CONSOLIDATION IN THE PHARMACEUTICAL INDUSTRY

This article looks at the recent trend towards consolidation in the global and domestic pharmaceutical industry and analyses the rationale as well as the impact of these mergers.

GLOBAL SCENARIO

The global pharmaceutical market which has been highly fragmented is now moving towards consolidation in order to support high Research and Development (R & D) expenditure, to achieve economies of scale and to strengthen the marketing network. However, past mergers have indicated that benefits accrue only in the short term and do not boost long term growth.

The total global pharmaceutical market was estimated at around US $343 billion (bn) in 1999 and registered a 10% growth in 1999 compared to 6-7% p.a. in the past three years. The industry is characterised by high fragmentation with the top ten companies accounting for only around 36% of the prescription pharmaceutical market in 1998. However, consolidation in the industry has resulted in an increase in the market share of the top ten companies to around 40% of the prescription pharmaceutical market in 1999. Some of the prominent mergers in 1999, were - Hoechst Marion Roussel with Rhone Poulenc to form Aventis and Astra with Zeneca to form Astra-Zeneca. None of the four companies, prior to their merger, were a part of the top ten companies in the world. However, post merger, in 1999 the two combined entities figured in the top five companies in the market. This trend of consolidation is expected to continue in future as well. The recent announcements of Glaxo-Wellcome merging with Smithkline and Pfizer merging with Warner Lambert are again expected to change the rankings in the world pharmaceutical market in 2000.

Rationale For Consolidation in the Global Pharmaceutical Industry

The main reasons for the alliances and takeovers in the pharmaceutical industry are listed below.

- Research and Development

The product life cycle characteristics of pharmaceutical products makes it imperative for a pharmaceutical company to continuously have some products in the product pipeline. A typical drug discovery process takes 10 to 12 years and another 2-3 years are spent on commercialising the same. This time duration has been increasing due to stringent requirements (which require higher number of trials) prescribed by authorities. Also, increased competition in industry and better research techniques have led to faster emergence of competition to the first drug in a therapeutic segment. This means that the duration for which the company enjoys significant pricing flexibility i.e. the exclusivity period, has been decreasing over the years. Hence, R & D activity is expected to move away from traditional drug discovery process to newer and quicker methods like genomics, combinatorial chemistry etc. This necessitates a huge R & D expenditure which yield results only after a few years. Hence, a number of companies have resorted to mergers in order to increase their sales base so as to support the high R & D expenditure.

A merger also helps the merging companies to have access to each other’s product pipeline. A number of mergers and acquisitions have also been guided by the expected synergies in the R&D activity in the form of elimination of duplication in the activity and benefits from the mutual learning and larger R&D infrastructure in the form of equipment and personnel.
• Reduction in Manufacturing Costs

Mergers are also used to effect cost savings and synergies in manufacturing. The reduction in costs from rationalisation of manufacturing operations, such as from reducing the number of manufacturing facilities world-wide, is also expected to be significant. Besides, the increasing pressure on pharmaceutical companies to contain costs will grow rapidly following the end of the ten year moratorium in 2005, provided to developing nations under the provision of TRIPS. The high prices of patented medicines will result in major proportion of such countries being unable to afford such medications. Further, the Governments of such countries will be unable to invest substantially in healthcare. Such social pressures will continue to rise and are expected to move the industry toward consolidation in order to effect reductions in the overall cost of production so as to reduce drug prices.

• Strengthening of Marketing Network

Mergers and acquisitions also result in cost savings and synergies in marketing. A large marketing and distribution force facilitates speedy launches in the global market. This will be especially crucial in future since the exclusivity period of a drug has been decreasing over the years.

Consequence of International Mergers

The number of mergers amongst the top companies in the global pharmaceutical market is expected to alter the rankings in the current year. However, past mergers have indicated that the benefits accrue only in the short term but do not boost long term growth. Pharma Strategy Consulting AG, a Basel based market research firm has conducted a study on the market share of companies that were formed in deals versus those that remained independent. It was found that nearly all merged companies witnessed a decline in market share in the years after the deal than the two companies enjoyed prior to the transaction. The companies that decided not to merge continued to gain market share.

Impact on Market Share

![Market Share Chart]

Source: Published Sources

The probable reasons cited for the failure of these mergers is that troubled firms have been the keenest to merge. Another reason is the disruption caused by the reorganization consequent to mergers and the added bureaucracy of a larger organization, which discourage creativity within the company. Thus, a merger may not necessarily lead to an increase in market share in the long term.
INDIAN SCENARIO

The current fragmented structure of the Indian pharmaceutical industry is expected to change as Indian companies consolidate in order to widen their therapeutic coverage and increase their sales base so as to support basic R & D which will be essential in the product patent era. Moreover, global mergers will lead to the merger of their Indian arms too. However, MNCs in India are not expected to fully derive the benefits of synergies arising out of the merger of their parents on account of a lack of support from parents in terms of introduction of new products in the pre 2005 period. But, mergers amongst Indian companies are expected to be successful under prevailing Indian conditions.

The Indian pharmaceutical industry is estimated at around Rs 148 bn., with around 250 manufacturing and formulation units in the organised sector, which account for 70% of total sales. The unorganised sector, which accounts for the remaining sales comprises around 23,000 manufacturing units. The introduction of the Indian Patents Act (IPA) in 1970 which did not recognise product patents but only process patents provided a major thrust to the Indian pharmaceutical industry and Indian companies, which through the process of reverse engineering, began to produce bulk drugs and formulations at lower costs. This led to high fragmentation in the Indian pharmaceutical industry due to the emergence of a number of small Indian firms. The IPA coupled with Drug Price Control Order (DPCO) which was introduced to provide quality drugs to the public at reasonable rates discouraged the MNCs from introducing new products. Consequently, the market share of MNCs decreased steadily from about 90% in 1970 to about 38% in 1998 as new Indian companies emerged.

However, the Indian pharmaceutical sector has also been consolidating lately. In 1998, the top ten players accounted for only 31% of the total pharmaceutical sales which increased to around 36% in 1999 mainly on account of the merger of Indian subsidiaries of international companies.

Rationale for Consolidation in the Indian Pharmaceutical Industry

- **Domestic companies**

Large Indian companies are expected to capitalise on their existing strengths by acquiring smaller ones. The four prime drivers of consolidation in the Indian market are as listed below:

- Consolidation leads to widening of therapeutic coverage which will decrease the risks of being in limited segments.
- A large sales base will help Indian companies to support the large R & D budgets required in order to remain competitive in the product patent era.
- Consolidation may also be driven by the need to strengthen the marketing and distribution network. Rural market is still a large potential for players where they can expand their reach by strengthening their marketing network.
- Economies of scale will help to achieve savings in costs.

- **Multinational companies**

Mergers between the Indian subsidiaries of multinational companies has been driven only by the merger of their parents. These companies already have a product pipeline of their parents and hence will not face the pressure of developing a R & D base in India. However, in order to strengthen their marketing network and reduce manufacturing costs, these companies have been entering into a number of alliances with large Indian companies with strong sales and distribution network, and low cost third parties for contract manufacturing.
Consequence of Mergers in India

- **Multinational companies**

The primary reason for mergers in the global pharmaceutical industry is that companies merge with the intention of owning a richer research pipeline post-merger. The global merger leads to a merger of their Indian affiliates also. However, very few companies have shown the commitment to introduce patented products in India on account of lack of product patents in India. As a result, the Indian subsidiaries do not derive the benefits of the synergy arising out of the merger. In some cases, it also leads to a merger of companies which do not have a complementary product portfolio in India. An apt illustration of the above scenario is the proposed merger between Pfizer and Warner Lambert. Both the companies have a substantial overlap especially in the cough and cold segment and since the parents of both the companies have been averse to introducing patented products, the Indian arms are not expected to benefit substantially. Another example of a global merger not fructifying in India is that of Glaxo India and Burroughs Wellcome India mainly on account of disparities in the wage structures of the two companies. Thus, these companies are unable to fully derive the synergies arising out of the merger of their parents.

- **Domestic companies**

The mergers by Indian companies are driven by considerations such as widening of therapeutic coverage, strengthening of sales and distribution network and achieving economies of scale, which are critical factors affecting the performance of pharmaceutical companies in India and hence are likely to be more successful under prevailing Indian conditions.

_Thus, the merger of global players will alter the rankings in the Indian industry but is not likely to affect the growth of the domestic companies in the pre 2005 period. The key success factors in the pre 2005 period are wide therapeutic coverage, strong marketing network and strong brands and hence domestic companies possessing the above strengths will continue to record robust growth in future. The consolidation taking place amongst the Indian companies is also synergy driven, which will further contribute to the growth in the domestic market. Moreover, Indian companies are also expected to grow through increase in generic exports whereas MNCs are restricted on this front on account of the presence of their parent in various countries. Hence, the global mergers are not expected to have a substantial impact on the growth of their domestic subsidiaries in the medium term._

_However, in the post 2005 period after the introduction of product patents, a strong research pipeline is expected to be a key success factor in the domestic market. MNCs are expected to receive support from their parent in this period in terms of introduction of patented molecules on account of the presence of product patents. The introduction of superior molecules is expected to result in an improvement in the domestic market share of these companies. Thus, the MNCs in India will be able to derive the benefit of the synergy arising out of the merger between their parents, only after 2005._