

Synergy or Vanity: the Appetite for Pharma Mega-Mergers

The late 1990s and early years of the current decade saw a number of mega-mergers between companies, which defined the current shape of the pharmaceutical industry, and have established a hierarchy of companies commonly referred to as 'big pharma'. In recent years, however, there have been no mega-mergers, suggesting that the industry might have lost its appetite for such deals. The publicly explained rationale for these mergers might differ between transactions, but the overall results are fairly consistent throughout the industry. First, combined companies allow a large degree of cost-cutting in overlapping functions, thus increasing profitability and giving an obvious and tangible return to investors. Second, enlarged R&D operations increase the development of new drugs that will drive future sales for the new company. Third, the combined marketing capabilities and sales forces of two already large companies will have a synergistic effect, ensuring that the new company will always have an advantage over its smaller competitors, and allowing a certain degree of power to influence the market in its favour.

These rationales may appear irresistible to pharmaceutical investors and their Boards of Directors, but the reality is that they are not always as straightforward to achieve as one might hope. While there are substantial savings to be made from cutting out overlapping activities, these advantages might be outweighed by the process of integrating the companies at a corporate level. Separately, these large companies already operate on a colossal scale, each with a unique organisational structure – not the least aspect of which is the Board of Directors itself. The roles for the expanded (or new) corporate departments (and the Board) will be much greater than before, so departments must increase in size, and integrate aspects of both merging companies – although to maintain efficiency, the size of the combined departments should ideally be less than that of the sum total of the originators.

Perhaps even more complicated is the alignment of the processes that these organisations have for everything from deal making to manufacturing supply chains. The complexity of these tasks cannot be underestimated. Even though **SmithKline Beecham** and **Glaxo Wellcome** eventually combined in 2000 (Deal no. 05344) – as **GlaxoSmithKline** (GSK) – only 2 years earlier they had attempted, and then abandoned, a merger. The explanation is that the rationale for the merger never changed, but that in 1998 the 'time was not right' for the transaction; organisational differences since aligned – such as manufacturing – were highlighted as reasons. However, industry observers (and the UK Government) have suggested that the initial merger had been proposed without adequate assessment, and that its collapse was mostly due to personal, rather than operational differences. If personal differences can put the brakes (temporarily at least) on one of the largest mergers to occur in the industry, it serves to remind us of the power that individuals can wield in such situations.

The public face of pharmaceutical mergers is the much touted increase in R&D power. While there may be certain overlaps that need to be eliminated after a merger, the resulting R&D capability

is, in theory, stronger than the sum of the two separate parts. In fact, most of these mergers have been accompanied by assurances that the merged company will actually increase the level of R&D investment, and that any cost savings from eliminating overlap will be invested directly back into R&D. Logically, one would hope that these increased R&D capabilities would translate into an improved pipeline, and thus more drug launches per year – although if we look at three notable companies created by mega-mergers, **Pfizer**, **AstraZeneca** (AZ) and GSK, we find companies whose internal R&D has failed to deliver the output expected of them.

While the anticipated increase in drug development might have looked quite tasty, the reality has failed to satisfy pharma's appetite. The usual explanation is that despite increased size, merged R&D operations lack the innovation and freethinking that their smaller predecessors encompassed. Indeed, it is now acknowledged by most that it is stability and the quality of research that deliver the best results – not increased critical mass. In recognition of these factors, the current favoured model for structuring R&D is to allow a degree of autonomy, as exemplified by GSK's Centres of Excellence for Drug Discovery (CEDDS), and AZ's decision to allow its newly acquired biologicals arm, **Cambridge Antibody Technology** (Deal no. 24261), to continue to operate as a separate research unit in Cambridge, UK.

Increased R&D capabilities might be the publicly acceptable face of pharma mergers, but cynics might argue that the real reason for such mergers is primarily to achieve increased sales and marketing muscle. In fact, it is known that Pfizer has people dedicated to planning how the company can exploit its position as the number one pharmaceutical company in the world. Furthermore, all other big pharmas are constantly modelling how a hypothetical merger with A or B would allow them to compete with C. Has being number one really been of any advantage to Pfizer? The lack of increase in the company's share price since its US\$60 B acquisition of **Pharmacia**, completed in April 2003 (Deal no. 10948), and the recent axing of 10% of its sales force would suggest not. Moreover, the company's proportional spend on R&D is now less than it was before it acquired Pharmacia.

Why, then, do rumours of mergers between big pharmas persist? Is the prospect of being number one too much to resist, meaning that mega-mergers will continue? Perhaps the motives can be put down to pure vanity? The most recent merger speculation concerned **sanofi-aventis** and **Bristol-Myers Squibb**; this would create a company to rival Pfizer, but other companies, such as **Roche**, AZ, **Schering-Plough** and **Novartis**, also continue to be mentioned as potential merging parties. So should the industry still consider mega-mergers as a tactic to deliver value to shareholders? Probably not if, like Roche and Novartis, you are in a position of strength and have a healthy pipeline – and it is hard to imagine Pfizer or GSK becoming even larger through acquisition. Organic growth alone is unlikely to result in significant changes in the big pharma hierarchy, so, for many companies, the prospect of moving up the pecking order may be too sweet to resist for long.