

# CHATTEM INC.: THE OVER-THE-COUNTER MEDICATIONS INDUSTRY

*Reina Garcia, Tobin College of Business, St. John's University, 8000 Utopia Pkwy, Jamaica, NY 11439, 718-990-6161, garciar@stjohns.edu*

*Robert J. Mockler, Tobin College of Business, St. John's University, 8000 Utopia Pkwy, Jamaica, NY 11439, 718-990-7415, mocklerr@stjohns.edu*

*Marc Gartenfeld, Strategic Management Research Group, St. John's University, 8000 Utopia Pkwy, Jamaica, NY 11439, 718-990-7419, mdj13j@aol.com*

## ABSTRACT

Chattem Inc., a smaller player in the pharmaceutical industry, was faced with the decision of examining how to improve the company's market position. Should they look to expand their product line to include prescription drugs or be acquired by a larger corporation? Should they look to acquire a smaller corporation or product line? Is their current business model strong enough to survive the industry trend cycles? The main question to be resolved was how to differentiate Chattem from its competition and so achieve a winning edge over competitors within intensely competitive, rapidly changing immediate, intermediate, and long term time frames.

**Keywords:** Strategic Management, Company Analysis, Pharmaceutical Industry, Decision Making

## INDUSTRY AND COMPETITIVE MARKET: OVER-THE-COUNTER (OTC) MEDICATIONS

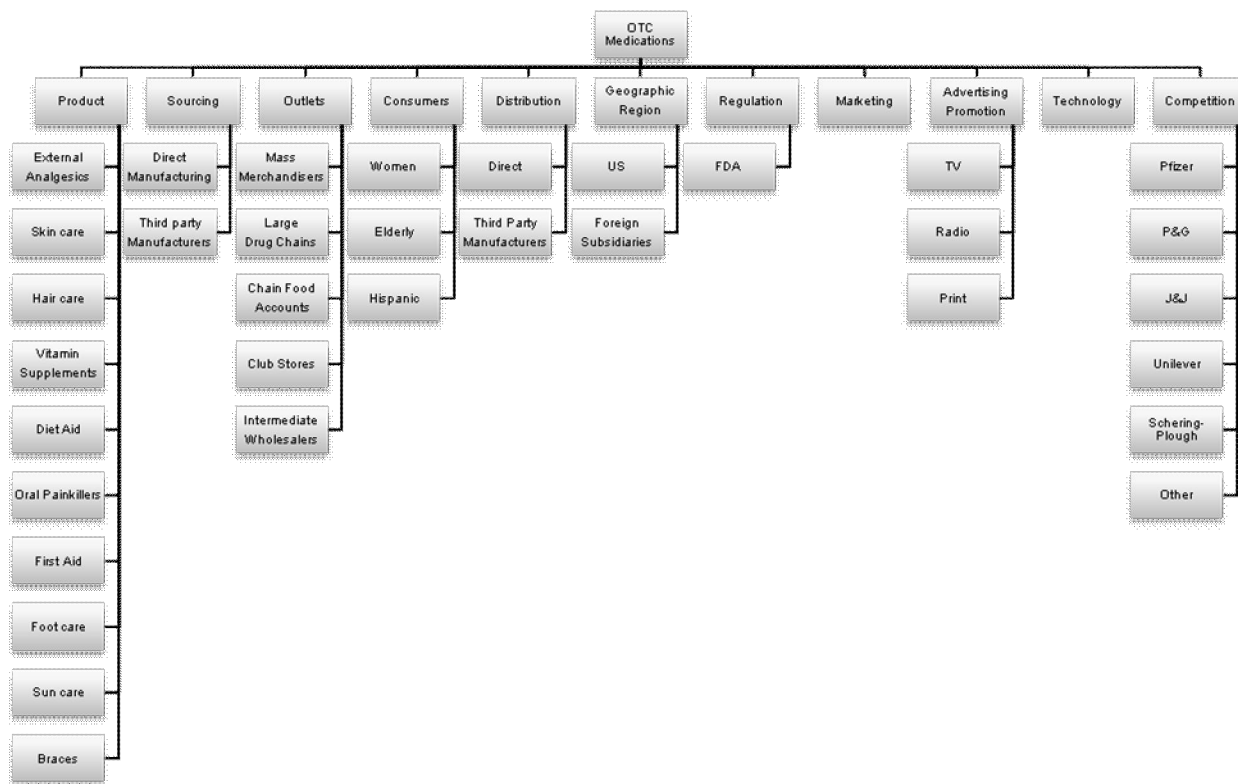
Over-the-counter (OTC) drug products were those drugs that were available to consumers without a prescription. OTC drugs played an increasingly vital role in America's health care system. There were more than 80 therapeutic categories of OTC drugs, ranging from acne drug products to weight control drug products. The OTC medications industry was comprised of various segments as shown in Figure 1. Over the past 10 years total sales from OTC drugs had increased from \$14 billion to almost \$20 billion. This increase in the consummation of OTC drugs was due to several factors. Consumers were becoming more health conscious in a time when healthcare costs were consistently increasing. Individuals were also becoming more comfortable with self-educating and self-diagnosing and as such were more inclined to find the remedies they needed without the help of a physician. Americans were aging and living longer and were finding that they were capable of curative and preventative health practices such as the use of OTC drugs. OTC drugs generally had these characteristics:

- their benefits outweigh their risks
- the potential for misuse and abuse was low
- consumers could use them for self-diagnosed conditions
- they could be adequately labeled
- health practitioners were not needed for the safe and effective use of the product

The products within this category were researched and developed by original manufacturers, third party manufacturers, or foreign subsidiaries and then processed through FDA or international regulatory guidelines before being approved for public marketing and consumption. Once approved for public consumption, these products would then be distributed to retail outlets directly from the manufacturers or through the use of wholesale distributors. Wholesale distributors were intermediaries who bought in bulk and resold to various smaller, local retail outlets. OTC products were sold domestically and internationally. Third party manufacturers located overseas or foreign subsidiaries provided the products

to overseas consumers. Customers of this industry and consumers of this industry were not necessarily one in the same. Customers of the corporations included large chain outlets, retail food and drug outlets, and wholesale distributors. Consumers of OTC products ranged over several demographic characteristics. Individuals of all ages, gender, and socioeconomic situation used OTC products for over 80 different therapeutic applications. Global OTC product sales totaled \$47 billion worldwide in 2001. Seventy percent of all Americans took an OTC product to treat common, everyday ailments. Adults 65 years and older consumed 33% of all OTC medicines sold in the United States [1]. Advertising & marketing was crucial in this market. Manufacturers and distributors generally worked with small margins and price competition was critical. Product differentiation was made aware through TV, radio and print media, and promotions. Competition in the OTC pharmaceutical industry was very intense. Large pharmaceutical firms often had the resources to promote brands and create strong advertising campaigns. The main competitors in this particular industry were Pfizer Inc. , The Proctor & Gamble Company (P&G), Johnson & Johnson (J&J), Unilever Inc. , and Schering-Plough Inc. (SP).

**Figure 1**  
**OTC MEDICATIONS INDUSTRY**

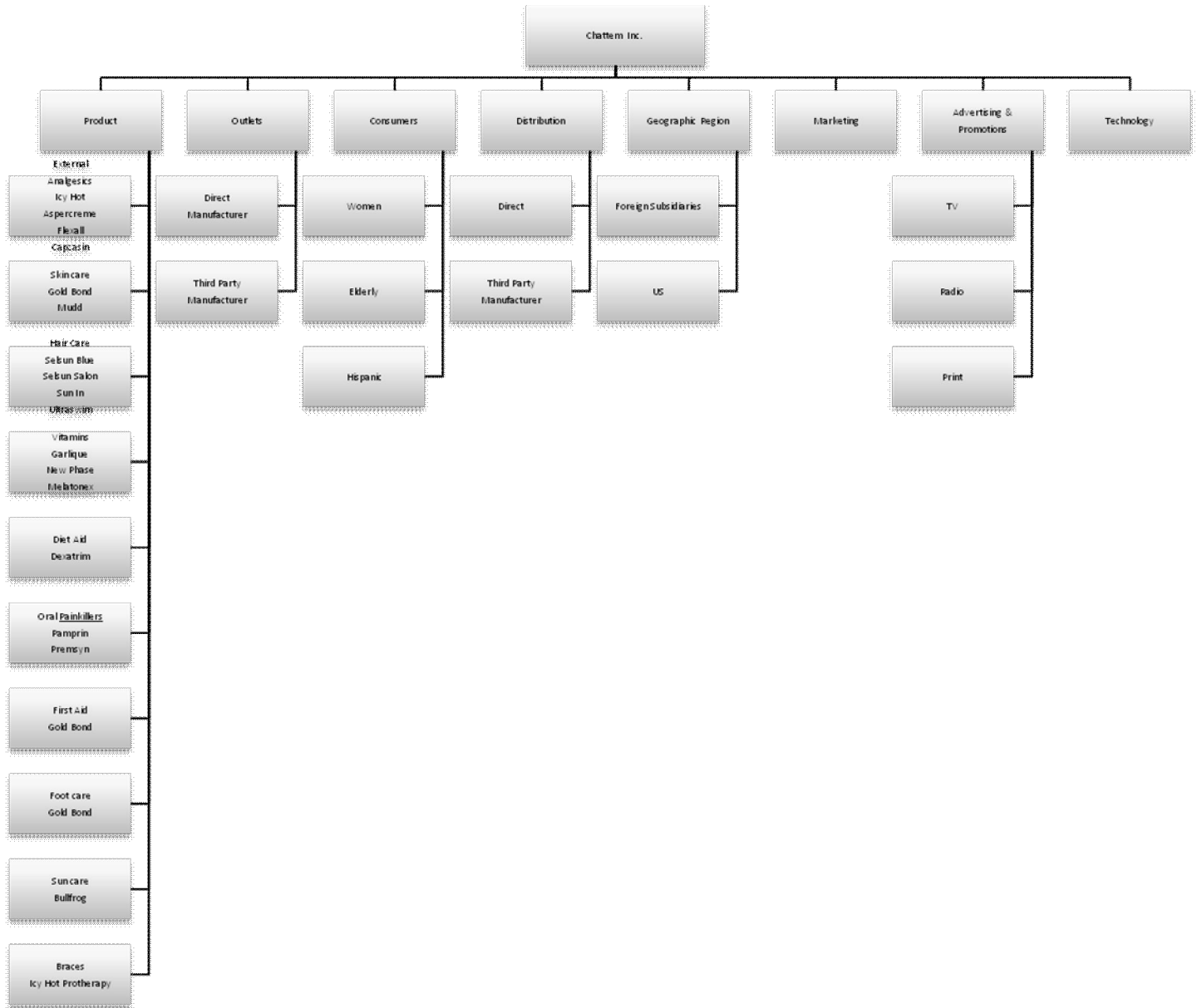


**THE COMPANY**

Chattem Inc. was a leading marketer and manufacturer of a broad portfolio of branded OTC healthcare products, toiletries and dietary supplements. The Company's products targeted niche market segments and were among the market leaders in their respective categories across food, drug and mass merchandisers. The Company's portfolio of products included well-recognized brands such as Icy Hot®, Gold Bond®, Selsun blue®, Garlique®, Pamprin®, and BullFrog®. Chattem conducted a portion of its global business through subsidiaries in the United Kingdom, Ireland and Canada. Following were

detailed analyses of Chattem Inc.'s business model as shown in Figure 2. Each section focuses on opportunities and strength and weakness in key to success areas.

**Figure 2**  
**CHATTEM INC – BUSINESS MODEL**

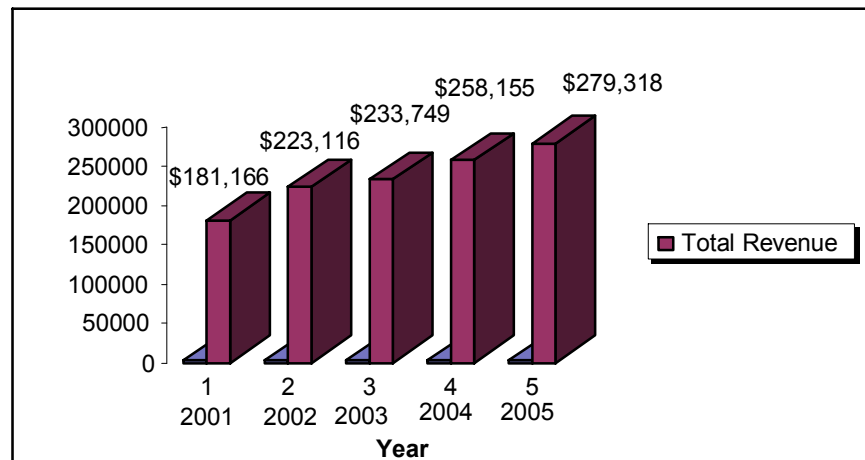


## Financial Analysis

Chattem Inc. was a financially strong company. According to the company's 2005 annual report, total revenues for 2005 exceeded \$279 million, up 8% from 2004; operating income exceeded \$75 million; and earnings per share were up 24% from the prior year to \$2.09. During the past five years, Chatters' earnings per share grew at a compound rate of 45%. In addition to increased sales, the company also

continued to improve their balance sheet, with net debt declining to \$135 million from \$160 million last year. The Company also repurchased 882,267 shares of its common stock in fiscal 2005 for \$34 million. The company's current ratio of 1.74 indicated that the company had short assets which could meet current liabilities specifically 1.74 times. Furthermore, the company's quick ratio of 1.41 supported the company's ability to pay short term liabilities with cash and cash equivalents by 1.41 times [2]. Figure 3 shows the company's revenue growth data [2].

**Figure 3**  
**CHATTEM INC REVENUE GROWTH – 2001-2005**



## Management and Strategy

Chattem would be focused specifically on expanding its brand awareness to the Hispanic community as well as re-organizing and expanding the international segment of their business. For fiscal 2005, international revenues increased 11.3% or \$2.7 million. The increase was primarily due to the introduction of Icy Hot in Canada and strengthening distributor sales in certain European and Middle Eastern countries [2]. An important step in beginning to cultivate the Hispanic community was the implementation of Spanish language radio, TV, and print media. 49% of Hispanics who watched television during prime-time hours, watched Spanish language programming. Radio was also a powerful media tool for targeting the Hispanic population. In fact, Hispanic's listened to radio more than they watched television and read print media. In 1980, there were 68 Spanish language radio stations, in 2003 there were 645. These changes also demonstrated that Hispanics preferred to listen to Spanish language speaking stations [3]. Focusing significant resources toward attaining the attention of the Hispanic consumer was key for the Company.

Chattem Inc's would continue to focus on targeting niche markets that were often outside the core product areas of larger companies. Chattem could sustain significant domestic and international market penetration through innovation and strong advertising and promotion support.

Recently, the company had launched a new product, Icy Hot ProTherapy. An extension of the already popular Icy Hot brand, Protherapy offered consumers a choice of Neoprene back or knee braces with slots for the insertion of either hot, cold, or medicated pouches. This product was new to the market and had no equal or even anything similar in concept available to consumers. Neoprene and elastic bandages were in a dying elastic support category but were widely used items. Chattem hoped to revamp the category and was expecting the Protherapy launch to provide almost \$2 million in revenue. The Protherapy opportunity could be the item to catapult the success of the company abroad. Specifically,

Chattem could couple the use of their endorser, soccer great Mia Hamm, to appeal to the Hispanic community. Soccer was a highly revered sport in the Latin American community.

Another strategy was to continue to grow the OTC business with strong brands. The acquisition of well known brands was an opportunity for Chattem, especially since the larger corporations were looking to divest some of these products.

The success of these strategies hinged on continued advertising and promotional support, which would be necessary to create brand awareness overseas. An international infrastructure would also need to be put in place to control all of the brokers and distributors in all of the different international locations. Cohesion would be needed at the management level to ensure international needs and cultural differences were being evaluated. Being aware of acquisition opportunities was essential to growing the business.

## **LOOKING TOWARDS THE FUTURE**

Since Chattem was solely focused in the OTC segment the Company had the opportunity to be the leader in the OTC market. Chattem would continue to stay innovative in the OTC pipeline and look for good deals among acquisition potentials. The company would also look to expand its international presence and capture the Hispanic market.

The first alternative for the company regarding their product line would involve a combination of maintaining the status quo on certain brands and increasing media support on others. Chattem would do the following within each product category:

Regarding other decision factors, as part of the first alternative, the company could maintain their focus on expanding their domestic business and avoid any further debt by not expanding internationally. In addition, the company could improve upon their current web page to increase domestic brand awareness of their products.

The second alternative considered by Chattem Inc. with regards to their product line would be a combination of increasing media support coupled with eliminating several under producing items. Chattem would do the following within each product category:

In regards to other decision factors the second alternative included focusing the company's attention not only on the domestic market but also on expanding internationally. Financially, the company would borrow funding in an effort to push its products into the international arena. The Company would also create an international expansion management team to handle this initiative. An element of the international restructuring would be the movement of a subsidiary location, specifically closing a European subsidiary and opening a South American subsidiary. Finally, the company could create a web-link from their current webpage for international information or directly linked to subsidiary information.

Both alternatives were reasonable. The first focused mostly on maintaining the status quo with few changes to conservatively maintain their domestic market share. The second alternative focuses on making small but significant advances toward international expansion. Both alternatives could potentially place Chattem in a strategically improved position but would most likely result in little or no change when compared to their large competitors. Further evaluation was necessary to make a decision.

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