Large scale mergers and acquisitions in the pharmaceutical industry: 1 + 1 = 1?

by Aris Angelis and Panos Kanavos

On 29 October, Pfizer and Allergan confirmed that they were in "preliminary friendly discussions" about a possible merger, proposed by Pfizer. If completed, the so-called "Pfizergan" deal is expected to cause significant debate in the US, not least because one of the main incentives behind the merger would be Pfizer's intention to change its current domicile to a country with a low corporate tax rate such as Ireland, where the headquarters of Allergan are located. This is not a negligible industrial event as Pfizer is the second largest pharmaceutical company by revenue globally, and a top tier 500 Fortune company in the US overall; Allergan is also expected to make it into the top 10 global pharmaceutical companies, a company which itself was formed following the acquisition of Allergan Inc by Actavis Plc and the discarding the latter's name. The outcome of such a deal would be the largest pharmaceutical company in the world with annual sales in the region of $60 billion and a market value in excess of $330 billion. The potential impact of such a mega-merger already has caused some reactions from US presidential candidates with Hillary Clinton opposing it on the basis of tax inversion, Donald Trump suggesting that the US tax code needs to change to keep companies in the country and Bernie Sanders saying that "it stinks". On the other hand Ian Read, Pfizer CEO, stated that "To be successful in the future, we need to have a competitive tax rate" and that "the shareholders of Pfizer expect us to maximize their return". Political pressure in the US could dissipate if Allergan were to acquire Pfizer rather than the opposite, in which case there would be no inversion from Pfizer's side. Such a transaction might even make more sense given that Allergan trades at a higher price to earnings multiple than Pfizer and shareholders of both companies could turn out to be better off.

When looking at the current "Pfizergan" deal one has a sense of déjà vu. The proposed takeover of the Anglo-Swedish pharmaceutical giant AstraZeneca by Pfizer in 2014, raised some pressing questions about the value and impact of such a mega-merger in both corporate and, more importantly, social terms. Although that takeover never materialised, the context of Ireland-based Allergan has several similarities with UK-based AstraZeneca. In a nutshell, what can be expected from such a takeover? What are the implications for Ireland's economy, manufacturing or science base? And should such a merger go ahead?

In a recent paper we addressed these questions and argue that the AstraZeneca takeover would not necessarily be in the best interests of the UK economy. The direction of the argument is the same in the Allergan case. Here is why.

What can be expected from such a merger/acquisition?

Similar to the AstraZeneca case, the key driving force behind this merger appears to be improvements in company performance and shareholder value. Allergan's portfolio consists of specialty drugs targeting a wide range of therapeutic categories and therefore economies of scale would be expected, including removal of R&D duplication and cost optimisation, possibly leading to higher sales and greater market shares. Allergan's products could also be used to boost Pfizer's innovative business, possibly helping towards a transformational break-up of the combined company into different divisions, namely a generics and off-patent drugs division with slow growth but steady cash flow, and a growth-focused innovative medicines division. Yet evidence suggests that, for large companies in the pharmaceutical sector, acquisitions lead predominantly to a decline in new molecular entities (NME) and mergers and acquisitions (M&A) overall little, if any, net benefit on productivity. According to what has been observed so far following Pfizer's three largest acquisitions (Warner-Lambert, Pharmacia, and Wyeth), R&D spend post-M&A is subject to considerable calibration in order to create a new R&D organisation. However, as a former Pfizer head of R&D points out this case might prove different given that Allergan's total R&D investment is significantly lower than Pfizer's, both in absolute terms and in relation to its revenue. Ironically, Allergan's key therapeutic areas include dermatology, ophthalmology and gastroenterology (in addition to central nervous system, women's health, urology and anti-infectives), namely three areas, which had been de-prioritised by Pfizer in 2007. Hence, it seems there is not much R&D complementarity between the two companies and consequently Allergan's R&D operations may not suffer, although it would be reasonable to expect some workforce optimisation.

What are the implications for the Irish economy and science base?

In the AstraZeneca case although the proposed acquisition could ensure the sustainability of Pfizer's current business model it would be unclear to what extent the UK economy and science base would benefit. The 2011 closure of Pfizer's R&D plant in Sandwich, UK offers one hint at potential outcomes. Considering that both Pfizer and AstraZeneca have research facilities in the UK, it would be highly unlikely that UK R&D operations would escape unscathed. In the case of the Allergan any impact on the Irish economy would be less damaging because Allergan is mainly a US company with 14 out of its 45 manufacturing facilities based in the US (4 in the UK, 2 in Ireland) and 8 out of its 27 R&D centres located in the US (4 in the UK, 2 in Ireland). As a result, the Allergan deal is not likely to face the same political pressure in Ireland as in the UK and the likely losses to Ireland's manufacturing or R&D activities would be limited.

Should such a deal go ahead?

Ensuring a portfolio diversification would make Pfizer's takeover or merger proposal look like a knightish one, but history indicates otherwise suggesting a knave-like behaviour. Creating such a corporate global empire could have negative implications to research activities, where individuality and small team spirit often drive the discovery process and innovation overall, giving credence to the 'small is beautiful argument' as opposed to 'big is better'. As a result the impact on patients' lives and society's welfare overall might not be beneficial in the long term.

Important deals such as this have a wider economic and social impact. Governments that act as sponsors of public policies promoting research, innovation and entrepreneurship, have a legitimate right to have some say on the terms of large scale pharmaceutical M&A taking place in their territory and ensure that the benefits from such deals diffuse more widely in society. As a guardian of health and industrial policy for the pharmaceutical sector, Governments have a legitimate right to become involved in discussions aiming to secure a better deal for long-term employment, manufacturing and exports. This is particularly so in the context of the recent financial crisis, which has been dominated by unfulfilled commitments in the banking sector.

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