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### How pharma can use deduction as addition

**Gireesh Chandra Prasad**

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Pharmaceutical companies got a much sought-after wish granted when FM Pranab Mukherjee said in his Budget speech for 2010-11 that companies spending on in-house research and development will be taxed less. Drug makers can deduct double the amount they spend on in-house research while computing their taxable income for the assessment year 2011-12 onwards, up from the present deduction of one and a half times the research spend.

The incentive for spending more money in research is welcome, but the quest for new drugs needs sharply higher investments by the public and private sectors and a change in focus from low-value copycat versions of MNC drugs to new therapies.

According to official estimates, the top 25 pharmaceutical companies in India spent about 6-7% of their total sales on research and development in the last fiscal compared to the global average of 12-15%. That worked out to a paltry Rs 3,500 crore by 25 Indian companies in an industry with a turnover of Rs 90,000 crore including exports. The total R&D spend by the domestic industry is less than 1% of the \$130 billion spent globally on drug research. Experts say that unless Indian drug makers spend more than 15% of their sales on research, they cannot have a noticeable presence in the world of sophisticated, high-value, new drugs.

One interesting aspect is that the current research spend is mainly for finding new methods for making copies of expensive and blockbuster MNC drugs without infringing their patents so that the copies can be sold in markets like the US to make windfall gains. The US allows a six-month exclusive marketing right to the first generic copy that enters the market without infringing the patent protecting the original drug or by proving that the patent was invalid. This route involves litigation with the innovator and entails huge legal costs. The history of patent challenges by Indian companies is dotted with a few spectacular successes and a number of failures. The interesting part is that the litigation cost is shown as research and development expenditure by most of the Indian companies.

Until Indian companies focus equally or more on inventing their own new drugs, Indian pharma industry cannot rise in global stature as a producer of new drugs. The present focus on generics or copycat drugs gets reflected in statistics. Despite being the third largest producer of drugs by volume, Indian pharma industry stands 17th by the value of its output because of the low-cost nature of the products.

Companies have genuine reasons for not being able to spend on research as much as their global counterparts. They are smaller in size and about a fourth of the market is under price control. Many Indian

drug makers are exploring the possibility of getting licences from the drug inventor to make an authorised generic version which will hit the market when the original drug's patent expires. The strategy is to join the rival if one cannot beat him. The government is also not able to allocate the large amounts required for drug discovery from its tax receipts or regular borrowings. The assistance that the department of science and technology provides by way of non-repayable grants and soft loans for research is also not sufficient.

Therefore, the government needs to find innovative funding models to support new drug research. For example, it could introduce a model which mobilises funds from investors who are willing to share the fortunes of the high-risk-high-reward game of drug research and funnel it to companies with promising experimental new drugs.

Recently, the Planning Commission gave the green signal to the department of pharmaceuticals to undertake a detailed project report on designing such a model. The department's idea is to ask agencies like UTI Asset Management Company to raise funds through tax-free bonds. The funds thus raised will be used to build institutions, train people and discover drugs. If the research leads to discovery of blockbuster drugs, it will benefit investors, the company and the final consumer. Even if it fails, the government will guarantee a minimum return on investments. It is estimated that only one in six experimental drugs makes it to the market. Public-funded research will also allow the government to exercise a say in the price at which the final product would be made available to the consumer. It might take several months before the finer details are worked out.

The FM's gesture of enhancing the tax sop for research, despite criticism that the weighted deduction scheme is prone to abuse, shows the government's commitment to promote new drug research. But much more public and private resources are needed to take the Indian industry to where the policymakers want to take it—the source of one in every ten new drugs invented.