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## A novel prescription

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### A big Western company moves into China, but not for the usual reasons

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WHEN large Western firms set up shop in China, it is generally because they plan to take advantage of low-cost manufacturing of goods that contain the minimum possible amount of intellectual property that might be stolen. But that is not the case for Novartis, the world's fourth-largest pharmaceutical company, which announced plans this week to invest \$100m in a new research facility in Shanghai. Its motives are different and rather unusual.

At the moment most cutting-edge pharmaceutical research is carried out in western Europe, America, Israel and Japan, all of which have highly educated populations and strong intellectual-property laws. Other countries, including China, must content themselves with the less sophisticated back-end work of product development rather than basic research. Indeed, confidence in China's domestic drugs industry is so low that the government is reluctant to approve clinical trials of anything not being used abroad. Novartis, however, hopes its new facility in Shanghai will eventually become one of its three big research hubs, alongside Cambridge, Massachusetts, and Basel in Switzerland—and ahead of its other facilities in Vienna, London, La Jolla, New Jersey, Tokyo and Singapore.

The company says its plans are not motivated by a desire to cut costs. Indeed, it argues that there is, in effect, an international market price for top scientists that is the same wherever they operate. By locating in Shanghai, perhaps China's most expensive city, Novartis turned down inland areas where prices are lower and government inducements abound. Shanghai, it hopes, will have more appeal to globetrotting researchers—and the city is packed with universities and hospitals bubbling with ideas.

The role of the research centre will be to create new drugs for which there is strong demand in China in particular, and in Asia more generally. At first it will concentrate on contagious diseases that are preventable or cause relatively benign illnesses outside China, but commonly lead to deadly cancers of the liver, stomach or nasal passage within China. Whether the different outcome is the result of environmental or genetic factors is unknown, but China offers a huge pool of subjects for study and a promising market for any resulting treatments.

## Another cultural revolution

Although it will be at least five years before any new drugs emerge, there may be subtle marketing benefits for Novartis in the meantime. Because of a recent crackdown on corruption throughout China, Western companies are no longer allowed to meet purchasing directors in hospitals, which are major distribution points for drugs. This has had a huge impact on sales: Novartis has watched its annual sales growth drop from 25% to 10%. Developing a reputation for advanced research into critical diseases could help its brand.

More broadly, Novartis's investment is a bet—albeit a modest one, given its gigantic research budget—that China is now evolving into more than just a commodity producer with cheap labour. An entire generation of scientists was lost to the Cultural Revolution in the 1960s and 1970s. In the 1980s a trickle of smart students began to emerge once again from universities, and the trickle has since become a flood, providing an immense pool of talented Chinese, says Daniel Vasella, Novartis's chief executive. En Li, a Shanghai-born biologist with a long track record of academic papers and research at major American institutions, will head Novartis's new research institute. The company hopes that other Chinese-born scientists working abroad will be eager to join him. Others will be hired within China. None of the Chinese universities is particularly famous, but Novartis believes their standards are already world-class.

What about concerns over intellectual property? Conditions are improving, says Mr Vasella, and are now tolerable, if not ideal. When it comes to counterfeiting, for example, producers of fake drugs are still not tracked down by the authorities, but they are dealt with when exposed by others. And since drugs take such a long time to develop, Mr Vasella believes intellectual-property protection will be sufficient by the time the research laboratory produces its first fruits.

Another factor that can discourage foreign companies from setting up sophisticated operations in China is the dramatic rate of employee turnover. Novartis has suffered from this itself, but Mr Vasella says turnover is highest among employees, such as those in sales and marketing, whose skills transfer readily from one industry to another. When it comes to attracting top-level scientists in China, the only real competition comes from academia, since the other big drug companies have not set up significant research centres. This advantage is unsustainable, of course: for if Novartis succeeds in China, its rivals will not be far behind.

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