



Big Pharma Works on Productivity— But Is It Enough?

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The changing fundamentals of the industry are causing Big Pharma to focus more on operating efficiency instead of just product performance.

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The annual ritual of year-end presentations by major pharmaceutical companies to Wall Street analysts had an interesting twist in 2003. The companies were not just trying to generate excitement about their new product pipelines (which have generated precious little excitement lately), but some executives were actually bragging about their efforts to increase their operational efficiency. This spotlight on efforts to improve productivity—including the reengineering of R&D operations, restructuring supply chain and manufacturing operations, and reducing the size of sales forces—is unusual in the product-driven pharmaceutical industry. This focus reflects the realization by pharmaceutical executives that they must show investors that they recognize the challenges posed by weak pipelines and growing consumer objections to high drug prices.

Among the companies discussing their productivity enhancements were the following.

- **Merck** (Whitehouse Station, NJ) claims to have increased its manufacturing volume by 42%, increased its headcount by just 10%, and reduced its sales and marketing infrastructure by 26% since 2001. The company plans to gain \$300 million from inventory reduction efforts by 2006.
- **Wyeth** (Philadelphia, PA) says that its efforts to reengineer its R&D operations have enabled it to increase the number of annual investigational new drug application (IND) filings from two per year to six per year and to reduce cycle times for Phase I studies from 12–18 months to 6 months.
- **GlaxoSmithKline** (London, UK) claims that it has experienced productivity improvements of 100–400% since launching its Centers of Excellence for Drug Discovery in 2001, noting that the number of candidate molecules has nearly tripled while its headcount has diminished 20%.

These productivity improvements have some interesting implications for CROs and contract manufacturers. On the one hand, as companies succeed in pushing more candidates into the

pipeline, the demand for development services is expected to grow. At the same time, however, the improved productivity will establish higher benchmarks for CRO performance. Tripling the number of IND filings without increasing staff, as Wyeth claims to have done, is equivalent to tripling internal capacity and reducing costs by two-thirds! For an industry that was built on providing supplemental capacity and whose mantra is “price is not the major determining factor,” productivity performance improvements at major pharmaceutical companies could be a major strategic threat.

Are productivity improvements enough?

Whether the current productivity initiatives are sufficient is open to question. A recent study by strategy consulting firm **Bain & Company** (www.bain.com) estimates that the cost to develop and launch a new drug is now \$1.7 billion, including discovery, development, and launch expenses, and the expected return on investment for a blockbuster drug has fallen to just 5%, well below a company’s cost of capital. The authors of the study join the growing chorus of analysts who say that the vertically integrated, blockbuster-chasing Big Pharma business model is no longer viable. They argue that pharmaceutical companies need to focus on a few therapeutic areas where they can leverage their in-depth knowledge of diseases, build upon relationships between physicians and patients, and use partnerships more effectively to reduce their costs and risks.

One of the Bain study’s key recommendations is that pharmaceutical companies should break themselves up into more-focused business units, and should abandon their insistence on being fully functionally integrated. Ashish Singh, a vice-president at Bain and one of the study’s authors, points out that in most major pharmaceutical companies, “the only profit and loss (P&L) statement is the corporate P&L statement,” and the CEO is the only executive with full P&L responsibility. By contrast, most major US corporations are broken into multiple

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business units, each accountable for its own financial performance, which must compete for capital on the basis of its ability to deliver strong financial returns. In the pharmaceutical industry, there are only a few examples of the business unit model such as the Novartis oncology business unit.

Singh says that the lack of diffused P&L accountability is one reason why the outsourcing of manufacturing and other functions has not expanded more rapidly in the pharmaceutical industry. "The CEO is the only person in a position to be making the decision" about outsourcing major functions, "and he (or she) has a lot of other responsibilities." In an organization where business unit executives are accountable for their respective return on assets (not just return on sales, which is where pharmaceutical executives focus today), Singh argues there would be a lot more incentive to outsource capital-intensive functions. Such functions would include manufacturing and activities such as in-

formation technology, in which many pharmaceutical companies have no expertise.

Invitrogen acquires BioReliance

BioReliance (Rockville, MD), a pioneer in providing contract research and manufacturing services to the biopharmaceutical industry, has been acquired by **Invitrogen** (Carlsbad, CA), a provider of research supplies and services and cell-culture media. The deal is valued at nearly \$500 million, consisting of \$430 million in cash for BioReliance stock plus the assumption of \$70 million in debt. The offer will pay BioReliance shareholders more than double the \$23 per share that the stock commanded at the beginning of 2003.

According to Invitrogen CEO Gregory Lucier, the company had made a strategic decision to grow its presence in the contract services business before agreeing to buy BioReliance. Lucier said that services already accounted for 35–40% of revenues in Invitrogen's

GIBCO business unit, which makes cell culture media and provides related products and services for biomanufacturing. The companies expect to boost revenues by cross-selling GIBCO and BioReliance's products and services, but other synergies between the two companies are less apparent.

After the deal closes, BioReliance will continue to operate under its own name as part of Invitrogen's bioproduction business segment, which includes GIBCO, and BioReliance's CEO, Capers McDonald, will continue to run the operation. Integration plans have not been announced, but McDonald says that BioReliance will move all viral manufacturing operations from its Rockville facility to the former **Q-One** facility in Glasgow, Scotland, and convert the Rockville facility to clinical-scale cell-culture production and process development. **PT**