# C1.3.1. Novartis Case Teaching Note:

# Property Rights: Novartis in India (Supreme Court decision 01.04.13)

# Video

I show the students a news report of an Indian Supreme Court decision from 01.04.13 to illustrate the property right problem for Novartis.

There are various reports of that on Youtube. I usually show this short video with the problem description: <http://www.youtube.com/watch?v=KYa6J8e5CRE>.

For more background information this video might be more interesting, however it is too long for classroom use: <http://www.youtube.com/watch?v=qhR9Cqswjg0>

# Relevant Information from the Annual Reports

I also ask the students to download the annual reports of Novartis from 2013 and the most recent report (currently 2016) from Novartis’ webpage to get a feeling for the impact of this decision on Novartis’ business. This helps students to research real life information. Some relevant statements I discuss in class are listed below.

* In 2013 Gleevec/Glivec (different brand names in different countries) was, with sales of USD 4,69 billion (14,6% of net sales), the most important driver of sales in the pharmaceutical’s division (Annual Report 2013, p. 147).
* “the patent on the active ingredient in Gleevec/Glivec will expire in 2015 in the US, in 2016 in the major EU countries and in September 2014 for the main indications in Japan…Generic versions of Gleevec/Glivec have already launched in Turkey, Brazil, Canada, China, India, Russia, and for a minor indication in Japan”.
* Interestingly, Novartis reports that some innovative features where added, whose patents might protect the product in future. (Annual Report 2013, p.147). This means intellectual property can be protected for longer, in case little changes are made to the product (this is also what was not accepted by the court). This has consequences for Novartis strategy.
* Since 2016 the patent also expired in some EU countries and there is generic product competition in the US and Japan. Sales declined to USD 3,323 millions, which is a loss of 29% compared to 2015 (Annual Report 2016, p.33 and 198).
* “In 2014, the impact of generic competition on our net sales is expected to be as much as USD 3,0 billion. Because we typically have reduced marketing and R&D expenses related to a product in its final year of exclusivity, it is anticipated that the loss of patent protection will have an impact on our operating income, which can be expected to correspond to a significant portion of the product’s lost sales.” (Annual Report 2013, p. 147).
* “It is estimated that, in the five years between 2007 and 2012, generic erosion of patented pharmaceuticals accounted for an estimated loss of USD 67 billion in annual sales among the top drug companies. Current estimates suggest that this impact could be even greater in the future, potentially amounting to USD 250 billion in lost sales from 2012 to 2015.” (Annual Report 2013, p. 172).
* Reflecting our commitment to innovation, Novartis Group invested 17% of net sales or USD 9,9 billion in research and development. In Pharmaceuticals, R&D investments were USD 7,2 billion or 22% of Pharmaceuticals net sales, focusing on the areas of greatest patient need and scientific promise (Annual Report 2013, p. 3). For comparison, Novartis investments in R&D in 2016: USD 9,039 billion; 18,6% of net sales (Annual Report 2016, p.41 and 178).

# Questions in Class (and answers):

1. How does intellectual property violation affect the strategy of a company such as Novartis? What would you do, if you were the CEO?

Teaching note: I encourage students to re-think the current strategy of Novartis (constantly developing drugs that can be sold at a premium for a short amount of time). What would happen, if there would be no protection at all, what would happen if there would be full protection for a long time?

Answer: If there would be no property right protection at all, it would not make sense to invest in the costly development of new drugs. If there is only a restricted property right protection it would push Novartis to constantly develop new drugs. The property right regulations of one country also impacts other markets, the firm engages in.

1. As a consumer, discuss the benefits of intellectual property violation (legal and illegal), and also the disadvantages of the practice.

Teaching note: I use this question to introduce the prisoner’s dilemma and the problem of individual intelligence vs. collective intelligence. I ask students upfront if they have violated property rights recently (e.g. illegal use of software, watching movies on illegal online platforms, copying a university textbook, etc.). Usually most of the students admit that they have done such things in the past. I then ask, why they have done it and who benefits/suffers from that? I use this to illustrate what would happen if all people would watch movies online on illegal platforms. Normally the answer is that no one would produce movies anymore, which would be sad for the public (collective intelligence). However, if they only think for themselves (individual intelligence), they might get the movies for free, while the “fair” watcher (that pays for the movie) maybe has to pay more now to recover the cost that would have otherwise been allocated to the illegal watcher. The “fair” user is therefore worse off. I then transfer the problem to the drug case to illustrate what this means if we talk about a life or death decision such as cancer treatment.

Answer: Advantage (individual intelligence): Cheaper drugs and access to drugs for the poor (see video). Disadvantage (collective intelligence): No incentive to develop new drugs in the future, less payers to recover the cost, maybe decreased speed of drug development.

1. China *claims* that it is trying to stop the practice of stealing intellectual property. India is protecting their “generic” products. Why do they behave like this? Consider the flying geese model.

Answer: Countries develop in different stages. It is quite normal to start the economic development process by copying other countries products and production processes (e.g. visible in the flying geese model, in Japan after WW2, or in Germany after 1871). At a certain stage the economy is developed enough to create its own innovations. India is still in the copying stage, whereas China already reached a more mature stage that allows for own innovations and therefore an interest in protecting patents (rather than copying yourself).

1. Do you think something similar can happen or has happened in Germany?

Answer: The same happened in Germany after 1871. German firms copied a lot of (back then more advanced) British products. Hence, the German government was interested in relaxing property rights constraints to help the firms to develop. “Made in Germany” was once introduced by the British to make consumers aware that this is a cheap German imitation and not a proper British product (same as “Made in China” during the last decades).