Mergers and acquisitions in the pharmaceutical industry

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Introduction

Mergers are done to expand the business and improve profitability by companies with mutual consent. Acquisitions occur when one company takes over another which may be friendly or hostile. Mergers and Acquisitions (M&A) are actively taking place in the pharmaceutical and biotech organizations and this trend is expected to prevail for the next one to two years. The bio-pharma industry is dynamic and is currently changing focus from R&D to licensing and outsourcing. So before any M&A activity a strategy formulation is very essential with emphasis on creating a competitive advantage for the business.

Mergers and Acquisitions (M&A) are generally done with the following motives: to exploit economy of scale, to eliminate duplicated functions, to share managerial expertise, synergy, taxation, market power because of decreased competition. M&A that are done with reduced competition as motive are socially unacceptable and illegal as they lead to monopolistic scenarios. The M&A may not be successful in generating returns if the deal was closed with a high price due to impulsive and enthusiastic deals. M&A also leads to diversification which has proved to be beneficial in stabilizing the returns.

A merger or acquisition is an extremely stressful process for those involved: job losses, restructuring, and the imposition of a new corporate culture and identity can create uncertainty, anxiety and resentment among a company's employees. (Appelbaum 2000) Companies focus on the legal and financial issues involved with the M&A and fail to pay attention to the long term effects like corporate identity and communication which greatly influence the employee motivation and productivity.

The pharmaceutical industry

The Indian Pharmaceutical Sector is currently the largest amongst the developing nations. There is a worldwide structural trend evolving in pharmaceuticals and Indian companies play a key role in this framework, driven by their superior biotech and drug synthesis skills, high quality and vertically integrated manufacturing assets, differentiated business models and significant cost advantages. Companies across the world are reaching out to their counterparts to take mutual advantage of the other's core competencies in R&D, Manufacturing, Marketing and the niche opportunities offered by the changing global pharmaceutical environment. (Shukla 2006)

The pharmaceutical sector offers an array of growth opportunities. This sector has always been dynamic in nature and the pace of change has never been as rapid as it is now. To adapt to these changing trends, the Indian pharmaceutical and biotechnology companies have evolved distinctive business models to take advantage of their inherent strengths and the " Borderless" nature of this sector. (Shukla 2006)

Environmental factors

The changing environment in the bio-pharma industry is driving an increased activity of Mergers and acquisitions. In 2008, sales growth of prescribed drugs globally has reached the lowest rate in since 2001. Along with this slowdown, the pharmaceuticals sector is faced with an increasingly challenging environment resulting from increasing patent expirations, growing generic sales, reducing new drug pipelines and stricter regulations. The biotechnology sector also faces increased regulatory challenges as well as shortage of credit.

The patents are getting expired and there is increased competition for generic drugs. Patients are becoming more aware and manage their own conditions. The healthcare models are thus changing. With such environmental pressures increasing the companies resort to M&A as a tool for corporate growth. M&A do not exceed their cost of capital. Still companies go for M&A because of some strategies like

- increased market strength
- consolidating for cost reduction
- broadening geographic coverage
- pipeline stuffing (Coles 2002)

Some recent M&A

The US and European generics companies are scouting for alliances/buyouts at the back end of the chain, which would allow them to offset any manufacturing cost advantage held by companies in the developing markets. The Indian companies are looking at the front-end integration as building a front-end distribution set-up from scratch could take significant time. (Shukla 2006)

There are also entry barriers for companies from the developing countries and acquisitions make it easy for these organizations to find a foothold in the developed markets. For instance, there is a cultural and language barrier in Europe and Europe is high on the radar of Indian pharmaceutical companies. The sheer heterogeneity of Europe and the fragmented nature of its pharmaceutical market make acquisitions an easy route for entry into this region and the US being the largest pharmaceutical market in the world will always interest the Indian pharma companies for its sheer size. (Shukla 2006)

The acquisitions of RPG Aventis (by Ranbaxy) and Alpharma (by Cadila) in France are clear examples of acquisitions proving to be a drain on the company’s profitability and return ratios for several years post acquisition. In several other cases acquisitions by Indian generic companies are small and have been primarily to expand geographical reach while at the same time, shifting production from the acquired units to their cost-effective Indian plants. A few have been to develop a bouquet of products. Other than Wockhardt’s acquisition of CP Pharma and Esparma, it has taken at least three years for the other global acquisitions to see break-even.

Most of the acquiring companies have to pay greater attention to post merger integration as this is a key for success of an acquisition and Indian companies have to wake up to this fact. Also, with the increasing spate of acquisitions, target valuations have substantially increased making it harder for Indian companies to fund.

In January 2009, Pfizer entered into a merger agreement with Wyeth valued at US$68 billion. The deal is to be financed through a combination of cash, stock and debt. A consortium of banks will provide US$22. 5 billion for the M&A.

In March 2009, Roche acquired the remaining 44 percent of Genentech shares for an all-cash US$46. 8 billion deal. Prior to the deal, Roche raised US$39 billion through bond sales.

In March 2009, Merck & Co. acquired Schering-Plough in a cash-stock deal worth US$41. 1 billion. The cash component includes US$9. 8 billion from Merck's cash reserves and US$8. 5 billion committed by JP Morgan Chase. (M&A: Outlook for pharmaceuticals 2009)

If a company was acquired for its R&D pipeline and development projects or platform technology, in majority of cases, the acquiring company failed to derive full benefits and most of the projects were later discontinued or terminated. Diversified companies like Roche, J&J, Abbott and Novartis with devices, generics and diagnostic performed better as compared to pure pharmaceutical R&D driven company like Pfizer and Merck.

Strategies for successful M&A

The industry’s experience shows that megamergers often do not produce the intended synergies, but rather tend to erode shareholder value and create major integration challenges, while not achieving improved new drug pipelines. (Alternatives to mega mergers 2009)

Tetenbaum (1999) suggests an alternative set of “ seven key practices” to assist with a successful merger or acquisition:

Close involvement of Human Resources managers in the acquisition process; they should have a say in whether or not the deal goes ahead.

“ Building organisational capacity” by ensuring that close attention is paid to the retention and recruitment of employees during the acquisition.

Ensuring that the integration is focused on achieving the desired effect (for example, cost savings), while at the same time ensuring that the core strengths and competences of the two companies are not damaged by the transition.

Carefully managing the integration of the organisations’ cultures.

Completing the acquisition process quickly, since productivity is harmed by the disorganisation and demoralisation that inevitably occur while the change is underway.

Communicating effectively with everyone who will be affected by the change. Other authors agree that “ being truthful, open and forthright” during an acquisition is vital in helping employees to cope with the transition. (Appelbaum 2000)

Developing a clear, standardised integration plan. Tetenbaum cites the example of Cisco Systems, which, like GE Capital, makes large numbers of acquisitions and has been able to learn from its experiences and build up tried-and-tested processes for carrying them out successfully. (Tetenbaum 1999)

Conclusion

The companies may be heading towards more megamergers of the scale seen in the recent past or they may move towards smaller strategic acquisitions. Deals in the biotechnology sector could increase further as small and mid-size biotechnology companies become increasingly willing to enter into deals at value prices. Large pharmaceutical and biotechnology companies are scouting around for deals at much lower valuations, and the current trend of M&A in generics is one to watch for in the future.

Although there are many different opinions on precisely what causes so many mergers and acquisitions to fail, and on how these problems can be avoided, there are certain points that most analysts appear to agree on. It is widely accepted, for instance, that the ‘ human factor’ is a major cause of difficulty in making the integration between two companies work successfully. If the transition is carried out without sensitivity towards the employees who may suffer as a result of it, and without awareness of the vast differences that may exist between corporate cultures, the result is a stressed, unhappy and uncooperative workforce – and consequently a drop in productivity.