



Consultant points of view

Your pharmaceutical merger: An opportunity to innovate or back to "business as usual"?

Summary

With industry challenges climbing, pharmaceutical companies are finding it difficult to sustain desired -- or expected -- revenue growth rates. Although mergers and acquisitions (M&A) offer several avenues for achieving growth, results are often short-lived. To develop capabilities that fuel growth over the long term, pharmaceutical firms should exploit M&A transactions as a potential way to dramatically improve research and development (R&D) productivity.

In the pharmaceutical industry, the trend toward the quick fix has produced an ongoing wave of merger and acquisition activity. Many companies have found blockbusters increasingly difficult to develop, and without the revenue these mega-products generate, it's hard to meet growth expectations or to begin to recoup draining investments made in new discovery technology. Mergers may help pharmaceutical companies realize the double-digit growth that shareholders expect in the short-term, but, in the long-term, the current trend toward consolidation only compounds corporate problems. For one thing, the newly merged company will have to deliver growth on an even higher baseline of earnings. For another, mergers focused to win marketshare by increasing size often sacrifice productivity in the process -- the red tape and bureaucracy that surround the merging of two separate companies can have a negative impact on both individual employee and corporate progress.

It is not company size, but innovation that enables faster and more effective discovery and development of new drugs that drives market value in the pharmaceutical industry. The seat of innovation in any pharmaceutical company is research and development (R&D). What most companies don't realize is that a simple shift in the way they view mergers with respect to R&D productivity -- from viewing the merger as an *interruption* to R&D productivity and business as usual, to seeing the merger as an *opportunity to improve* R&D productivity -- is the key to unlocking innovation and a more promising course to sustained profitability.

Improved R&D productivity has not typically been a driver for pharmaceutical mergers for two main reasons: One, corporate executives are more adept and experienced at creating shareholder value by implementing strategies around volume, price and cost than they are at understanding how to increase R&D productivity, and; two, long-

term success in improving innovation is difficult in any situation, particularly during an uncertain period like a merger. Returns are, therefore, difficult to predict.

But it is safe to say that without the new chemical entities that R&D innovation produces, pharmaceutical companies would be hard-pressed to convince shareholders they are worth continued investment. And while strategies that leverage volume, price, and cost can offer a quick boost in short-term gains, they are often not resilient enough to withstand the onslaught of industry pressures most companies face: increasing demands from public and private payors, a saturated market, shrinking windows for exclusive drug sales, increasing regulatory requirements, and increased spending on technologies -- the benefits of which may be years away.

Strategies to optimize post-merger R&D productivity should be built around four main areas:

- Portfolio investment -- Determining the most attractive research areas and projects in which to invest and the amount to invest in each area
- Number of candidates in process -- Maximizing the number of compounds discovered and in development
- Failure rate -- Enabling early identification of failures
- Cycle time -- Decreasing the time it takes for discovery and development of new compounds.

Executives involved in a pharmaceutical merger should not only familiarize themselves with the details of these areas within their own company, but also work with executives of the acquired firm to build an understanding of what each company can contribute to improve R&D innovation.

A merger or acquisition may have begun as a means to plug pipeline gaps or to facilitate short-term growth, but it is very possible the two companies can help each other in additional ways that translate into sustained growth for the merged company. For instance, the companies may have different information from research performed on the same enzyme that when melded together unlocks a new discovery. Or, one company may have useful trial information about a drug similar to one the other is currently developing. As far as corporate architecture and organization are concerned, one party may have solved an organizational difficulty in the past that the other company is currently experiencing.

Whatever the synergies are between the companies involved, there will be challenges in discovering them. Merging distinct cultures causes friction at all levels of an organization, from executive level clashes over determining the path forward to employee angst over job security and project related issues. These conflicts can stall innovation and cripple productivity, especially in R&D where ideas, experiences, and experimentation by individuals or teams of researchers and scientists generate market value. To combat these threats, corporate executives should set up an integration process that is even-handed, where decisions are based on what is right for the new organization, where both legacy organizations win. Researchers and other staff need to be given something positive to work towards or they will retreat and wait for "business as usual" to resume. Finally,

management must keep the lines of communication open from the lowest to the highest levels of the corporate hierarchy, and work to create a recognized and fairly enforced system of measurement and reward for employees.

By building mechanisms -- whether they are supported by technology, long-standing personal networks, or corporate cultural mores such as organizational reverence for an open door policy -- that allow for the easy transfer and access of knowledge and information across the merged company, executive leadership can create an environment that encourages innovation. Companies that focus on getting back to business as usual after a merger or acquisition will no doubt continue to struggle to achieve the growth necessary to impress their shareholders. But companies that make improved productivity the focus of mergers and acquisitions will create an environment that fosters long-term gains through innovation.