

# Mergers and acquisitions and their effect on outsourcing

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**F**or several years, the pharmaceutical industry has continued to change and evolve. Large pharmaceutical companies continue to merge and acquire other large pharmaceutical companies. In addition, they are looking to improve their product portfolios through the acquisition of product lines as well as smaller pharmaceutical companies. Smaller companies, which can be cash poor, realize that if they are to survive, they must find strategic partners or become part of an acquisition strategy as well.

While the pharmaceutical companies have been re-inventing themselves, the fine chemical industry has not sat idle. We continue to see increased mergers, acquisitions and divestitures. They are not immune to the same problems. In addition, there is too much capacity available for production.

Over the last few years, in general, we have seen a decline in the number of products in the pipeline. In addition the new drugs are more complex and seem to take longer to develop. Also, the overall volumes for these compounds, seems to decline as well. The net result of all of this is fewer companies dealing with fewer companies having fewer projects.

**A**ll of this has had a dramatic effect on the outsourcing of pharmaceutical intermediates and API's and the future of many companies. As the landscape changes, companies adapt which often leads to more mergers and more restructuring of the

companies and their portfolios. We have also noted that often, in the rush to get bigger, the amount we are prepared to pay goes up as well. The high cost of acquiring a particular asset, can burden the group with goodwill for years to come.

A simple cause and effect of the merger scene is to change the basic philosophy of the some companies. Pharmaceutical companies that have historically outsourced their full production now become part of organizations that not only had a history of producing but many have excess capacity and manufacturing sites grossly under-utilized. You can expect that when times get bad, large pharmaceutical companies that have capacity will begin bring in as much as possible.

Most pharmaceutical companies try to reduce the number of suppliers that they have in general. Often, post-merger, the relationships that have been developed over the years no longer exist and once considered a preferred supplier, many companies are finding themselves starting over again.

Interesting enough, while the pharmaceutical companies continue to merge and change, they strive to have their suppliers to be very stable. Rumors of mergers or announcements of planned spin-off often cause the sourcing groups to rethink their position with a particular supplier.

Consider that you have just spent several years developing a product and have just learned that the capacity that you planned to use next year will now be idle. If you are a large corporation, you most likely will change your criteria and begin

**JAMES BRUNO**

**10 Hoffman Drive  
Hamilton Square, NJ 08690, USA**

published by  srl  
Via Cesare da Sesto, 10  
20123 Milano (Italy)  
Tel. 0039 02 83241119  
0039 02 83241358  
Fax 0039 02 8376457

looking at lower margin products in order to keep your cost down and you capacity up. Some companies have been know to actual lose money as long as the marginal cost are covered.

**F**or several years the number of potential projects has declined. Large pharmaceutical companies are seeking that rare blockbuster. Mergers most likely result in some rationization as they seek the one or two mega projects out of the combined portfolios.

In an area where the total number of potential targets has declined, this will result in even less targets. Once again, the number of projects declines and more people are fighting over fewer projects. As a potential supplier, what if you chose the wrong project.

In addition, while the companies review their new portfolios, many products are delayed. Those validation batches and launch quantities may not come next year if at all. Once again the fine chemical group may face some difficult decisions. As with the pharmaceutical companies, they will need to review their portfolios and most likely start looking at some shorter-term results. Consider the company that invested in new capacity to handle that new project. While the variable costs may decline with delays in production, most of the fixed costs are still there.

All of this can have a profound effect on the fine chemical companies. As utilization of your facilities declines, your costs go up. As you seek short-term returns, often profits suffer. One of the first areas that suffer is research and development. For me this includes investments in new technologies. The new technologies could have lead to better profits and product differentiation. A simple Catch-22, I

have no money to invest and cannot get newer technologies that could generate higher profits which would allow one to invest.

**T**he risk factor enters some where around here. Lower risk, normally means lower profits. However, often this lower risk project can as the times get tough, larger companies tend to focus on lower risk projects and therefore generate lower profits. You will also find that at this point, many people will be thinking of their next job. The overall uncertainty will lead to some of your best people looking for newer employment.

The above is not limited to just the larger pharmaceutical companies. Recently, there have been more mergers of smaller biotech and emerging companies. While the synergies of both operations and product lines often are a driving force so is the need to generate cash in an environment where raising cash is difficult. In order to save their cash, studies will be delayed and needs reduced. It can be a significant impact on earning if the validation batches go from 1000 kilos to only 100 kilos.

Overall, every part of the supply chain will suffer. In general, most investments will be delayed. This could include new equipment or expanded facilities. It is interesting to see the FDA's interest in Process Automation Technology. As investment dollars decline, these types of initiatives could suffer as well.

As earning decline, most corporations begin to reduce spending. This results in most people traveling less. For the pharmaceutical company, they will do fewer audits and decrease the opportunities of many companies becoming a potential supplier. For the chemical companies, fewer people will attend trade shows,

business meetings and training courses.

**T**here is a human side to all of this as well. Living in an area of uncertainty is often difficult. While you wait to be acquired, you start to consider other employment alternatives. During periods of change, many people consider that it is a good time to change jobs. This results in a loss of talent and history. Overall, one could expect to see productivity also declining at the same time. If you're a pharmaceutical company, the lose of some people will result in further delays as new people "come up to speed." If you are the supplier, big pharmaceutical companies do not want to take the time to "bring you up to speed."

**I**n general, mergers and acquisitions have a negative impact on outsourcing. Today, companies must plan on negative outcomes in the future and balance their overall portfolios with a collection of projects that are short-term and long-term as well as high risk and low risk. Furthermore, it is important to have close contact with your suppliers and your customers in order to maximize your chance to react to events around you.

In addition, one most continue to look to the future. Investments in technology and specialized equipment will allow you to differentiate yourself from your competition and allow you to continue to operate. This is difficult when market conditions around you are poor. However, losing money and declining profits will spiral you into a worsening profit picture.

Finally, one most plan. It is often said that no one ever failed by over planning but many fail by not planning. It is important to select both your partners and your projects based on what is good for your company.

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