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Pfizer and the Challenges of the Pharmaceutical Industry (b)

Renate Kratochvil and Phillip C. Nell wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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In general, by 2018, pharmaceutical companies had displayed a diverse set of responses to overcoming market challenges. Over the past few decades, for example, there had been a tendency for firms to consolidate, accomplished predominantly through large mergers and acquisitions (M&As).[[1]](#endnote-1) These strategic moves resulted in a reduction from 60 large pharmaceutical companies down to 10. In 2016, these top-10 pharmaceutical firms had a global market share of around 35 per cent.[[2]](#endnote-2) Pfizer Inc. (Pfizer), for example, acquired Warner-Lambert for $111.8 billion in 2000 and Wyeth LLC (Wyeth) for US$68.0 billion[[3]](#endnote-3) in 2009 (see Case A, Exhibit 2).

Patents were a major issue for pharmaceutical companies, and finding strategies for overcoming them was crucial to ongoing success in the marketplace. Thus “patent cliffs,”[[4]](#endnote-4) along with cost savings, were major motivations for undertaking large M&As.[[5]](#endnote-5) M&As had also come to be used as a tactical move to help pharmaceutical companies grow in size and power and add value to their research pipelines, and as such they were increasing in number industry-wide.[[6]](#endnote-6) Pharmaceutical companies had tended to favour risk-averse M&As: of the ten biggest M&As in 2016 (see Exhibit 1), seven involved companies with established products and another two, companies with products at the end of the approval process.[[7]](#endnote-7)

As the trend for engaging in M&As evolved within the pharmaceutical industry, companies seeking mergers shifted their focus onto smaller companies (e.g., young biotechnology firms and established niche product providers) and onto those divisions of established pharmaceutical companies that had the potential to strengthen their own core activities. This was because less diversified companies with a narrow focus had been shown to produce higher returns (around 12 per cent) and to exhibit greater efficiency.[[8]](#endnote-8) A process had thus begun, with companies buying and selling divisions according to whether they fit with their main business portfolios. Pfizer, for example, strengthened its vaccine segment by acquiring the vaccine division of Baxter for $635 million[[9]](#endnote-9) and selling its animal and infant nutrition business. Pfizer also divested from its Alzheimer’s and Parkinson’s research in 2018,[[10]](#endnote-10) despite the fact that the Food and Drug Administration (FDA) cited this as an important research area and was encouraging research by relaxing drug approval regulations for drugs aimed at these diseases.[[11]](#endnote-11)

In contrast, other big players in the market, such as Hoffmann-La Roche Ltd. (Roche) went through relatively few, small consolidations or else followed an organic growth approach.[[12]](#endnote-12) Other innovative companies, such as Sanofi SA (Sanofi) and Novartis International AG (Novartis), developed and/or absorbed large generics businesses, over-the-counter (OTC) products and diagnostics and non-medical consumer goods (e.g., Johnson & Johnson).

Another area of strategic activity was the attempt to decentralize research and development (R&D) units. Most large pharmaceutical firms had until recently had relatively centralized R&D, a position which hardly changed for a number of years. However, the increasing importance of new sciences like biotechnology and genetics, driven by companies like Pharmaco, Genomics, and Proteomics, led to a growing trend in “personalized drugs.” These were described as “a form of medicine that uses information about a person’s genes, proteins, and environment to prevent, diagnose, and treat disease.”[[13]](#endnote-13) Due to the individual adjustment of such drugs to patients and some relatively minor privacy concerns on the part of patients, the value added by such medicines was of interest to a variety of stakeholders (especially insurers and national health systems), and this justified the higher drug prices involved. Nevertheless, personalized drugs promised rather marginal rates of return, since R&D costs were spread across a smaller pool of patients.[[14]](#endnote-14)

The “one-drug-fits-all” approach, which previously characterized the “blockbusters” (drugs with more than $1 billion in yearly revenues), was becoming outmoded.[[15]](#endnote-15) Blockbuster drugs usually targeted diseases that affected a large population. Drugs for specific patient groups had become more numerous, supported by further developments in the research process such as iterative test procedures that used imaging methods. These new procedures had little to do with traditional R&D (see Case A). More and more often, universities and smaller biotechnology firms had been ranking higher than the large pharmaceutical firms in terms of number of innovations. This led to changes in how R&D was conducted. GlaxoSmithKline Plc (GSK), for example, initiated a decentralization process and designed an open innovation strategy in order to have more flexibility at the research front.

For drugs with a relatively small patient population, the profit might be increased by targeting the disease pathways and biological mechanisms of other disorders within the same therapeutic area. Novartis successfully demonstrated this approach with Afinitor, a cancer drug initially developed to treat kidney cancers, which was subsequently broadened to treat lung and breast cancers. The combined sales turned Afinitor into a blockbuster.

Growth leveraging also occurred through the exploitation of developing markets, which in 2015 accounted for 22 per cent of global pharmaceutical sales.[[16]](#endnote-16) Pfizer, as a way of sharpening its focus, added emerging market sections to all of its units. Developing markets themselves also spotted the opportunities in the pharmaceutical market. The Chinese government, for example, encouraged the industry to invest in pharmaceutical R&D and to consolidate; the Chinese pharmaceutical market in 2017 was fragmented, with thousands of small manufacturers.[[17]](#endnote-17)

Another important means of counteracting the patent expiry problem was to experiment with the product’s life cycle. The goal of this was either to increase the time a branded product was on the market before it was exposed to competition from generics, or to increase the revenue a product would generate under patent protection, or to minimize the loss of revenue to competing generics once the patent expired. For example, after the loss of exclusivity of Lipitor in the United States in 2011, Pfizer embarked on four innovative initiatives:

* First, it entered into “pay-to-delay” deals, in which it paid generics producers to postpone launches. The result was that only one generics producer, Watson Pharmaceuticals, brought an authorized generic version onto the market. It shared around 70 per cent of the product’s profits from the generic version with Pfizer.
* Second, in the last year of patent protection, Pfizer raised the price of the drug in the United States by 17 per cent.
* Third, if patients ordered Lipitor through certain pharmacies, they received a discount and the product was delivered straight from Pfizer to the customer.
* Fourth, the “Lipitor for you” coupon program offered patients out-of-pocket savings of up to $100 a month. Pfizer maintained a market share of 33 per cent in the first four months, three times the amount expired blockbuster drugs usually made.[[18]](#endnote-18) The strategy nevertheless proved unsuccessful in the long term. After six months, the market was opened to competition, and a year after the loss of its exclusivity, Lipitor had a market share of only five per cent.[[19]](#endnote-19)

**Pfizer’S chief executive officers**

In 2010, Ian Read became chief executive officer (CEO) of Pfizer. Jeff Kindler, his predecessor, had implemented several major strategic changes. In January 2007, he announced the redundancy of 10,000 employees—around a tenth of Pfizer’s total workforce. This was very unusual in a hitherto profitable industry. The layoffs included one-fifth of the sales force in the United States and Europe as well as the closure of five research centres and several factories.

The R&D departments had also undergone reorganization. Instead of globally dispersed “Centers of Excellence,” research activities were now structured around therapeutic areas (e.g., oncology, vaccines). Pfizer’s objective was to offset R&D costs that had resulted from the late identification of potentially long-term side effects of drugs such as Torcetrapib. Kindler also encouraged his “traditionally isolated” researchers to take part in more external collaborations. He issued instructions to the effect that Pfizer should increase the transparency of its research initiatives and publish information that would serve to facilitate acquisitions and focused collaborations. In 2010, the company launched the Centers for Therapeutic Innovation (CTI) program, connecting academia with the drug developer. Anthony Colye, the head of the centre, said that CTI was “bridging the know-how for taking a great idea from these [academic] labs and turning it into something that looks and feels like a drug.”[[20]](#endnote-20) This move was intended to enhance the discovery process, improve the quality of early research studies and clinical trials, and reduce costs. Pfizer competitors such as Novartis and Sanofi followed suit and launched their own programs.

Finally, Kindler prompted a paradigm shift in the product portfolio, recognizing that the era of blockbusters was coming to an end: “We need to be as effective at selling a large number of $500 million drugs as we were at selling drugs with multi-billion dollar sales.”[[21]](#endnote-21) Kindler also introduced the “string of pearls” acquisition strategy; its goal was to buy smaller, innovative companies with a focus on biotech. This approach, however, only lasted until Kindler initiated a $68 billion deal with Wyeth, making Pfizer bigger than ever. After the Wyeth acquisition, cost-cutting continued, including in the R&D division, where outgoings totalled a further $9.5 billion by 2010, even given the cost cutting initiatives.[[22]](#endnote-22)

When Read took over as Pfizer CEO in November 2010, his mission was clear. He was expected to lead Pfizer’s R&D division back to success. He made it his goal to enhance the “ability to respond to market dynamics, greater visibility and focus distinctive capabilities optimized to deliver value to patients and shareholders.”[[23]](#endnote-23) In 2012, he stated that “Pfizer has achieved the scale it needs, both in its science and in its global reach.”[[24]](#endnote-24)

A mere two months after he became CEO, Read’s iron hand was already in evidence. He began the restructuring of the company into five core therapeutic areas (see Exhibit 2), and he actively pursued the cost-cutting program of his predecessor: 20 per cent of the staff were laid off. One year after Read took over, Pfizer’s costs were the lowest they had been since 1980. The workforce was reduced by a further 38,500 people, which was double the amount that Kindler had originally planned.[[25]](#endnote-25) Then, in 2012 and 2013, Read decided to sell the health nutrition and animal health businesses in order to be “better positioned to focus on the core business,” and went on to concentrate the company’s efforts into buying smaller biotech companies that fitted with Pfizer’s R&D focus.

In 2017, Read announced his intention to split Pfizer into its constituent businesses, something that mimicked to some extent the activities of other corporations. A strategic move of this kind had been under consideration in 2013[[26]](#endnote-26) but had subsequently been dropped.

It seems that, by 2017 it was higher up on the agenda. According to a company press release,

Pfizer Consumer Healthcare is a leading player in the largest OTC categories, with iconic brands, robust retail partnerships, global reach and strong fundamentals . . . Although there is a strong connection between Consumer Healthcare and elements of our core biopharmaceutical businesses, it is also distinct enough from our core business that there is potential for its value to be more fully realized outside the company. By exploring strategic options, we can evaluate how best to fuel the future success and expansion of Consumer Healthcare while simultaneously unlocking potential value for our shareholders.[[27]](#endnote-27)

However, Pfizer did not (again) finalize the split. From 2010, Pfizer experienced many ups and downs over the course of its various M&As. The planned takeover in 2013–14 of AstraZeneca’s late-stage, small-molecule anti-infective business had failed.[[28]](#endnote-28) Pfizer had in 2016 also planned a merger with Allergan in a deal worth $160 billion—potentially the biggest merger to date in the pharmaceutical industry—the main intention being to move its corporate headquarters and fiscal affairs to the more tax-friendly Republic of Ireland. This merger was frustrated by a recently implemented U.S. administration policy aimed at restricting mega-deals. The underlying purpose of the new policy was to prevent U.S. companies from moving monetary and fiscal responsibilities abroad. The failure of this merger may have been a victory for President Barack Obama (in office at this time), but it was not so for Read.[[29]](#endnote-29)

In 2018, the forecasts for Pfizer’s future could have been rosier. Such forecasts would evaluate pharmaceutical companies’ research pipelines and the prospective value creation from recently launched innovative products. As a result, Pfizer was now viewed as having fallen behind its major competitors Gilead, Novartis, Roche, and Johnson & Johnson.[[30]](#endnote-30)

**How to turn it around?**

By July 2018, Read felt that there was some cause for optimism when Pfizer’s stock price reached a new peak of $39.90. But Pfizer was not the only company with a rising share price. Roche and Novartis had also hit new price peaks (see Exhibit 3).

Considering the difficulties Pfizer had faced during the preceding years and the various industry challenges that lay ahead, was Read’s current optimism justified and would he be able to maintain the firm’s strong position? Were Pfizer’s recent strategic moves a sufficient response to the developments in the industry? And what was next for Pfizer?

Exhibit 1: The biggest Pharma and Biotech M&A Deals of 2016

|  |  |  |
| --- | --- | --- |
| **Acquirer** | **Target** | **Value (US$ bn)** |
| Shire | Baxalta | 32.0 |
| Pfizer | Medivation | 14.0 |
| AbbVie | Stemcentrx | 9.8 |
| Mylan | Meda | 7.2 |
| Pfizer | Anacor Pharmaceuticals | 5.2 |
| Lonza | Capsugel | 3.5 |
| Allergan | Tobira Therapeutics | 1.7 |
| Pfizer | Astra Zeneca’s ex-US anti-infectives | 1.6 |
| Galenica | Relypsa | 1.5 |
| Jazz Pharmaceuticals | Celator Pharmaceuticals | 1.5 |

Source: Sy Mukherjee, “These Were the 10 Biggest Pharmaceutical Deals of 2016,” *Fortune*, February 24, 2017, accessed May 29, 2019, http://fortune.com/2017/02/24/biggest-biopharma-deals-2016/.

Exhibit 2: Proxy Statement for the Annual Meeting of Shareholders in 2017

|  |  |
| --- | --- |
| **Our Strategic Imperatives** | *1. Innovate and lead*  Improve Pfizer's ability to innovate in biomedical research and development and develop a new generation of high-value, highly differentiated medicines and vaccines. |
| *2. Maximize value* Invest and allocate our resources in ways that create the greatest long-term returns for our shareholders. |
| *3. Earn greater respect*  Earn society's respect by generating breakthrough therapies, improving access, expanding the dialogue on healthcare and acting as a responsible corporate citizen. |
| *4. Own our culture*  Build and sustain a culture where colleagues view themselves as owners, generating new ideas, dealing with problems in a straightforward way, investing in open and candid conversations and working as teammates on challenges and opportunities. |
| **Our Purpose** | Innovate to bring therapies to patients that significantly improve their lives. |
| **Our Mission** | To be the premier innovative biopharmaceutical company |
| **Our Values** | Customer focus, community, respect for people, performance, collaboration, leadership, integrity, quality, innovation |

Source: Pfizer, Proxy Statement for 2017 Annual Meeting of Shareholders, April 26, 2018, accessed May 13, 2019, www.pfizer.com/sites/default/files/presentation/2017\_Proxy\_Statement.pdf.

Exhibit 3: Stock prices of Pfizer compared to Novartis AND ROCHE, 2009–2018 [Close price, $]

Source*:* Novartis (NVS), Pfizer (PFE), Roche (RHHBY), “Stock Prices”, Yahoo! Finance, accessed May 13, 2019, https://finance.yahoo.com/quote/PFE/history?p=PFE.

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3. All dollar amounts are in USD unless otherwise specified. [↑](#endnote-ref-3)
4. A patent cliff meant that the company’s sales numbers "fell off a cliff" as one or more established products went off-patent and other companies (i.e., generics producers) could produce them for cheaper prices. [↑](#endnote-ref-4)
5. This was gaining steam as regulatory pressures increased, R&D productivity diminished, and the number of M&As grew. [↑](#endnote-ref-5)
6. Before a drug could be sold to the public, it had to undergo various processes. Hence, a company’s “drug pipeline” contained all drugs which they had discovered or developed. It was a critical predictor of a pharmaceutical company’s long-term success. The acquisition of Hospira and Medivation, for example, added $3.1 billion to Pfizer’s global revenue. [↑](#endnote-ref-6)
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