Alone we might survive, together we can thrive

The industry must shift from going it alone to building larger companies.

Charles Woler

Experts and pundits alike agree that the biotechnology industry must undergo some fundamental, dramatic changes. From the beginning, the industry has largely followed a relatively simple model: one company, one technology, or one target. And with one proof of concept, a fledgling company would receive its small share of the venture pie. From that point on, corporate success was a matter of chance, opportunity, or both, but rarely did it arise from following a structured strategic process with adequate resources to follow that plan.

Today though, we are struck by the obvious: there are too many technologies with too narrow a focus serving as the foundation for too many companies. It is doubtful that these technologies are leading to new products at the pace needed to sustain this industry. Technology is now seen as a tool, not an investment vehicle, and even large pharmaceutical companies seem reluctant to invest heavily over the long-term in single-technology companies. Combine this with the fact that the public equity markets are largely closed to small biotechnology, and we have an impending funding crunch that could doom many small companies by as early as next year.

The only option is consolidation on a large scale. What follows are some strategies for companies pursuing mergers and acquisitions. It is important to remember, however, that a strategic option is only theory if it cannot be implemented before others decide to follow suit.

M&A strategies

Technology for the sake of technology will not create sustainable competitive advantages unless it leads quicker to better products with less financial resources. Therefore, in crafting an M&A strategy, your first thought should be to avoid merging with companies that are based on one technology. The exception is if you are attempting to fill a technology hole that is hindering drug discovery efforts, or if your strategy is to become a true technology leader with a differentiated technology portfolio with which you can offer other firms a “one-stop shop” to fill their technology needs. With the outsourcing of R&D prevalent in both large and small companies, this approach to building a contract research organization through M&A activity seems to hold promise.

Building a technology-based company does create the opportunity to conduct one’s own internal drug discovery or development effort. However, success in such an endeavor will once again create a need for large cash resources to fund the development of any drug candidates discovered in-house to the point that there is enough data to interest prospective deep-pocketed development partners. The problem then becomes one of financing an increasing number of discovery and development programs with an acceptable burn rate while limiting the risks and speeding up time to partnering—the precise problem confronting many mid-cap biotechs today.

Another option is to merge with an already-existing CRO. For a biotechnology company, a successful CRO will bring industry contacts and cash flow to the table, while the biotech company can bring in development candidates that can flow through the CRO’s established infrastructure. Thus, the biotechnology company can move up the value chain and capture a bigger piece of the drug discovery and development pie.

These approaches are all based on the one-to-one merger or acquisition. A more useful strategy may be to embark on a multicompany strategy that would end up creating a mid-sized pharmaceutical company. Sanofi (Paris) successfully pursued this strategy in the 1970s, and finally merged last year with France’s Synthelabo, which had followed the same strategy itself. Taking such a path, however, requires a shift in mindset, primarily at the level of the CEO and board of directors.

Indeed, there is no reason why biotech companies should not follow such a model if the board and CEO are on the same page as far as the subsequent actions that must be taken for mergers to translate into increased value. Downsizing, restructuring, and pruning must occur following a merger, no matter how difficult these actions may be. It is hard to imagine any value accruing to the new company without taking such harsh steps.

In fact, the industry must face up to the reality that a choice now lies before us to either conduct a massive restructuring of our industry, complete with layoffs and technology pruning, or to see a wave of company bankruptcies. That this must happen has been apparent for several years; delaying will only produce a further loss of value and a waste of hundreds of millions of dollars that could better serve the efforts of those companies strong enough to survive the coming fallout.

The industry’s hope

There is one fact that may be overlooked in this doom-and-gloom scenario. The number of meaningful drug discovery and drug development programs has to increase in order to drive pharmaceutical company growth. That creates a huge opportunity for the biotechnology industry, but only if we work to capture that opportunity, rather than squander it because we are too busy competing with one another instead of looking at the big picture.

The days in which each of us can function as a stand-alone company are over. For biotechnology to become an industry with a future, we must map out a route that will take us through painful territory to be sure, but with the promise of a more secure and vibrant future. In fact, I believe that investors are ready for the needed wave of consolidation and will reward the industry post-consolidation by reopening the door to the public equity markets. In addition, I believe that a consolidated industry will put us in a better position to work with large pharmaceutical companies, who themselves are growing so large that today’s collection of biotechnology companies are, for the most part, too small to merit attention despite what they might offer.

Fewer companies, with increased value. Stronger companies with better balance sheets and sustainable cash flows. Consolidated technology portfolios that offer one-stop research and development shopping for potential partners. Larger companies able to negotiate on more equal footing with large pharmaceutical firms. These are the benefits that await our industry if we take the necessary steps and finally begin the process of consolidation. ///

Charles Woler is president and CEO of Cadus Pharmaceutical, 777 Old Saw Mill River Road, Tarrytown, NY 10591 (charles.woler@cadus.com).