Radical treatments for difficult times

The economic downturn is only one of many factors forcing the drug industry to rethink its strategy. Andrew Jack reports

When AstraZeneca unveiled a programme of factory closures and 1400 job losses across Europe last November, some media reported it as yet another extension of the spreading chill of the recent global economic downturn. In fact, the announcement was the result of a decision that had been taken many months before, and with results that are likely to be deeper and longer than those of the crisis related measures seen in other sectors.

In common with other large drug makers such as GlaxoSmithKline, Pfizer, and Merck, AstraZeneca is being forced to adapt at an increasing pace to a range of growing pressures. Drug companies’ existing products are under threat from expiring patents and the launch of similar new and generic equivalents; pipelines of experimental treatments to replace them are thin; health systems are making new demands as a condition of reimbursement; and the emerging markets are becoming ever more important.

AstraZeneca, for example, is seeking to get a larger proportion of the statin market for its blockbuster drug Crestor (rosuvastatin) by differentiating it from other statins such as Pfizer’s Lipitor (atorvastatin) with extensive and costly new clinical studies. Both companies must adjust to fresh pressure on sales sparked by the sharp price drop when simvastatin went generic.

AstraZeneca has also had to defend itself against the threatened launch of a cut price version of its asthma drug Pulmicort Respules (budesonide inhalation suspension). Teva, the Israeli generic manufacturer, was challenging the validity of the patent, which is not due to expire until 2013.

Sales threat

Not long ago, operating costs were such a modest percentage of the sales price of a drug that there was little incentive to trim them. Healthy revenues supported corporate jets, fancy headquarters, and large networks of underused factories, offices, and laboratories inherited from the different companies that have been folded into the giant groups formed by mega-mergers over the past decade.

As the threat of falling sales has increased, these costs have begun to receive much greater attention. “The pharmaceutical sector really needs to re-look at its operating model to make it leaner,” says Stephan Danner, who runs the healthcare practice at Roland Berger, a German based consultancy which has seen a sharp jump in requests from clients in recent months.

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A survey of companies he coordinated last summer showed that more than two thirds had cut costs in sales over the previous two years, and almost 60% had trimmed them in production, distribution, and marketing. Around a quarter were considering substantial additional cuts in marketing and sales. Pfizer, the world’s largest drug group, launched a cost reduction plan in early 2005, broadened it in 2006, and added more aggressive targets at the start of 2007, aiming to reduce its 100000 strong workforce by 10000 by the end of 2008 in order to pare more than $1.5bn (£1bn; €1.2bn) annually from its expenses. Merck, Eli Lilly, Amgen, and other US companies have taken similar steps.

The European drug companies, which face tougher restrictions on redundancies, have been slower to cut staff. But that too is changing. AstraZeneca’s former finance director Jon Symonds unveiled a series of efficiency measures, and GlaxoSmithKline in 2007 unveiled its own wide ranging cost cutting plan, dubbed operational excellence.

Sales and marketing are among the hardest hit functions, partly because they swelled so fast in the past. A decade of liberalisation in marketing rules and aggressive competition for prescriptions in the US led to an “arms race” of recruitment of many thousands of representatives who “detailed” doctors to push their medicines.

If—as in other forms of advertising—half of the costs were wasted, the remainder resulted in increased sales. And, as Jean-Pierre Garnier, the former chief executive of GlaxoSmithKline, argued, there was no “first mover advantage” in cutting back. Once a few began to cut back, however, others quickly followed.

In Europe, more health systems are introducing “health technology assessment” procedures such as those implemented by the UK’s National Institute for Health and Clinical Excellence (NICE) (see next week’s feature for more details) to scrutinise cost effectiveness,
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while others, like Germany, have pegged the price of innovative drugs close to that of generics. In the US, insurers have introduced formularies that also attempt to study value for money, squeezing margins.

Tougher, more centralised reimbursement and prescription rules mean that individual doctors have less power, and fewer sales representatives are needed. Newer forms of more sophisticated marketing using more highly qualified sales staff are focusing on making a stronger, evidence based case directly to payers.

**Contracting**

A second area of focus for cost cutting has been manufacturing. The trend for innovative drug companies to buy their generic rivals—Novartis bought Hexal in 2006 and Daiichi-Sankyo bought Ranbaxy of India last year—is partly explained by the acquirers’ desire to exploit the experience of generic companies in production at the lowest possible cost.

Some drug developers—such as Gilead, the biotech company based outside San Francisco—have always used “contract manufacturing,” delegating production of their drugs to outside parties. But most traditionally did so in-house and are only now rethinking the approach. AstraZeneca last year set the objective of buying all of its active pharmaceutical ingredients (the compounds that make up its medicines) from outside suppliers. Many of its latest planned redundancies in Europe reflect the shift to purchases from producers in India and China; other job cuts will be offset by posts created in new, lower cost packaging plants it will open in these countries, where demand for its medicines is rising fast. Other drug companies are making similar moves, including GlaxoSmithKline.²

Restructuring is also taking place in research and development. Companies that have long boasted of conducting their research in-house are now licensing an ever greater proportion from biotech companies and forging partnerships with academia. Basic laboratory functions, and even some sophisticated research, are increasingly contracted to companies in India and elsewhere and clinical trials are being handled and streamlined by clinical research organisations. Amgen has signed a deal with the clinical research organisation Quintiles and Eli Lilly agreed a 10 year $1.6bn contract with Covance in August.

Drug companies are also using joint ventures and other forms of cooperation to trim costs and share risks. The US companies Sanofi-Aventis and Merck have long had a joint venture for the sale of both companies’ vaccines in Europe. More recently, AstraZeneca joined up with Bristol-Myers Squibb to share costs and future revenues on diabetes drugs.

**Economic pressures**

Although large drug companies were already making these changes before the current downturn hit, the recent financial turmoil has touched the sector. Biotech companies burning their investors’ cash as they attempt to develop new medicines are in trouble. Ardana and Phoqus in the UK went into administration this summer; AtheroGenics and Accenta in the US have filed for bankruptcy protection; and Curalogic of Sweden, which is being liquidated.

Ironically, many of the larger, better established companies stand to gain in the short term. With top selling medicines generating billions of pounds in sales each year, they remain cash rich, with little reliance on debt. Roche has insisted that its planned $44bn full takeover of Genentech will go ahead, for instance, even if the timetable may have been pushed back.

The big drug companies are able to negotiate better terms for licensing and acquisition of struggling biotech companies that had previously hoped to hold out for more money or go it alone. The downturn has also provided the larger companies with “cover” for job losses already under way. In the medium term, however, the prospects are not so bright. Recession will accelerate governments’ resolve to tighten health budgets, potentially accelerating US President Barack Obama’s hints that he may become directly involved in drug price negotiations with companies.

The consultancy IMS Health estimates that the current economic pressures will reduce growth in the US by two to three percentage points, while demand may also slow in many fast growing developing countries such as Brazil, India, and Russia that had begun to help compensate for more sluggish developed world growth.

But net job losses are not always as stark as the headline figures indicate. AstraZeneca is reducing staff in countries such as Germany but recruiting fast in China, where it generated sales of $456m in the nine months to September 2008, up 46% on the previous year.²

The pattern is nuanced, with some employment displaced to different regions or outsourced to external providers. But after a long period of growth, the number of people that drug companies employ has probably peaked as they adapt to the tougher new realities of the drug sector.

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