Private Sector & Development

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Helping the pharmaceutical industry meet health challenges in Africa

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With 13% of the world's population and 24% of the global burden of disease – but 6% of health expenditure and only 3% of the world's pharmaceutical output, Africa faces the challenge of access to quality medicines. This challenge is today exacerbated by the development of chronic diseases, which have taken over from the great pandemics of the end of the last century, and the demographic and epidemiological transitions (aging, urbanization) underway across the continent. Over the past three decades, the international community has taken extensive action to provide quality medicines to African populations.

PS&D

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Agence Française de Développement (AFD) and PROPARCO mobilize their respective expertise to improve access to medicines in Africa. AFD supports the regulatory directorates of Ministries of Health in a number of African countries, via grants and technical assistance programs, to assist in the implementation of a coherent institutional framework. It also finances an increase in capacities for the storage and distribution of health products. But while the health sector is a major priority for public authorities, the mobilization and role of private players on the continent are equally essential, in particular throughout the value chain of the drugs economy. PROPARCO, as a private sector development finance institution (DFI), has the objective of supporting private projects that contribute to improving access to quality products, with a focus on supporting all the players in the drug chain, via a customized and innovative range of financing.

Building sustainable players: a central issue for our operations

African production presents a mixed picture with, on the one hand, "pharmerging" – South Africa, Morocco, Kenya and Egypt – where private producers have regional ambitions (Aspen, Ascendis, Cooper Pharma) and, on the other hand, countries with a limited number of small-scale production units, producing generics and parapharmaceutical products and led by individual entrepreneurs and families. As a DFI, PROPARCO makes these SMEs, which have little access to long-term financial resources, central to its operations. They are often companies which have been operating for over ten years and are recognized on their market. Their production activities mainly focus on a limited number of therapeutic ranges: OTC products (anti-inflammatories, wound healing products, antiseptics, dermocosmetics…), prescription products, such as generics, or patent drugs (anti-infective drugs, antibiotics, antimalarial drugs).

The investment projects of the African laboratories we have supported aim to increase production capacities and are sometimes integrated into the development of a new site. One example of this, in Senegal, is the flagship project to relocate the only production site for yellow fever vaccines in Africa to the new city of Diamniadio. It is supported by a EUR 6.5m AFD non-sovereign loan allocated to the Institut Pasteur in Dakar. These investments aim to extend the therapeutic range or introduce modern production lines, which contribute to improving operational efficiency (increase in volumes and reduction in costs, and including an energy efficiency component). What the development projects of these SMEs have in common is that they achieve a threshold effect, which is based on economies of scale and upgrading quality standards. Achieving this threshold effect requires heavy investments and a capacity to control the technical and operational risks brought about by these investments. Supporting these projects requires an appropriate structuring of financing and often strengthening the equity of these SMEs.

Addressing the challenges of quality and growth

This issue of quality, which is a prerequisite for DFI support, requires the laboratory to adhere to a process to implement the standards of good manufacturing practices (GMP). This can go as far as a WHO prequalification process, a sine qua non condition to be referenced as a supplier to international health product procurement organizations (UNICEF, Global Fund, GAVI Vaccine Alliance). Consequently, the implementation of these standards requires close support from engineering consultancy firms and GMP experts, ideally right from the investment project design phase. The compliance of a production unit with GMP standards generates an additional cost, which needs to be taken into account in the project investment cost and in future operating costs. DFIs like PROPARCO have technical assistance tools (financing, network of consultants) to support this type of quality approach, for example, in the form of grants to cover part of the GMP audit costs or for capacity building.

At the same time as the technical risk of the facility's non-compliance with quality standards (GMP, WHO-GMP), the investment project needs to be soundly structured so that it is robust against technical hazards, which generate potential direct additional costs (unexpected increase in ancillary costs for the facility, additional development costs) or indirect costs (delay in completion, leading to a postponement in income generation). The financing of these projects often requires increased efforts in terms of structuring. For example, an investment program may comprise a provision for contingencies to be financed by a standby equity line or standby debt. Partial financing by banking debt must include a capital grace period long enough to cover a period of time comprising the initial construction period and adding a buffer period (up to 50% of the initial period). The capital repayment can be designed to increase in order to follow the ramp-up of the new production unit. These provisions allow the laboratory to get through this critical phase where the debt is increasing, whereas income generation is still based solely on the historical production facilities. We also see that there is a need to strengthen the historical shareholding base of the founders: equity or quasi-equity financing by DFIs or partner investment funds is an increasingly important issue.

The second thing which the development projects of these laboratories have in common is the visibility and assurance of additional margins or incomes generated by these investments. This is a prerequisite for making these investments and a core factor for their profitability and sustainability. For example, we see that generic manufacturers who extend their therapeutic range with higher added-value products and bank on higher final selling prices and unit margins have made these investments on markets where public authorities were developing incentive mechanisms: bid invitations for public procurement centers requiring a percentage of sourcing from local producers, or setting the final sale price of locally produced medicines with price revision clauses discussed at the time of the marketing authorizations (MA), on the basis of a dialogue between the public authority and manufacturers. As regards manufacturers who make investments to increase capacity, the size of markets is an essential factor, particularly the prospect of growth drivers for export. Access to these markets is facilitated by GMP standards recognized by the supervisory authorities,

or is sometimes hampered by a lack of regulatory harmonization at regional level. We thereby see that public procurement, regulatory and taxation policies that are conducive to the local productive base are an essential driver in stimulating private investment.

Another factor which affects the operational sustainability of these laboratories is how they control the growth in their working capital requirements (WCR), alongside the growth in activity. This growth in WCR stems from the increase in the minimum stocks required by the public procurement centers and wholesalers/distributors and is, in addition, increased by the long payment periods of these buyers. Consequently, access to WCR financing lines for these African laboratories, the availability of documentary credits for local importers, or exchange risk hedging instruments (active principles often denominated in dollars) are all financing needs for which there are now expectations towards traditional financial players or even donors.

Investing throughout the value chain?

Working with the private sector with the aim, for DFIs, of improving access to medicines for populations also requires investing in the pharmaceutical distribution sector for two major reasons: quality and price. The quality criteria require the commitment of all players in the supply chain, from production to the last link in distribution. The fragmentation of drug distribution channels in Africa explains extreme situations, where the margin of intermediaries accounts for 90% of the final price paid by the consumer. We consider the consolidation of drug distribution networks as a key factor in economies of scale, allowing the investments required for quality to be made and leading to efficiency gains which can be passed on by a price reduction. For example, PROPARCO has invested in a number of pharmaceutical distribution platforms in Sub-Saharan Africa via commitments in private equity funds active in the region. By supporting this type of company, DFIs contribute to extending the footprint and outreach of well-managed distribution networks, which supply high-quality medicines to consumers at reasonable prices. Goodlife, an East African chain of pharmacies, which also offers diagnosis and telemedicine services, is an example of this. Goodlife has been particularly successful in shortening the supply chain by working as much as possible directly with GMP-certified manufacturers. This sourcing policy has allowed the company to eliminate the additional margin added by intermediaries, which pushes up the retail price, and at the same time guarantees the quality for the final user. PROPARCO is an investor in the LeapFrog Emerging Consumer Fund III, which has recently invested USD 22m in Goodlife. LeapFrog Investments' experienced team is now mobilizing its extensive internal expertise to support the management team in the implementation of an ambitious growth strategy, which will target a network of over 100 stores to reach over 5.5 million consumers by 2020.