

MERGERS AND ACQUISITIONS AS STRATEGIES OF BUSINESS EXPANSION IN THE PHARMACEUTICAL INDUSTRY

Maria Condrat¹, Anamaria Boboia¹

¹-,Iuliu Hatieganu” University of Medicine and Pharmacy, Faculty of Pharmacy, Cluj-Napoca, Romania

Summary

Introduction: The present paper deals with the issue of the increasing usage of corporation mergers and acquisitions strategies within pharmaceutical industry environment. The aim is to identify the triggers of such business phenomenon and the immediate impact on the financial outcome of two powerful biopharmaceutical corporations: Pfizer and GlaxoSmithKline, which have been sampled due to their successful approach of the tactics in question.

Materials and Methods: In order to create an overview of the development steps through mergers and acquisitions, the historical data of the two corporations has been consulted, from their official websites. The most relevant events were then associated with adequate information from the financial reports and statements of the two corporations indulged by web-based financial data providers.

Results and Discussions: In the past few decades Pfizer and GlaxoSmithKline have purchased or merged with various companies in order to monopolize new markets, diversify products and services portfolios, survive and surpass competitors. The consequences proved to be positive although this approach implies certain capital availability.

Conclusions: Results reveal the fact that, as far as the two sampled companies are concerned, acquisitions and mergers are reactions at the pressure of the highly competitive environment. Moreover, the continuous diversification of the market’s needs is also a consistent motive. However, the prevalence and the eminence of mergers and acquisition strategies are conditioned by the tender offer, the announcer’s caliber, research and development status and further other factors determined by the internal and external actors of the market.

Keywords: market supremacy, offer diversification, capital investment, revenues, net income

1. Introduction

The Pharmaceutical Industry is nowadays one of the most expansive and profitable industries in the world, with a highly important impact as it targets the quality of life. This type of healthcare industry started as a local drugstore in the 18th century when, the manufacturing and selling of drugs to cure diseases has shown, for the first time, its profit potential. As a result, it has grown, over the last centuries, into large pharmaceutical companies, especially when new and essential drugs have started to be discovered, such as insulin or penicillin whose accessibility to the mass population was vital. Moreover, it is an environment which nowadays is continuously undergoing dramatic changes. Everyday a new competitor arises, a new product or concept is being launched, a new marketing strategy is being developed. In addition, it is by law of nature for the strongest to survive, especially when there are so many constrains that ought to be taken into consideration such as the internal actors of the market structure (demand, supply, retailers, prescribers or opinion leaders) and the external environment (regulations, technology, economy, socio-cultural aspects). The marketing concept that holds the key to achieving organizational goals consists of the company being more effective than competitors in creating, delivering, and communicating superior customer value to its chosen target markets [1]. Furthermore, gaining competitive advantage implies internal development (organic growth), external development (external growth through mergers, acquisitions of titles, companies etc.) and contractual development [2]. In the pharmaceutical environment, mergers and acquisitions have proved to be very popular as they have been used both for creating strong companies and for conquering new markets, as far as healthcare services and geographical expansions are concerned. A couple of solid examples would be the rise and development of Pfizer and GlaxoSmithKline (GSK), two of the most powerful multinational pharmaceutical companies in the world. Multinational corporations, as organizations with diversified activities, localized in multiple geographical aerals, wouldn't be able to practice their strategies without having an adequate structure to the ultimate goal on an international level [3]. External development is an adequate measure in a competitive environment which imposes achieving certain dimensions or owning a minimum market share in order to remain present in an evolving and fluctuating market sector. It is also a comfortable way to engage in a diversification strategy [2]. ACQUISITION is a technique through which an enterprise acquires a sufficient number of shares in order to gain control of the emitting company. After the takeover proceedings, the companies are juridical independent however, the company in control together with the controlled one form a group. As concrete ways of acquisition materialization the following can be mentioned: *tender offer* (public offer of purchase – that can be diplomatic or hostile); *exchange public offer* (exchange of the owned titles by the targeted company with the titles of the company that launches the proposal); *negotiation of a control centre* (acquisition of a title package that assures control power); *creeping tender* (acquisition of a large number of shares from the secondary market and usually precedes the launch of a tender offer); *proxy fight* (gaining control over an enterprise by obtaining the majority of the titles in the Administration Council, not by holding the majority of shares). The share selling and buying actually implies the commercialization of an enterprise, partially or totally. As a result, acquisitions can be made through its titles – concentration of a sufficient volume of titles

is the most important mean of controlling a ranked company. The possibility of share acquisition creates amplification of the industrial structure mobility, redistribution of capitals between different economic activity sectors. MERGER is another technique that implies transfer of ownership and control of a company (usually when two firms have resources and abilities that brought together create a stronger competitive advantage). The most frequent used in the pharmaceutical sector are the fusions made through *absorption* (the controlled company is being dissolved) or through *consolidation* (both companies disappear and a new one is being founded) [2]. As far as the unit structure is concerned there can be distinguished: *horizontal mergers* (realized by competitive entities with the same product), *vertical mergers* (between commercial partners like client – provider), *concentric mergers* (between entities who do not have commercial relationships and do not sell the same product, but are complementary) and *conglomerate mergers* (between entities form different areas of activity, their ultimate goal being the diversification of activities with minimum risks) [2]. Considering all the above, the purpose of this article is to study the amplitude of merger and acquisition strategies, to particularly identify the motifs of their usage, what do these market phenomenon imply and which are the immediate consequences upon the biopharmaceutical business of two of the most profitable multinational enterprises in the Pharmaceutical Industry: Pfizer and GlaxoSmithKline.

2. Material and Methods

Two well established pharmaceutical and biotechnology corporations: Pfizer and GlaxoSmithKline have been sampled in order to have a wider perspective of the amplitude of mergers and acquisitions strategies from two marketing management style angles. Their strategic steps were approached after consulting the historical data [4,5] of the two corporations provided by their official websites. Moreover, in order to assess the impact of this strategic approach, financial data regarding Pfizer[6] and GSK[7] have been collected from the corporate websites, “Institution of Mergers, Acquisitions and Alliances”[8], “BioSpace”[9], “Pharmexec”[10]. The last, being web-based providers of financial data regarding companies from around the world.

3. Results and Discussions

According to the “Institute of Mergers, Acquisitions and Alliances” (IMAA), this type of business development has confronted with a presumptuous evolution worldwide in the past two decades reaching transactions of billions of dollars. In 2007 both the value and the frequency of mergers and acquisitions have reached the highest pick: 50.000 transactions of over 5.000 billion USD. Although, since 2007 the value of the transactions has decreased (an explainable consequence of the economical crisis occurrence) the number of such events has kept a high profile as illustrated in Fig.1.

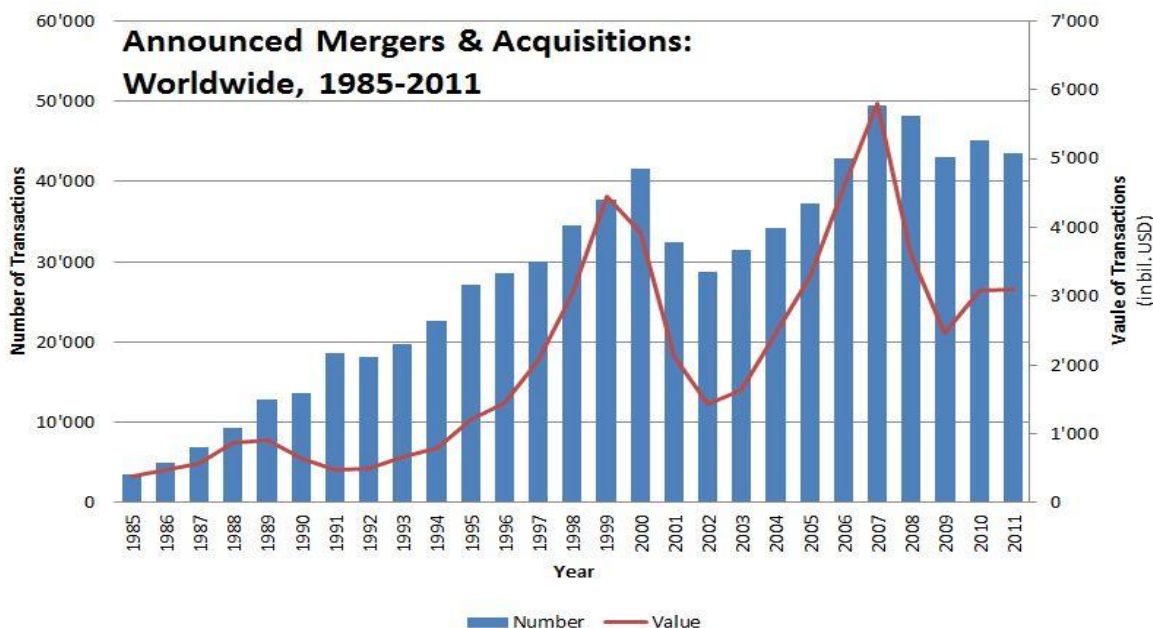


Fig.1 Announced Mergers & Acquisitions Worldwide [8]

Even though the energetic and communication sectors are the most active from this point of view, Pfizer and GSK, as representatives of the Healthcare Industry, have succeeded in being responsible of two of the top 10 deals both at an European level(GSK placed 4th) and worldwide, making transactions of over 70 billion dollars (Table I).

Table I. Worldwide Transactions based on IMAA data [8]

Rank	Year	Acquiror	Target	Transaction(bil.USD)
1	1999	Vodafone AirTouch PLC	Mannesmann AG	202.8
2	2000	America Online Inc	Time Warner	164.7
3	2007	Shareholders	Philip Morris Intl Inc	98.2107.6
4	2007	RFS Holdings BV	ABN-AMRO Holding NV	98.2
5	1999	Pfizer Inc	Warner-Lambert Co	89.2
6	1998	Exxon Corp	Mobil Corp	78.9
7	2000	Glaxo Wellcome PLC	SmithKline Beecham PLC	76.0
8	2004	Royal Dutch Petroleum Co	Shell Transport & Trading Co	74.6
9	2006	AT&T Inc	BellSouth Corp	72.7
10	1998	Travelers Group Inc	Citicorp	72.6

As illustrated in Fig.2, Pfizer’s Warner-Lambert acquisition (two of the top pharmaceutical companies) in 1999 has certainly left an imprint on the Biotechnology and Pharmaceutical market and secured a top spot for Pfizer.

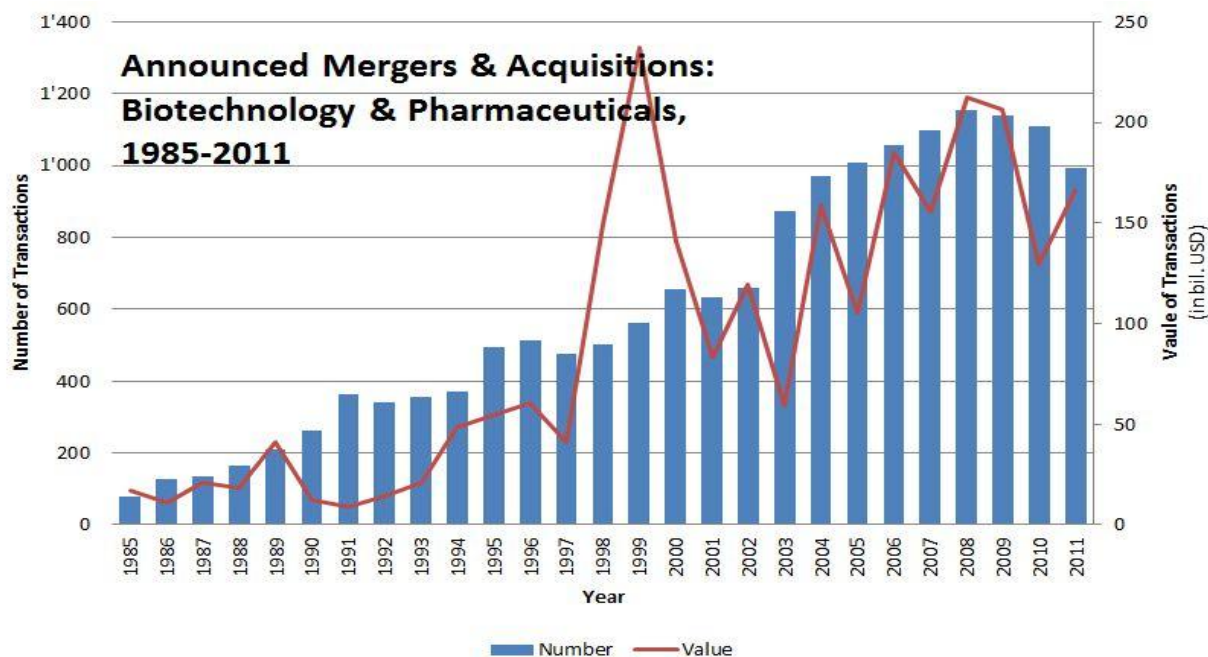


Fig.2 Announced Mergers & Acquisitions in Biotechnology & Pharmaceutical sector [8]

However, this was not the first merger-acquisition phenomenon in Pfizer's history. Since 1862 Pfizer, founded by cousins Charles Pfizer and Charles Erhart in 1849, has experienced an accelerated organic development encouraged by the external market actors who provided favorable circumstances. With the occurrence of the Civil War, a consistent governmental demand for painkillers, preservatives, and disinfectants was advanced. Thus, the company was stimulated to expand their drug offer and also to tap into mass production with the commercialization of iodine, morphine, chloroform, camphor, but also with mercurials (used in the emerging field of photography) tartaric acid and cream of tartar (products vital to the food and chemical industries), citric acid (also used by Coca-Cola™, Dr. Pepper™, and Pepsi-Cola™). We can observe the fact that even from the beginning Pfizer's politics targeted, not only the healthcare environment but, also other emerging industries that could benefit from their products, thus inferring future absorption mergers. As a result, the incomes doubled and assured a successful development in the following decades as the company highly invested not only in the discovery and mass production of new drugs but also in the development of production technologies. Penicillin (the "miracle drug") and oxytetracycline (first real defense against bacterial infection) proved to be a turning point in human history and in the history of Pfizer due to the fact that they actually assured international expansion. In addition, Pfizer created the International Divisions by sending specially trained pharmaceutical salesmen to promote Pfizer's first proprietary pharmaceutical products. Between 1952 and 1953 Pfizer tries to reach other branches of the industry by opening animal health division. This was actually the first initiative of business expansion through a diplomatic tender offer acquisition that assured the activity diversification by purchasing SmithKline Beecham's animal health business. The acquisition of \$1.45 billion in cash followed the tender offer made as a response to SmithKline Beecham's public selling offer (whose goal was to reduce the company's debts).

This strategy made Pfizer a world leader in the development and production of pharmaceuticals for livestock and companion animals [4]. Even though this tactic seems to target different objective, the ultimate goal was still the assurance of human wellbeing. Animal healthcare improvement actually assured the quality and safety of meat based food products. Moreover, animal drug studies helped new drug developments or new pharmacological effects discovery. Another opportunistic approach was targeting the enhancing of pet's life quality. Pet care became an emerging and promising business closely related to the pharmaceutical industry as veterinaries started to use Prozac for depressed dogs. This initiative triggered the investments in Companion Animals Healthcare division. As a result, by adopting an indirect approach of the same market target they succeed in gaining new clients, maintaining old ones and even creating new markets. The affiliation of Warner-Lambert, announced in 1999 and completed by June 2000, was a hostile acquisition whose tender offer was triggered by Warner-Lambert's merger intentions with another biopharmaceutical company, that threatened Lipitor(cholesterol-lowering statin)co-marketing agreements. Pfizer realized a veritable transfer of power and control with an organic restructuring and patrimonial mutation that concretized in surpassing the imperatives of the economical growth. With Warner-Lambert, Pfizer gained full Lipitor ownership and diversified its product lines from Parke-Davis branded pharmaceuticals to Listerine mouthwash to Schick and Wilkinson Sword wet-shave products [4]. Thus, not only did Pfizer enlarged product portfolio but also extended market areal by absorbing Werner-Lambert's personalized market. Another advantage was the actual reduction of the company's costs with approximately \$6 billion (as stated in the 2005 financial annual report). Even though Pfizer invested a large capital for the acquisition, the results did not fail to make the difference as in the next 6 years Pfizer's income tripled, reaching total revenue of \$51.3 billion in 2005. However, the net income of \$8.1 billion was in fact 2% lower in comparison with the \$11.4 billion, in 2004. The 2% decrease was the main consequence of the company continuous expansion based on the same acquisition-merger strategy. In 2005, \$1.9 billion in cash were allocated for the acquisition of Vicuron Pharmaceuticals (a biopharmaceutical company specialized in discovery, development, manufacturing of new-generation drugs, especially anti-infectious ones) and \$298 billion in cash for Idun Pharmaceuticals (a biopharmaceutical company focused on the discovery and development of therapies to control apoptosis). These were the results of a long term research collaboration agreement between Pfizer and the two companies. As far as Vicuron is concerned, Pfizer began by purchasing some of their products like Anidulafungine and Dalbavancin. The next step was the acquisition through negotiation of a control center - by purchasing the majority of shares of Vicuron's common stock with \$29.10 per share in cash adding up to approximately \$1.9 billion. As stated in the 2006 financial report, this transaction builds on Pfizer's extensive experience in anti-infectives and demonstrated commitment to strengthen and broaden its pharmaceutical business through strategic product acquisitions [6]. The penetration of the anti-infective market was a strategic move due to the fact that nowadays infectious diseases are extremely wide-spread and antibiotic resistance has become a concerning aspect that requires taking into consideration new drug designs and also proper patient counseling. 2006 is characterized by lower acquisition related expenses - \$835 million for Powder Med Ltd., (specialized development and

manufacture of DNA-based vaccines for viral diseases and cancer) and Rinat Neuroscience Corp. (specialized in protein-based drugs for nervous system therapies). To the latter, a tender offer was made. In response, Rinat declared to be pleased that Pfizer, the largest pharmaceutical company and a leader in neuroscience, has recognized the potential of their programs to treat significant unmet medical needs [9]. The diplomatic takeover targeted enlargement of drug portfolio and insertion into new therapeutical markets with yet unexploited profit potential. More acquisition investments have been made in the next period: \$283 million for the affiliation of company specialized in anti-diabetics and new protein drugs (BioRexis) and a concentric merger with an animal health company (Embex). Furthermore, in 2008 Pfizer and Wyeth start the merger agreements that will result in a \$68 billion absorption-consolidation merger transaction in 2009, the second most important investment after the \$89.2 billion acquisition of Warner-Lambert in 2000. Regardless the fact that 2008 was an economically concerning moment for Pfizer due to multiple drug patent expiration including Lipitor (which assured a consistent 25% of the firm's incomes, according to the financial reports), the company took the risk of expanding. Under the given circumstances, even though it was expected for Novartis, Sanofi, and GSK to all overtake the company by 2013, based on this deal, and if the other companies do not partake in Merger and Acquisition activities, Pfizer is to stay in the top spot in 2013 [10]. In addition, we can safely assume that for the first time the merger-acquisition strategy was not done with the direct purpose of organic development but with the intention of surviving and gaining advantage over competitors in the increasingly aggressive pharmaceutical environment. What makes a merger like this so attractive is the ability to maintain revenue levels and cut costs by eliminating redundancies [10]. According to the 2009 financial report the Wyeth merger was initiated through the acquisition method of accounting. As a result, a full inventory of the two companies was done before merging in order to register the real value of the assets and liabilities to be acquired. The consequence was an increase in the net income from \$8.104 million in 2008 to \$10.009 million in 2011, as shown in table IV (based on 2011 annual financial report data) which also gives an overview of the total revenue and the acquisition investments from the past 5 years.

Table IV. Financial evolution (in millions of USD) for the past 5 years [6]

	2011	2010	2009	2008	2007
Revenues	67,425	67,057	49,269	47,529	47,733
Acquisition-related charges	-	125	68	633	283
Net income	10.009	8.257	8.635	8.104	8.144

In the past 4 years Pfizer continued to expand its product portfolio with new vaccines, dietary supplements and lifestyle products, vitamins, generic drugs etc., by merging an acquiring biopharmaceutical companies specialized in drug research and manufacture. Pfizer also interceded to enhance the pharmaceutical industrial technology division by negotiating the control center of companies specialized in the desired technologies. In 2009 an interesting collaboration was initiated as both Pfizer and GSK merged their vaccine sector of their research division. As a result, ViiV Healthcare Limited, a new corporation was founded by means of cohesion-creation merger, with the exclusive and ultimate goal of research,

development and commercialization of human immunodeficiency virus (HIV) medicines. We are practically witnessing the fusion of two magnates of the pharmaceutical research industry whose financial results will certainly intimidate the competitors. When it comes to GSK, its present market position is also the result of long series of acquisitions and mergers, however at a lower rate than Pfizer's. The first merger was a cohesion-creation fusion through which SmithKline & Co. and Richards and Company (a French laboratory) sized to exist as independent entities in order to found SmithKline and Laboratories French in 1891. The result was mainly diversification of product portfolio which was enriched with cosmetics (perfumes, liniments, tonics, hair oils, etc.) and an important palette of home remedies. In the time being an important breach in the industry caught the attention of one of the founders, Mahlon Kline who saw a problem in filling orders and time delivering. Thus, SmithKline and Laboratories French was the first company to establish a policy through which they took the engagement of delivering all morning orders by late afternoon. It was an approach that will mark one of their future business strategies of development – Retail and Distribution. However, the next century meant a research commitment for the company. As a consequence, most of the acquisitions were made with the intention of research development. The most important and innovative products, for that time, developed by their research division were: dried milk powder (which triggered the initiative of a baby product line development), poison ivy lotion, iron tablets and lozenges (products that formed “Blue Line”), laxatives, cold remedy powders (produced by Beecham), glycosides for heart failure treatment, a series of anti-bacterials, vaccines, etc. In order to improve their vaccine research division, Smith Kline and Laboratories French acquired, in 1963, Recherche et Industrie Thérapeutiques from Belgium. In the next decade the company experienced a global expansion with the acquisition of some laboratories across Canada and USA, a skin care product specialized company. In 1988 the company grows with 50% by acquiring one of its largest competitors, International Clinical Laboratories, for \$400 million. The strategic purchase assured their market leadership. By 1989, the cohesion-creation merger with Beecham Inc. was finalized with the creation SmithKline Beecham (after a long collaboration based on product diversification: anti-infectives, vaccines, laxatives, cold powder etc.) with a stock value of £107.3 billion. The ultimate goal was to gain competitive advantage by bringing together their resources and liabilities and also to cut costs (£1.1 billion announced). Afterwards they continued investing in the purchase of new research laboratories but, they also began to acquire shares from Europharm, Romania, a company with a well established retail-distribution system on the regional market and also specialized in mass production of generics and OTCs. The acquisition started with the creeping tender (by 1998 they owned 43% of the firm) which was followed by the tender offer, thus full ownership was gained by 2003. As a result, SmithKline Beecham's ultimate goal was not only to expand its product offer but also to conquer a new market with maximum avoidance of supplementary taxes, through ownership of local retail and distribution network, thus becoming the top leader of the Romanian pharmaceutical market. Meanwhile, in 2000 SmithKline Beecham and Glaxo Wellcome sized their legal function and a patrimonial mutation of the two entities delivered GlaxoSmithKline (GSK). This was another cohesion-creation merger of \$76.0 billion that

brought the new founded company: market expansion, enrichment of product offer, development of retail and distribution sector, lower chargers etc.

4. Conclusions

Both Pfizer and GSK have used merger-acquisition strategies mainly to expand their research and development department by targeting already developed companies with profitable products and services portfolios. Research and development evolution is incontestably the key for market supremacy and higher revenues as shown by the two companies' market domination which is the actual result of their strategic mergers and purchases alongside with their intensive research projects. As far as regional development is concerned, by comparison with Pfizer who always aimed at the top competitors on the market, GSK has focused mostly on smaller companies but more diversified as far as healthcare products and services are concerned. Furthermore, when entering in small regional pharmaceutical environments like the Baltic markets, GSK has concentrated its focus on small and solid multifunctional companies (owning generic lines of drugs, distribution facilities and retail) with potential of becoming top leaders in the targeted countries. Nevertheless, this type of business development approach has proved its efficiency by allowing biopharmaceutical players to raise the standards of their research and distribution divisions, to tap into emerging markets, to diversify product offers and healthcare services, to update their biotechnologies, to approach new therapeutical markets, to surpass intimidating competitors and survive in the aggressive, fluctuating and constrained environment of the pharmaceutical industry. All the enumerated benefits are finally reflected in costs, taxes and debts reductions which assure profits of millions of dollars. Thus can be explained the high frequency of merge-acquisition transactions as far as biotechnologies and pharmaceuticals are concerned.

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