DRUG BARON

K Raghavendra Rao (PGP '79),
Orchid Pharma

Raghavendra Rao has built up a $300 million dollar pharma company in 13 short years. The son of a working class Railways employee, he now dreams of making Orchid India's first $1 billion pharma company.

K Raghavendra Rao could probably sell ice to an Eskimo, *garam chai* to a Bedouin and plastic bags to Greenpeace. He has that kind of charisma.

The impressive thing about Orchid Pharma is how grand a plan and vision it was from the very beginning. While most entrepreneurs start small and mature into large entities, Orchid was big from day one. The project Rao conceived required Rs 11.95 crores of capital and scaling it down was not an option.

So first of all, he put in everything he had. And then, he raised the rest of it. From institutions, from the general public, from friends and even strangers. Like colleagues of his brother, who was a doctor at Apollo Hospital.

Orchid Pharmaceuticals stands testimony to the fact that where there is a will there is more than one way. And if it means tagging along with him on the way to the airport to hear more of this fascinating story, so be it.

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K Raghavendra Rao came from a working-class background. His father was an employee of the South Central Railways. “We don't have any liquid assets or ancestral property. Nobody from our family was in business basically. And we don't have any lands or roots in any particular place.”

Rao grew up in the town of Tenali with his parents and grandmother. That's where he did all his schooling and college. After BCom he went on to IIMA and then took up a job in Kwality Ice Cream in Bombay. Rao put in two and a half years with Kwality and was part of the team that helped turn around the brand in Ahmedabad, where it had not been doing too well.

But there was nothing more to learn there beyond a point. So Rao moved on to Ashok Leyland in Chennai, the makers of buses and trucks. He was one of the few people who was rotated in different departments - budgeting, accounting, costing and development. During that period he also did his Cost Accountancy and Company Secretaryship because there was nothing much to do after office hours.

There was this urge to constantly ‘do more’ and Ashok Leyland wasn't proving to be enough of a challenge. So in 1986, Rao joined the Standard Organics group in Hyderabad. The group had many activities like medical diagnostic centres, leasing, hire purchase and bulk drug manufacturing. “That is where my exposure to the pharmaceutical business started.”

What's more, the chairman of the company, Mr Chandrashekhar Reddy, gave the young man a free hand. Rao joined as a project manager, quickly became vice president (finance and projects), and then vice president (operations). “Right from making applications to ICICI to getting loan sanctions, to recruitment of people, purchase of equipment and coordination with marketing, I was *de facto* in charge of everything. I got a lot of exposure.”

Among other things, Rao helped set up diagnostic centres in different locations in India and was one of the key members of the team which expanded the bulk active plant near Hyderabad.

Standard Organics was one of the first companies to get US FDA approval for its sulphamethoxazole antibacterial product and Rao was closely involved in that effort.

The two and a half years he spent there were enthralling. The company grew five times, from Rs 5 crores to Rs 25 crores. More importantly, the seed of an idea was planted in Rao's brain. "I realized I have it in me to develop and successfully manage enterprises. And if I can make other companies bigger, why not start something on my own?"

By that time, Rao was married and had a daughter. His wife was a homemaker and his bank balance was a princely Rs 11,200. That was after working for almost nine years!

"As a salaried employee in India, being able to start something of your own is very difficult. I didn't want to start a small scale unit. They fail because of lack of economies of scale and market reach. And to start a medium sized industry, you need capital."

So Rao made a conscious decision to go abroad. The idea was to earn a tax-free income, save most of it and then come back to India to do something in the pharmaceutical field. With that intention, Rao went to Oman. But it was not a typical accounting or management job. Rao joined a group called 'Al Buraimi' which wanted a financially oriented professional to take its hotel business forward. AF Ferguson had put out the ad and the interview was held at Mumbai's Oberoi hotel.

"When I landed in Oman, it was a kind of rude shock for me because there was a small 16 room hotel (three star type) and a few pieces of land but the owner had all kinds of ambitions. And there were only 20-30 employees, the highest qualified was only 12th standard pass."

But Rao decided to take this as an opportunity and try to grow the place. In three-and-a-half-years, between end-'88 and mid-'92, there was a complete transformation. "I was the *de facto* chief executive, the director and the top person. I assembled the team to make that kind of a thing happen. From less than two million dollars annual revenue from a 16 room hotel, we made that group into 80 million dollars in about four years time."

Based on the Standard Organics experience, Rao helped Al Buraimi put up a pharmaceutical factory called Oman Chemicals and Pharmaceuticals in 1990. It is the first and only bulk active plant in the entire Arab world even today. And it was done with Indian equipment, Indian manpower and Indian technology. In this

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period, the company also put up a readymade garment unit, the biggest in the Gulf called Al Buraimi Garments. Rao also put up a steel plant called Middle East Metal Industries and a five star hotel. Employees grew from less than 20 to 2,000. A small scale business was now a conglomerate.

There was no question of shareholding, as only locals can be owners in the Gulf, but Rao was "taken care of very well." From a $2,000 p.m. salary, he was soon earning $10,000. The Buick car was upgraded to a BMW. Having made enough capital, he decided it was time to return to India to start his own company. The year was 1992.

"Of all my experiences I chose pharma for two reasons. One is that this has been my first love in terms of my entrepreneurial spirit blossoming. I came to know of my own potential in Standard Organics. And secondly, this is one industry which can never go out of fashion. As long as people are there, medicine will be required."

Rao had savings of about half a million dollars and he invested all of it in the company. "I took a two bedroom rented flat in Madras and started Orchid Pharmaceuticals. For the balance amount, I went to private equity people, IDBI and also to the public. We started as a public limited company right from day one of the organisation. Because I went and told them, I am committed to this, this is my plan and this is what I have. I have put everything I own into the company."

The total project conceived initially was Rs 11.95 crores. Rs 15 lakhs was the state subsidy as the plant was located in a developing zone. The balance Rs 11.8 crores was to be funded thus - Rs 6 crores as capital, Rs 5.8 crores as loan.

Rao went to IDBI and met the General Manager, Mr Maitra. "I always believed in directly going to the top people in the institution. And going and making a pitch in an open manner. Lot of people say you need to lobby, and use your contacts. I never did any of those things in any of the departments, any of the institutions, any bank whatsoever. I have always met with only appropriate response from the right people when I take things head on and talk passionately about what I believe. That's what I have done."

IDBI agreed to provide the Rs 5.8 crores as loan. Rao then told them that Rs 6 crores is the equity but I have only Rs 1.5 crores in cash. That's what he had managed to save in Oman. IDBI agreed to put in another Rs 50 lakhs as capital, one of the very few and first instances of IDBI participating in equity capital of a first generation enterprise.

But Rao was still Rs 4 crores short. IDBI suggested the company should float a public issue and agreed to lead manage and underwrite the issue. This would raise another Rs 2.5 crores. But still, there was a shortfall. The only option was private equity people or venture capital. So Rao went and knocked at a few doors. It took a bit of perseverance but he managed to get ANZ Grindlays - 3i, PLC to invest Rs 50 lakhs. The balance came from friends, both in India and abroad.

Pitching your idea to investors is something every entrepreneur is prepared to do. But it's one thing to make a PowerPoint presentation to a venture capitalist and quite another to speak to people you know, people like yourself, and sell them your dream. Rao's brother, a medical doctor working in Apollo hospital introduced him to many of his colleagues. Rao went and talked to them, individually, and several put in their money.

It takes a really strong belief in yourself and what you're doing to raise capital like this. But it can be done - Orchid is testimony to that!

But why was it so important to raise exactly Rs 11.8 crores? If capital was hard to come by, could he not have downsized the project?

"It is not a question of cutting the cloth to suit your size. Without that kind of a minimum critical mass, that project would not be viable. We didn't create or invent any new niche there, we needed to set up a 100 tonne antibiotic plant. The cost and technology were not in favour of downsizing the project."

MBAs who take up entrepreneurship are generally attracted to knowledge based industries, or services. Few venture into large, manufacturing projects.

Rao reflects, "With due respect to the service industry and trading and things like that, I feel that here you create something. By adding different types of chemicals, we can come up with something which is not there. It is always a fascinating experience

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for me, rather than taking from X and selling it to Y or just converting knowledge into money. These are also good businesses but I was always fascinated by manufacturing."

By this time Rao had of course set up several projects - for Standard Organics and Al Buraimi. Was it any different now that he had invested his own money?

"Wherever I worked, even when I held zero shares, my attitude towards the work and the project has been absolutely the same. If anything, now there is a bit of additional responsibility when you take money from other stakeholders. So many people have trusted me and looked at me and given their money, so I must repay the faith that they have reposed in me."

That faith was well placed, everything went as per plan. In fact, better than expected. On 1st July 1992, the company was incorporated. On 24th November 1992, Orchid received the sanction letter from IDBI. Exactly one year later, 24th November 1993, the project was inaugurated by former President of India, Mr R Venkatraman. Trial production started immediately. Commercial production began on 1st February 1994.

On 6th September 1993, Orchid also had its maiden public issue. As per the prospectus issued then, the company was supposed to complete the project by 31st March,1994. That deadline was actually achieved five months ahead of schedule. In fact Orchid had two months of commercial production from 1st February to 31st March and thus managed a turnover of Rs 5 crores and a profit of Rs 43 lakhs in its very first financial year. And this over-achieving streak was to continue.

In 1994-95, the company had projected Rs 27 crores of turnover but actually did Rs 43 crores. In 1995-96, the revenue figure mentioned in the prospectus was Rs 32 crores but actual turnover was Rs 111 crores. The following year's figures were even more spectacular - Rs 192 crores, as against the projection of Rs 37 crores.

"There wasn't an enterprise in manufacturing that did a turnover of Rs 192 crores in three years flat, starting from scratch. I was voted as the best young entrepreneur of the country and represented India in Canada for the finals. And I got a gold commendation there also. That was in 1997."

So what was the secret of this success?

Rao says it boils down to three things. One is an excellent team - very, very good people. Rao had taken some of his colleagues at Standard Organics with him to Oman. And subsequently the same people came and joined him when Orchid was set up.

"These five are professionally qualified, experienced people in their own functions and they used to gel as a good team. I am not against family owned organisations or anything like that but somehow I feel very comfortable to deal with a co-professional finance chief rather than my brother-in-law, or father-in-law or whatever. So that way I have been fortunate to have a technician, a commercial person, a strategist, an engineering person, and a finance expert - a chartered accountant."

The commitment of the team was such that for the first five months, until the IDBI sanction letter came, no one took any salary. Whatever common expenditure was required, that was incurred. Of course, all these individuals had a shareholding in the company as well.

The second thing was, smartness in terms of identifying the product group or some therapeutic area that Orchid should be in. Because the pharmaceutical industry is very vast. There are companies that have succeeded doing a bit of many different things. However, Rao had a different approach.

"I have always felt that you should take a niche segment, go deeper and broader into that, create a nucleus and reach a critical mass so that you become one of the low cost producers. And add value. You then replicate that in other therapeutic areas. So by design, you will limit competition. Even if others try to replicate it later they will be less efficient because they will be trying to catch up with you."

So how did Orchid identify the right niche? There are two main kind of microbial drugs - antibiotics and anti bacterials. The subtle difference between the two is that one kills the bacteria, while the other maims the reproductive ability of the bacteria. In antibiotics, the most well known is penicillin which was invented in the 1920s. But penicillin kills indiscriminately, destroying even the good bacteria which is required by the body.

Then came semi-synthetic penicillins with lesser side effects, but the spectrum they cover is also narrow, i.e., the drug is not as effective against a variety of diseases.

Then came cephalosporins which act on the cell walls of the bacteria so that the immunity or the resistance system is not damaged. And its spectrum is also broad which means they can selectively kill different types of bacteria rather than a narrow range. So without going into too much of technical detail let us just say that Orchid chose to focus on a cephalosporin range, where by definition, competition is limited.

“That is something which has got a bright future because it is only the third generation of antibiotics ever invented in 75 years,” adds Rao.

Within the cephalosporin group, Orchid manufactures many products, from orals to injectables. At the time, there was no company which specialised in cephalosporin in this manner. And even today there are only five companies in the world who have attempted to do it.

And the third reason Rao offers is that Orchid was one of the first companies born out of liberalisation with a global view. “We were the first company incorporated as EOU, ie, 100% export oriented company in the pharmaceutical space. People used to say, ‘Oh! India contributes only one per cent of the total requirement of the world in pharma.’ So I said, ‘Great, that means there is 99% of the world available for us to look at.’ Even though we are basing ourselves in India we can conquer world markets.”

Were there any problems in convincing foreign buyers to import drugs manufactured in India? After all, this was the early ‘90s, when India was not exactly known for its high quality in anything. However, this was not an issue for Orchid.

“In pharmaceutical language, to keep things simple, the basic ingredient which cures the disease is called the bulk drug. It is made in a large quantity and cannot be eaten by or injected into people. It has to be given in a 'formulation', i.e., made into a tablet, capsule or injection. So formulation is the front end, and bulk active or basic active is the back end.”

Orchid entered the bulk drug segment first because even if it was a nameless, faceless operation to begin with, it would help the company build the business, achieve turnover and reach more people faster.

“It is like selling picture tubes. Who knows what is there in Sony or Panasonic. They are competing at the brand level, but the input can be from any vendor.” Similarly, other companies used Orchid's bulk drug to create a formulation and sell it under their own brand name.

Orchid started exporting only to three countries - Singapore, Hong Kong and China. In the second year, this was expanded to 12 countries. By year three, Orchid was exporting to 30 countries. Now the company has clients in 75 countries. America and Europe were tough markets to crack but today, one third of Orchid's revenues comes from the US (if you take the value of Orchid products eaten by or injected into US customers or US patients).

Few companies grow so big, so fast. And yet, it is never easy or painless. The initial challenge was attracting talent apart from the core group. Pharma is a highly technology oriented, process oriented and hazard oriented industry, so you can't just go and pick up anyone out there. It has to be people who have experience in this field and convincing them to join a new company was no child's play. As always, Rao sold them a dream.

"I used to market to them my 'five year plan'. In fact I always carried the five year plan book with me and I would say, with or without you, I plan to do these things. But if you join me, you can contribute in this way." It wasn't merely higher salary or designation that Rao used to lure these people. He told them "this is your chance to *make a difference*."

"If you want to believe and join us, you are most welcome. If you don't believe, see me after 2-3 years, judge what has happened. Join me at that time, so that we can make the next step happen." And once again, some bought his argument and joined Orchid. They have grown with the company, manifold. And of course, they have an ownership stake.

In fact, a large number of people at Orchid hold shares in the company. Right from the boy who brings tea to the Deputy Managing Director. "And I did that even with my own money, even before we went public," says Rao. "So those employees who were there at that time, 135 of them, all have shares. We didn't know the price or the value that will come out of the shares later. It is the gesture that you do and your intent that speaks." In fact, other

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than IT companies, Orchid was the first company in India to give ESOPS, in 1999.

Little wonder that the attrition rate in Orchid is quite low. "One reason is the rapid growth of the company and the variety of opportunities that we give to people. From scratch we have built up a 300 million dollar company, in about 13 years, I don't think any other pharma company has done it at that pace."

Early on, Orchid invested in R & D and gave its scientists a free hand to convert their ideas into reality. When the centre first came up in 1997 people remarked that it looks like a hotel, and was so much expenditure really necessary? Rao emphasises,"Without that R & D centre, none of the processes that we boast of now would have been possible."

The second challenge was growing beyond the initial model, i.e., moving from bulk active to the active dosage form. The company would need to expand beyond cephalosporin to diversify its risks and also invent new molecules. To do all this, Orchid needed about $100 million dollars.

"As a five year old company, organically built up you don't have 100 million dollars of cash, however successful you might have been. So I said, 'Okay, I will make another five year plan from 2000 to 2005. I will go to international investors and private equity guys and market this story. You want to believe in it, participate in this, and together we will execute the plan. And don't look everyday, every quarter at *Economic Times* and see what is Orchid's share price.'"

What Rao promised was that in four years time, Orchid would do all four things - build up FDA approved manufacturing plants, build dosage forms and go to regulated markets, develop R & D, and patent its own processes. The idea was to have international marketing tie-ups in place and sell these products as soon as 'product patents' expired in 2005. Schroders put in $40 million and IFC provided $20 million and the balance $40 million was borrowed from the banking system.

This time it was far easier raising money. "But the first time we had more vigour, more youth, more passion and drive, comparatively speaking," recalls Rao. "We were rejected then by four different agencies yet did not take 'no' for an answer." It is one of the ironies of life that money chases track records, but few fund the entrepreneur seeking to lay down that track.

Orchid's plans went exactly as projected. 2005 saw a massive ramp up in operations - the company found success in regulated markets and tripled its profits. Profits have again doubled for the year ending March 31 2008*. "It is an innovation led, formulation oriented, international market penetration story."

Half the company's revenue is coming from the dosage form, one third of the revenue is coming from the US market, and the activities and product range of the company have been successfully diversified.

Execution was, of course, a huge challenge. "International marketing of formulations is a different ball game, intellectual property or looking at the patents situation is a totally different story. And making bulk active of carbapenems is quite different from making cephalosporin injectable. They are like chalk and cheese."

Different lines of business require different sets of people. "Only corporate planning, philosophy, motivation and finance departments, you could say, remained the same."

This time, getting the people was not difficult but executing different pieces and integrating them into the culture of the organisation was the key issue. "Because an R & D scientist will be in his own world whereas a formulation or a sales guy for the local market, wearing a tie and going to meet a doctor, will have an entirely different mindset. To make both of them think that this is one Orchid, was a big challenge."

One of the unifying factors is Rao himself. The company now has 3,700 employees and 10 locations but he makes it a point to visit, interact with the staff, share his thoughts with small groups and encourage them to speak to co-workers. Rao ensures his presence and participation in annual days and sports events. Even his fluency in 4-5 different languages, especially South Indian languages, has helped in building that personal connect.

** Orchid achieved Rs 1,301 crores of revenues and a net profit of Rs 175 crores for the 12 month period ended March 2008. Revenues for the year ending March 31, 2007 were Rs 985 crores against the profit of Rs 78.5 crores.*

"The bus service to this area dropped the workers 5 kms away. When Rao noticed it, he decided to buy a bus. There was no food facility in the area, so Orchid opened a canteen."

At the policy level also, there is a 'company as family' approach. "There is no point in merely saying we are all a family. We have to believe it, we have to show it, we have to behave, we have to walk the talk."

For example, the very first factory Orchid put up was the 24th one to come up in that location. And the bus service to this area dropped the workers 5 kms away. When Rao noticed it, he decided to buy a bus. There was no food facility in the area, so Orchid opened a canteen. And of course, workers got shares.

The company also funds the further education of employees without taking any bond. "I said let us help someone become a post graduate by attending evening classes or whatever. If we are not able to give him a better opening and he gets a chance elsewhere, he becomes a better person. So be it. I can always recruit another graduate." Higher education of children of employees, paternity leave, birthday gifts are all par for the course and it is equal for all employees. Irrespective of the level or the cadre.

So what lies ahead? Rao has a 'specific plan' to take the company to one billion by 2011. It is a very ambitious kind of target and this time it is not so much about raising money but differentiation in terms of identifying niche products, where the competition will be limited. "Development based on knowledge and innovation are going to be the keys to take us from 300 million to one billion."

The idea is to be the early bird in some segments instead of jostling around with many other players in the large and obvious market opportunities. The secret is that niche products always command higher margins.

"What I mean is we will focus on a couple of niche products each year. Once we do that, others will notice and try to catch up. Prices come down, and by that time I move on. I have 'new hills' to climb in the form of another 10 products that are lined up for launch in the next four years." Smart choice of products and proper timing is what Rao is banking on.

Everything is planned in advance. But does life really work out that way? In the pharma industry, perhaps.

"It is different in the electronics or fashion industry, where obsolescence is high. In pharma, it is a patented regime - what is happening is all documented and is in public domain." So one can use that information and plan accordingly.

Of course, the same information is available to all other pharma companies as well. You still need to put the pieces of the puzzle together. And there is also a risk you take in terms of investing a lot of money to make it all happen.

"When you create this kind of excellence where you are able to create such 'hills' in the sub-specialisation of antibiotics, you need to make separate dedicated investments in those products and wait for 3-4 years to reap the benefits."

Pharmaceutical exports need to abide by FDA regulations. Due to issues like cross contamination, you are not allowed to make cephalosporin in a penicillin plant and so on. A patient may have an allergic reaction and even die due to a microgram of the other drug being present.

"Right from canteen to godown, everything has to be different. So how many companies will be discerning enough to make those kind of niche investments silos, wait for the product patent expiry to take place, then launch a product? We have done that and we will keep doing it..."

The price of ambition is a tremendous strain on the balance sheet. "We are quite leveraged, we have borrowed, we have invested, we are waiting. But the hills are beginning to unfold now..."

And more are waiting to be climbed, ahead!

Epilogue

On Monday, March 17 2008, the stock price of Orchid Chemicals & Pharmaceuticals Ltd fell by 39.09% to end at Rs 127.05.

Commenting on this, an Orchid spokesperson stated that a combination of macro factors and market rumors contributed to the sudden negative sentiment on the stock.

The trigger was the sale of a stake held by a major institution (Bear Stearns) liquidating its position in many companies. This was coupled with the margin call on a particular portion of the promoters' stock which was funded. As a result, the promoters' holding fell by 7.9%, creating further pressures on the stock price.

In the process, K Raghavendra Rao is estimated to have lost close to Rs 75 crores in what can only be called a 'Black Swan' or unforeseen event. What's more, Solrex, a Ranbaxy owned company, used this as an opportunity to snap up close to 15% of the company by buying shares from the open market.

Following speculation about a hostile takeover, the two companies formally announced a 'business' alliance on 22nd April 2008.

Speaking on the development, Mr Malvinder Mohan Singh, CEO & MD, Ranbaxy *, said, "Orchid is a niche player in the global pharmaceutical industry with an impressive track record, particularly in sterile products. We are pleased to enter into this long term strategic alliance with Orchid. The agreement will be mutually beneficial and synergistic, allowing both organisations to leverage each other's inherent strengths."

Commenting on the alliance, Mr K Raghavendra Rao, Managing Director, Orchid Chemicals & Pharmaceuticals Ltd said, "We are happy to join hands with Ranbaxy, India's largest pharmaceutical company. Ranbaxy's global scale and market reach and Orchid's state-of-the-art development and manufacturing capabilities would expand the business of both companies. We believe that this will be a win-win arrangement for both companies."

As they say, always expect the unexpected and then make the best of whatever hand life deals... And who knows what the next round holds.

** Ranbaxy was acquired by Japanese pharmaceutical giant Daichi for $ 4.6 billion in June 2008*

ADVICE TO YOUNG ENTREPRENEURS

Choose a goal and focus on it. It can be in the area of product, service or knowledge. Longevity of the field is important. Combine reason and intuition. If there's a tie, go with intuition. Think either big or niche. Doing what many others do won't take you anywhere. Build teams. Believe in dignity of labour. Be passionate and direct about your ambition. There is no dearth of capital to back right ideas and entrepreneurs. Aim to create lasting value. The country will remember you for that.