

Interviews with the IEDC Alumni

Mr. Andrey L. Mladentsev, CEO of Nizhpharm & VP of STADA AG, Russia: Turning a tanker into a speedy fleet

*How to take a Russian pharmaceutical company, founded in 1919, into the 21st Century? **Andrey L. Mladentsev**, IEDC Presidents MBA, turned the company Nizhpharm around, managed to get substantial financial backing from the European Bank for Reconstruction and Development, and recently convinced a strategic investor, the German STADA Arzneimittel AG, to buy 97.47% of the company's shares. Andrey, who is the CEO of Nizhpharm, talks about the tremendous changes he had to implement to move the company from pure production to marketing and services, and reflects on what some of the future challenges might entail. Mark Vanderbeeken was the interviewer, with support of Anna Bagrova.*

How did you get involved with Nizhpharm?

In 1992 I graduated from the physics department of the Lobachevsky Nizhny Novgorod State University and I immediately started working, not in physics though but on the stock market. I worked as the head of the stock market department of the NBD bank in Nizhny Novgorod, a city 450 km from Moscow. In 1994 we established the Nizhny Novgorod Regional Depository, which provided depository and consulting services on the securities market, and I was the general director of the Depository until 1998. During all these six years on the stock market I worked closely with companies from different industries helping them through the privatization process.

And Nizhpharm was one of those companies?



Indeed. Our collaboration started in 1994, when the shareholders of Nizhpharm – a pharmaceutical plant located in N.Novgorod - asked me to help them incorporate and manage their assets. In other words, they needed help to understand what they should do with the company. In January 1995 at the shareholders' meeting I was elected as a member of the Board of Directors, representing the shareholders. It was a job I really liked and on this post I was very much involved with overall improvement of the corporate governance. A year later, I was elected Chairman of the Board.

So you became more heavily involved with Nizhpharm.

Yes, in comparison with the other companies I was working with at the time, I started spending more time on Nizhpharm. But I continued working on the stock market within the Depository.

What was the main challenge you were facing at Nizhpharm?

We needed to provide sustainable growth for the Company's development and we realized we couldn't do that without external help and resources. We decided to attract a strategic or financial investor. For two years, we conducted a thorough investigation and negotiated with various investors, and concluded that we first of all needed a financial investor, not a strategic one. At the end of 1998, we found that financial investor: Quadriga Capital Russia, a company that manages the assets/investments of the European Bank for Reconstruction and Development (EBRD) in Russia. When we signed the agreement with "Quadriga", we had to introduce a new management structure and the EBRD suggested that I would become Nizhpharm Chief Executive Officer.

CEO rather than Chairman of the Board?

In Russia, as in some other countries, it is not possible to occupy the posts of the chairman of the board and chief executive at the same time. And for our financial investor, it was more important to keep me on the executive side, because they knew me already quite well from the negotiation process. They evaluated my capabilities and agreed with the other shareholders that this was the right time for me to become the CEO. I started working as a CEO in January 1999.

Let's talk a bit more about the challenges within Nizhpharm.

Nizhpharm was a typical example of a Russian plant that had to face a new competitive business environment in the mid-nineties: at that time we first

produced drugs and then thought how to sell them. By the end of the nineties we had come to the realization that it was essential to transform Nizhpharm from a production-oriented company to a market-oriented one, focus on market demands, analyze why our goods were not selling well, and to produce only those products that meet the needs of consumers and have some unique consumer properties increasing products' value to our customers. Consequently, we started to pay more attention to our customers and saw it as our mission to provide our consumers with high-quality products that meet their needs.

How long ago was this?

In 2001 we were considering two options for the Company's strategy: either concentrate on production and provide a full manufacturing cycle service for international companies, or to develop our own marketing capabilities. But in the two years' time I had been a CEO, we didn't receive any propositions from international companies interested in working with us on production. So once I had a talk about this with Jeffrey Lack, a former CEO of Bristol-Myers Squibb in Russia and a close friend of mine. I asked him what he thought we should do to develop our company in such a way that it would become interesting for a potential strategic investor. He answered: "You will only be interesting for potential strategic investors, if you can do something on the Russian pharmaceutical market that they themselves cannot do. There are many companies producing pharmaceutical products all over the world, so it is not a problem to find production facilities. What is more important: your relation with consumers. If you can develop these relations, you will become interesting for an investor."

So you started moving from a production company to a services company.

Yes, rather than just investing in the reconstruction and modernization of our production facilities, we now allocate substantial resources to quality assurance measures, promotion of our products, consumer research, and

development of new medicines. We studied the needs of our customers, acquired experience and expert knowledge, and started concentrating on particular types of pharmaceutical products and particular therapeutic areas, such as for example gynecology, dermatology, neurology, gastroenterology and a few more that we are really good at. But even within these areas we cannot produce all the products required to meet our consumers' demand. We therefore started seeking outsourcing solutions and looked for partners that could produce goods for us. Today we are still partly a production company and partly growing into a service company. We render services to our customers by producing goods that satisfy their needs, and to production companies by promoting their products and bringing them to customers.

Will you eventually end up being just a services company?

It is difficult to say which of the two development paths - production or service – will prevail. I do not want to be judgmental by saying that it should be definitely in this or that direction. It all depends on which path will turn out to be better, but in any case we do not intend to be just a production company or just a service company. Actually it is highly possible that we will remain both a production and a service company, especially in the area of suppository and ointment medicines manufacturing, as we have modern high-technology facilities and unique experience in this area accumulated over many decades. With other types of products, e.g. tablets, we are unlikely to build up and enhance our production capability, so in regards to tablet production we will concentrate more on the service aspects.

But your focus on services paid off, since you have been acquired by a German pharmaceutical company.

Yes, we managed to attract a strategic investor and now we belong to Stada AG, the German pharmaceutical company. This is not the kind of thing that is happening each day in Russia and I doubt that there are any pharmaceutical companies in Russia like

Nizhpharm that have the potential to become interesting for a strategic investor. Attracting a strategic investor became possible exactly because of our service capability that we started to develop more intensively several years ago in comparison with our production capability. In fact, when Stada held negotiations with us, they clearly told us: "We tried to go to the Russian market by ourselves as we have a lot of products that we can sell there. But we are missing the connection with the customer".

So what about splitting the company in two: a production company and a service company?

I think it might happen. In fact, I already did it for a Nizhpharm division, which is dealing with printing and packaging materials. Our company was established in the Soviet time as a full-cycle company that was also able to produce packaging materials for our products. We split off that packaging production facility into a separate company and right now it produces packaging materials not only for Nizhpharm but also for a number of other companies. We also have a transport division in our company, which mainly deals with the transport of personnel and raw materials, not with products' distribution. I hope that we can also close down this division one day, because we are a company that works in pharmaceuticals not in transport. Unfortunately we currently do not have enough transport companies in Nizhny Novgorod that can provide good transport service. I hope that this will change in a few years, so we will be able to outsource the transport facilities.

What about your pharmaceutical production, will you split that off too?

We are leaders in Russia and in Europe in ointment and suppository production. This is our core competence. We produce about 65 million packs of ointments and suppositories a year. So we are really big. But what will we do in the future with this core production? I don't know. Our development vector now focuses mostly on marketing and services.

Especially since we do not only sell our own products, but also the ones that are produced by other companies and are given to Nizhpharm for marketing and distribution, and the ones from Stada product portfolio. The future will tell, I guess.

Your website talks about accommodating the interests of your key stakeholders and sustainable valuable creation. You want to create real value for four target groups: your shareholders, your consumers, your personnel and the state. What are these values and how do you get to know what is important to them?

We have defined those target groups because they are crucial for the success of our business and we seek to meet the needs of all these groups. It is our objective to organize our company's business in such a way that our actions don't conflict with the interests of these target groups. With this policy in mind we can effectively plan our steps. This policy saves us resources and prevents us from implementing actions that will not satisfy at least one of these groups.

What are these interests?

For shareholders, we need to make profit and we need to enhance quality of Nizhpharm business.

And the personnel?

We employ 1,400 people and we want to have efficient goal-oriented personnel. We invest substantial money in HR, though it was a difficult decision to start investing more in personnel than in for example modernization of production facilities. Now of all Nizhpharm expenses personnel investment is the first priority, followed by marketing and promotion. All other directions of investments depend on these two. To motivate our people of course we make ample use of both financial and non-financial instruments of motivation like good working conditions, educational opportunities and so on. Our experience shows these kinds of investments are very profitable. This is however a mutual investment. When people work for a company and they are

motivated, they invest their efforts, knowledge and skills and their attitude in the company and it gives great results!

What about consumers?

Our consumers are distributors, doctors, pharmacists and end-users, the public at large. We provide them with high quality effective products. When we got the money from the financial investor, we spent it on increasing the quality of our production. But since we are not an international mega company like Pfizer, what else can we deliver to consumers? The answer is - additional value. For instance, when we make the so-called generic drugs, they are never simple generics, simple duplications of a well-known product. They always have additional value, like one or two or three additional components to increase their efficiency in comparison with those produced by our competitors. Another value we can deliver to our consumers is the capability to deliver our products to the right place in the right time and in the right amount. This means not just understanding general demands of our consumers, but also region-specific demands. In order to have this capability to provide value we work very hard with distributors, doctors and pharmacists through our medical reps network.

How do you know what these stakeholders value? What methods do you use to find out?

This question is easy to answer: we simply ask them. For instance our medical reps will ask doctors and pharmacists what kind of products they prefer to prescribe, what they think of our products, what they are expecting from our company, what kind of new products they would like to get from our company, and what we can do to improve our products and to develop our presence in their region. We pay special attention to any complaints or dissatisfaction from any representative of our stakeholders' groups. Right now we are busy with developing a customer relations management (CRM) system. This was an issue that I clearly understood taking my PMBA course at IEDC in Slovenia: it is not enough to understand the needs of our key

audiences — we need to develop our employee management and our customer relationship management.

You also mentioned the state. What is important for the state?

First of all we pay taxes and as it is still not a normal and regular practice for many businesses in Russia Nizhpharm is differentiated from others as a law-abiding company. Besides what is even more important is that we pay more taxes per dollar of income than some other companies. Therefore we deliver more to the community than others. But there is of course more to the state than taxes. We need to do our business with minimal external risk. The government can increase our external risk very dramatically if we don't develop the right relations with it. Bad relations with the government is a big risk, good relations is also a big risk. We need to be in the middle. We constantly analyze how we can best serve the interests of the government, and we tell them what we do for community good.

You tell them what you do?

For instance, we let them know that our average salaries are higher than those of other companies in our region, that we have won awards as one of TOP 100 best Russian employees so our social security system is one of the best, and that we have received a quality standard in environmental issues, that Nizhpharm donates medicines and participates on a regular basis in charity actions and events. In a word we let them know what is Nizhpharm contribution for the public.

You are in the healthcare business and the government as well. It is the government's responsibility to help taking care of the health of its citizens. Are you helping your Ministry of Health with expertise and ideas about how to better do this?

Of course we are a very active participant in the development of the healthcare sector and the government policy on this issue. Three years ago I met with President Putin and we discussed how to improve the healthcare

system in Russia. I was the only representative from the Russian pharmaceutical industry that participated in that discussion. We have our own expertise, and also have quite a bit of knowledge on what is happening in the pharmaceutical industry and the healthcare sector in Europe and the United States. But it is not always easy to work on these policy issues with our government, since some participants on the governmental side are more concerned with personal well-being than with the development of the healthcare sector in Russia.

You would like to do more?

I am as active as I can. Last year, our government started with a new federal health insurance program, a first step towards insurance medicine, so that the cost of buying medicine gets distributed more equitably. This will boost the development of the Russian pharmaceutical market. Up till last year 60% of treatment costs were covered by the consumers themselves and it was not uncommon for them to choose the type of treatment based on the medicine price, basically to decide which drug they could afford. This is absolutely incorrect. The decision concerning the choice of treatment should be made solely by the doctor, with a preference to high quality, effective and safe medicines, which should be covered by insurance funds. Otherwise the consumer will never be able to afford effective treatment, which is as a rule costly.

You were involved with this program?

Yes, I am an active participant in it. I don't agree with all aspects of how the government started to implement this, but I understand that we cannot develop such a big-scale project without mistakes. Some of our mistakes are due to the fact that we have a very long history. I mean it is very difficult to change the path of a supertanker like Russia, change the direction of the Russian mentality and the Russian government. But the supertanker is right now generally moving in the right direction, maybe not in the most optimal way, maybe not in the shortest way, but

we are finally moving in the right direction. And I am an active participant in this movement. I understand that not all people think about the wellbeing of the citizens and do something to improve it, but I am trying to remember that however we did realize many good projects, and that there are many responsible leaders who do care about the people. I am staying on the positive side.

Also here in the West the healthcare system is under enormous pressure, primarily because of the sharply growing trend of chronic diseases, which is in large part due to people living their lives badly, not exercising, and eating badly. The costs are out of control. So there is a tendency to move from healing to prevention. Do you see your company, Nizhpharm, having a role in prevention?

Right now we are more on the treatment side. But of course we are constantly facing the issues of prevention. Since we concentrate on the needs of our consumers, this is definitely an opportunity for our future development. We are trying to be more than just a company selling pharmaceutical products. We, as a company specialized in a particular medical problem, need to let our customers know that we are looking to solve this particular problem, based on the problem's inherent condition, not based on how many products we can sell.

For example?

We produce products that treat gynecological diseases and we have become profitable because we managed to understand the issue, we got involved with all the aspects of it, and communicated that to women. So when women now have a gynecological condition for which they seek treatment, they will ask their doctor for our products.

Why?

Because they know that we are thinking about their problems and we have proved to them that we have gained

expertise and profound knowledge in these matters. If a consumer will tell you "they are thinking about me", then this is the highest evaluation we can get in our job.

How do you innovate in your company?

Innovations allow us to differentiate ourselves from our competitors. It goes without saying that the major source of differentiation are our products, which should of course be more effective than those made by our competitors. But there are also other ways in which we can differentiate ourselves. For example, in 1999 we were the first Russian pharmaceutical company that built up and developed a network of medical representatives. It made us different from Russian companies and we justly reckoned this initiative would help us leave behind our Russian competitors and enable us to compete with foreign pharmaceutical companies. We were also the first company in the pharmaceutical industry to set performance efficiency targets, a program that we are currently putting in practice in our company. We have introduced a balanced scorecard that helps us assess the performance of each employee with maximum precision and in an unbiased manner, which allows us to take steps to increase our personnel's performance efficiency.

Who generates those ideas? Who is responsible for those innovations?

We work a lot with proactive managers who are loyal to the company, the so-called change agents. Of course, we first need to identify those people. One of the ways to do this is the Myers-Briggs analysis. Change agents are as a rule extravert, intuitive, feeling and perceiving. We need to work with them on a personal level or create a system that can develop and motivate those people. In most cases I work with those kinds of people personally. Based on my education at IEDC, we created a project office, which deals with a range of currently important projects or problems. Each project has its own working group with several of these proactive managers in it. We use many techniques such as brainstorming,

seminars and corporate events, and during these sessions we discuss strategic issues relevant to the particular project or problem. We are thinking what we can do to solve that particular problem. My business right now is to identify currently important projects, to define the priorities, and to provide all the right conditions for that working group to work on that project. So all people in our company are occupied with their functional job, but proactive people are also busy with a project job. We set them additional targets that help the company develop. These additional targets are also an incentive for them.

Are there examples of an innovation that you can name that come from these proactive managers?

I have already mentioned one innovation: we started to use outsourced products – provide marketing and distribution services for products manufactured by other companies. It is not a common practice in Russia, because there are some legislation obstacles that are not easy to overcome, and in general there are no conditions to develop outsourced products projects. But we started that as a project, and we got successful results from it.

What will drive the future changes in your business and how can you best address them?

Now that Nizhpharm is owned by Stada Group, we would like to expand into new markets and enter those markets Stada is already present at. We assume that the Russian market will develop dynamically due to the forthcoming integration of Russia into the WTO and the world community, and due to quality standards harmonization.

To our regret, there are still cases of counterfeit pharmaceutical products being realized in the Russian market. This has of course a negative impact on those pharmaceutical manufacturers that produce effective high-quality medicines. We hope that the manufacturers that produce those defective drugs will be banned by better laws here in Russia.

Another trend in the Russian pharmaceutical market is the rapid development of methods that are already well known in Europe, e.g. pharmaeconomy for disease treatment and strict requirements concerning drugs clinical trials. We hope that our investment into high-quality product manufacturing will be fully justified.

We have made a lot of improvements in our delivery system: products are shipped in the required quantity, at the right time and to the right place. But we want to close the cycle: from understanding consumer needs, developing and manufacturing the necessary product, delivering it to the point of sale, introducing the product to the customer, assessing the degree of customer satisfaction, and finally, if necessary, to improving the product and its way of delivery basing on the customers' feedback.