strategy.

3PL Maturity

Most of the major 3PLs have a presence in Hungary and especially in the

Budapest area. In addition, development can be seen in the regions surrounding Debrecen and Miskolc.

Romania

Political/Economic Situation

A variety of opportunities are available as the economy of Romania is currently growing, and the political and economic system becomes more mature. The country, however, will require time and further investment to balance opportunities with risks.



Staffing

Staffing quality is not 100 per cent optimal and requires improvement, with the main issue being workers' availability. The quality and availability of able resources in Romania is on the rise, and soon this will not be considered a drawback, as compared to Hungary and Bulgaria.

Warehousing

Warehouse capacities are limited compared to Hungary. Older warehouse space is available, but many warehouses do not meet the quality standards for a pharmaceutical distribution centre. There is also a high risk of insufficient capacity in new warehouses.

Traffic

Traffic conditions can be considered hectic. The traffic in Bucharest is a critical obstacle, and passage through several cities in general can be difficult.

3PL Maturity

Most of the big 3PLs have operations in Romania. Bucharest is the most developed region, but the major 3PLs also have a presence in Timisoara and Constanta Cluj-Napoca. Most pharmaceutical distribution is currently managed by local wholesaler organisations, not 3PLs, who are more heavily focused on industrial/automotive goods and have limited pharmaceutical experience. However, there is potential interest in investing in infrastructure to support pharmaceutical distribution.

Bulgaria

Political/Economic Situation

Bulgaria also presented challenges in terms of stability, transparency and maturity. The general development of the country has made progress and people seem to be more open minded and similar to western Europe.



Staffing

This aspect is also similar to Romania, with a shortage of qualified workers. The primary issues are the language barrier and the lack of logistics experience – a situation that is not helped by net immigration out of the country.

Warehousing

Warehouse capacities are limited compared to Hungary, and although older warehouse space is available, many warehouses in general do not meet the quality standards for a pharmaceutical distribution centre. There is also a risk of insufficient capacity in new warehouses.

Traffic

Current traffic conditions are acceptable. The only major traffic concerns are in Sofia.

3PL Maturity

A good mix between big 3PLs and regional providers can be found in Bulgaria, and a lower density than in Budapest or Bucharest. Most pharmaceutical distribution is currently managed by local wholesaler organisations, not 3PLs. As with Romania, 3PLs are more heavily focused on industrial/automotive goods and have limited pharmaceutical experience, although the desire for infrastructure is there, which may lead to development.

Project Approach

As part of the process of deciding how best to expand the distribution network, we were not considering Greenfield thinking as a potential solution to the business challenge. As a rule, it is far more important that the solution makes business sense and is not based purely on a mathematically optimised model.

“ Within the pharmaceutical industry, eastern Europe is seen as an emerging market, but several questions remain regarding the best way to satisfy customer service requirements while minimising fixed costs ”

In this case we determined it was best to take a phased approach to the project:

Project Startup

In this phase, the project should be mobilised, and an appropriate project team should be appointed and a detailed project schedule laid out. It is important to establish a common understanding of project requirements, business objectives, required service levels and strategic intentions, and define potential scenarios and variants to evaluate. The target countries should also be agreed on and the relative importance of all factors for DC site selection should be determined before finalising data collection.

Data Gathering/Model Development

The next stage is development of a model to calculate transport distances. The distance/year should be compared (km/year), and the main axes/lanes for each variant should be defined. The required DC storage volumes should also be confirmed.

Assessment of Regional Capabilities

A key task is to determine the actual situation and evolution for the three candidate countries for DC location. Once this has been achieved, it is necessary to assess the impact of the location(s) selection on the overall distribution network. An interview with 3PLs and site visits should be conducted to determine experience and capacity.

Reporting

This phase involves validating the recommendations and preparing a final report on the project, including the data collected and methods used. While the project was being developed in western Europe, resources in local offices in Romania were used to assist with the

analysis during the data gathering phase. A good level of team diversity helped to ensure the data we were compiling reflected the local knowledge of the area. The site visits were important in the assessment of the existing transportation infrastructure. Through this phased approach, the factors most important to the business regarding a potential new distribution centre were determined and a mathematical model for the potential solutions was built. Regional capabilities for each of the countries could then be addressed, and a recommendation was finally made for the location of a new DC.

Conclusion

Within the pharmaceutical industry, eastern Europe is seen as an emerging market, but several questions remain regarding the best way to satisfy customer service requirements while minimising fixed costs. Nevertheless, many companies are considering expanding their distribution network to include operations in the region. Much of eastern Europe is still a low-cost area where there may be cost advantages to setting up warehousing operations. Industrial and manufacturing companies have already started to expand operations in these countries to realise cost advantages. While it may make sense for a pharmaceutical company to establish operations within these areas, care must be taken to ensure the most important factors are identified and considered for site selection.

The eastern European market has grown quickly, in some

cases forcing pharmaceutical companies to pick a 3PL as a reaction to this growth. Ideally, a 3PL would be able to use their local knowledge to maintain high levels of customer satisfaction until a time when it is appropriate to consider a potentially more cost-effective means of distribution.

A more proactive approach would allow pharmaceutical companies to plan for the growth, make better decisions about the overall distribution strategy for the organisation, and enable the impact of future challenges to be minimised. This thinking must be considered for other emerging markets, such as the Middle East and Africa, as well as the Commonwealth of Independent States, where similar and more complex challenges exist. These include more complex economic and political conditions, increasing Ministry of Health requirements, major differences in cultural and commercial behaviour, the logistics infrastructure and dealing with more government organisations as customers.

About the Author



Martin Meyer is a Partner at the Switzerland office of Lodestone Management Consultants. Martin has been involved in large-scale, global ERP implementation for 14 years. He has several years of experience in the pharmaceutical industry, in addition to his background in logistics and supply chain planning and execution. Martin is currently leading a project with one of the world's largest pharma generics players to implement a new global ERP landscape. Email: martin.meyer@lodestonemc.com