

GlaxoSmithKline and what the world expects from a big pharmaceutical company

Case taken from The International Business Environment, second edition (Palgrave, 2006), by Janet Morrison

GlaxoSmithKline (GSK), the world's second largest pharmaceutical company, was formed in 2000, combining Glaxo Wellcome, which had research expertise in chemistry, with SmithKline Beecham, which specialized in biology and genomics (research on the human genome). Hopes were high that the complementary strengths of the two companies would lead to reductions in costs and improved performance in global markets. The prevailing view in the pharmaceutical industry favoured consolidation to achieve economies of scale. In common with all drug companies, GSK needs to maintain a steady flow of new drugs to take the place of those which become superseded by newer ones or to replace those whose patents expire. The long lead time for drugs requires a resource commitment over several years, to see the drug through lengthy trial phases, before it is finally released. A drug company seeks to have numerous drugs in the pipeline, to compensate for those that fall by the wayside. For example, the patent application could founder or the trials could reveal harmful side effects. Importantly, every drug must be navigated through the regulatory authorities in each market, before it can be prescribed or sold over the counter. It is little wonder that big is thought to be better in the pharmaceutical industry. The research figures of GSK were impressive: it had a \$4bn.-a-year budget and employed 15,000 scientists. Still, it had to find the winning drugs and get them successfully to market.

Decentralized research units: the recipe for innovation?

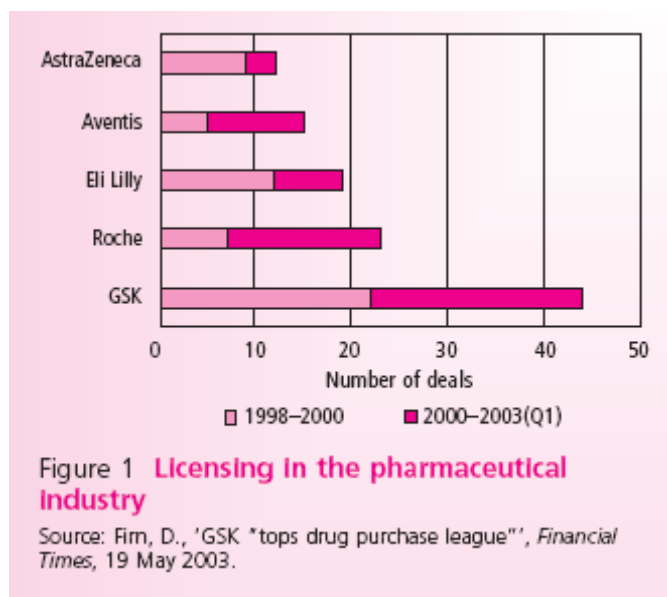
At the time of the merger, there was the risk that research would be smothered by bureaucracy. GSK decided to devolve research into six separate units, each with its own budget, called 'centres of excellence for drug discovery'. Each focuses on a particular area of research, such as cancer treatment. These drug discovery units were intended to foster the entrepreneurship and creativity that is found in smaller biotech companies. However, realizing this ideal in practice turned out to be difficult. The creation of the units came on the heels of the upheaval caused by the merger, creating uncertainty among the scientists, some of whom left. Older researchers had endured a long period of uncertainty, dating back to the SmithKline Beecham merger in 1989 and the Glaxo Wellcome merger in 1995. The remaining scientists have found that bureaucracy was reduced in the new research units, making it easier to get new drugs into the trial phase. To provide incentives, 20 per cent of scientists' remuneration in the new centres is performance-linked.

What was in the pipeline in the aftermath of the merger? The research cupboard looked rather bare. Glaxo and SmithKline had each suffered setbacks in the run-up to the merger, as three potential money-spinners had had to be pulled in the late stages of tests. Its top-selling drug, the anti-depressant, Paxil, is reaching the end of its patent life, and the threat of generic producers is looming. Augmentin, an antibiotic, generated \$1.4bn. for GSK in 2001, but in 2002, an American court ruled that three of its patents were invalid. As a consequence, cheaper generic copies gained sales and Augmentin's sales fell 42 per cent in the following year. By 2004, 70 per cent of GSK's turnover came from products whose sales were declining. Looking to the future, the company's investment in genomics is expected to bring long-term benefits which will yield advantages over its competitors. Biotechnology has become the basis of most new drugs and vaccines.

Buying in winners: a winning strategy?

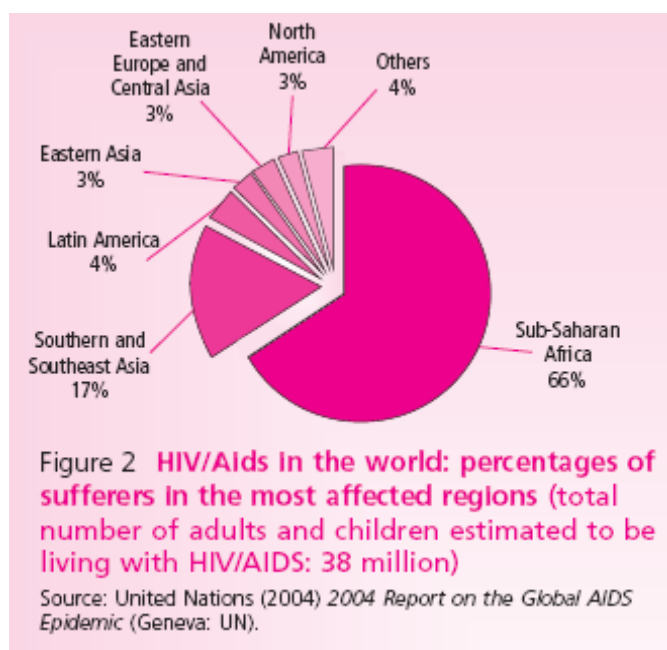
When there seem to be too few 'blockbuster' drugs in the pipeline, the large drug companies look to buy in drugs from the smaller biotech companies. Researchers in these smaller companies create drugs which often stall in the experimental stages, as their companies lack the resources to take the development through to the later phases and clinical trials. They also lack the marketing expertise to promote the drug globally. The large company steps in, agreeing to produce the drug under licence, for which it may have to pay. Known as 'in-licensing', these deals can be risky, as the drug may turn out not to be the money-spinner that had been hoped. Marketing these licensed drugs created by others now contributes about 24 per cent of total revenues of the major pharmaceutical companies. GSK has become the leader in in-licensing agreements. Between 2001 and 2003, GSK bought rights to almost twice as many drugs as its rivals (see Figure 1). It is perhaps a sign

of the trend that Bayer, the German group which created aspirin, has turned to GSK to market one of its drugs.



While licensing deals are beneficial to the small biotech companies, they raise questions over the innovative capacity of the large companies' in-house researchers. GSK has developed the marketing side of the business, aided by its 17,000 salesmen across the world, but doubts remain about its R&D productivity. Investors fear that there are too few drugs of its own in the pipeline, despite the assurances of the Chief Executive Jean-Pierre Garnier that licensing is merely a short-term strategy until its own drugs come to market. The use of licensing may be a sign of changes in the structure of the pharmaceutical industry, with smaller, specialized companies discovering drugs and the large companies marketing them. Yamada, the GSK research director, seemed further to cast doubt on GSK's research when he said: 'I am not sure that we are any better than a biotech company, a small pharmaceuticals company or a university department' (Durman, 17 March 2002).
Dilemmas in global markets

GSK is the world's largest producer of HIV/Aids drugs. The company has found itself at loggerheads with the governments of developing countries, where the disease has been most widespread and where sufferers are least able to afford the drugs. Of the world's 38 million people living with HIV/Aids, 25 million (66 per cent) live in sub-Saharan Africa, where only 12 per cent receive treatment (see Figure 2) (UNAIDS, 2004). Generic drug makers have been producing HIV drugs in breach of patents held by GSK, Merck, Pfizer and other drug companies, which launched legal action against the South African government. The negative image of these companies which this action created eventually persuaded them to drop the cases. GSK, having led the action, then licensed three HIV medicines to a South African generics company free of charge in 2002. The inability of poor people in developing countries to afford life-saving drugs led to pressures from GSK's institutional investors to reduce prices. In response, it halved the prices of its biggest Aids drug, bringing it more into line with prices charged by Ranbaxy, the Indian generics company (which manufactures without patent infringement under the much laxer Indian law). The new prices, which it said allowed for no profit, applied to 63 developing countries, including sub-Saharan Africa. However, even the reduced prices were more than their generic rivals.



Forging links with its erstwhile enemy, GSK announced in 2003 a link-up for drug research with Ranbaxy. Ranbaxy's scientists would be able to do early-stage research into new drugs, helping it to diversify away from generics. The alliance resembled an outsourcing arrangement, in that Indian scientists in Indian laboratories are paid much less than those in Western economies. The company denies the outsourcing allegation, saying that: 'the idea is to combine their skill sets, which include excellent chemistry, with our technology infrastructure' (Dyer, 23 October 2003). There are risks, however, lurking in the weak intellectual property protection that is afforded in India. GSK is actually suing Ranbaxy in the US for its manufacture of a generic version of Augmentin.

Corporate social responsibility rises up the agenda

The price of Aids drugs in poor developing countries highlights the problems faced by the pharmaceutical industry generally. Suffering negative publicity over their pricing, companies reduced prices for poor countries. However, the generic producers, who have borne none of the development costs, are still undercutting them in these countries. The WTO's Doha Round of negotiations reached an agreement which would allow 'compulsory licensing' of life-saving drugs where public health is at risk. On the face of it, this agreement was a blow to the pharmaceutical industry, as it would allow governments to override patents in the interest of public health. In practice, however, patent protection had already become eroded by generic copies.

Further price-cutting pressures are coming from governments generally, as they increasingly question the prices of medicines that public health systems are being asked to pay. Health authorities, because of their huge buying power, are in a position to exert pressures on the pharmaceutical companies to cut prices. It is notable that healthcare expenses are much higher in the US than in other countries, as Figure 3 shows. Canada, having successfully managed to negotiate lower prices for its citizens, is finding that US citizens are increasingly 'reimporting' cheaper Canadian drugs in preference to those with higher US price tags. Canada's internet pharmacies are particularly benefiting from increased sales. Future drug innovations, companies argue, depend on maintaining revenues, the bulk of which have been provided by US consumers. But rebellion against high prices has now become widespread, bringing the pharmaceutical companies into conflict with consumers and governments worldwide.



Investors, too, have been raising their voices. In 2002, at a time when shareholders were having doubts about the long-term health of the large pharmaceutical companies, GSK announced plans to double the remuneration of its CEO. This proposed leap in remuneration was contained in a complex package estimated at \$18m., including bonuses, share options, pension provisions and other benefits. Besides concern over the proposed increase itself, there were concerns that the remuneration package was so complex as to make it difficult to discern the total remuneration and that links to performance were unclear. The plan was rejected by shareholders. The rejection was considered a landmark in UK shareholder activism by UK institutional investors. The CEO, nonetheless, received a 26 per cent increase in remuneration in 2003, making him one of the UK's highest paid executives. The executive remuneration issue highlighted a further dimension of corporate responsibility, again focusing on the values underlying GSK.

Sources: Durman, P., 'Week of stress leaves Glaxo looking sick', Sunday Times, 17 March 2002; Dyer, G., 'GSK in Indian drugs link-up', Financial Times, 23 October 2003; Dyer, G., 'Sagging morale, departing scientists, a dwindling pipeline: when will GSK's research overhaul produce results', Financial Times, 24 October 2002; Jenkins, P., 'GSK drops Garnier pay plan', Financial Times, 27 November 2002; Dyer, G., 'GSK cuts price of top Aids treatment', Financial Times, 28 April 2003; Michaels, A., 'Symptoms grow worse for world's drug companies', Financial Times, 15 January 2002; Firn, D., 'GSK "tops drug purchase league"', Financial Times, 19 May 2003; Dyer, G., 'As the pandemic spreads, developed nations must respond to a new challenge from the White House', Financial Times, 2 June 2003; 'Health-care', *The World in 2004* (London: The Economist); Jack, A. 'Glaxo's catalyst for creativity', Financial Times, 18 March 2005; Urry, M., 'New leader rings change at GSK', Financial Times, 30 March 2005.

Case questions

What were the benefits of the merger of SmithKline Beecham and Glaxo Wellcome to form GSK?

What are the specific difficulties that arise for R&D in the pharmaceutical industry? Assess the success of GSK's decentralization of R&D.

How has licensing of other companies' drugs represented a change of strategy for GSK?

What issues of corporate social responsibility are highlighted in the case study? How successfully has GSK handled them?

@ GlaxoSmithKline's corporate website is at www.gsk.com