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## Matthew Lynn

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## GlaxoSmithKline -- Lessons of a Failed Merger: Matthew Lynn

By Matthew Lynn

London, Nov. 20 (Bloomberg) -- When Sir Richard Sykes moved from running Britain's biggest pharmaceutical company, GlaxoSmithKline Plc, to become rector of London's Imperial College last year, he planned to inject some financial pizazz into a sleepy old academic institution.

What Imperial needed, Sykes decided, was to grow. So within a few months he put together a deal -- a merger between Imperial and University College London.

The merger was designed to create a `super-university', one of the largest in Europe, with a massive research budget, as well as scope for cost-savings. (``What, two experts in medieval embroidery? Sack one!'')

Unfortunately for Sykes, the professors of Imperial and University College London were smarter than the last recipients of his strategic wisdom, the shareholders in the formerly independent drug companies Glaxo Wellcome and SmithKline Beecham.

Academics may not be dynamic, but they are good at picking holes in flawed arguments. They looked at the Imperial-University merger proposal, gave it a 'C-Minus', and said no.

By contrast, shareholders allowed Sykes to merge Glaxo and SmithKline -- then sat back and watched the value of their stock plummet.

As anyone at the philosophy department over at Imperial might point out, irony is the great governing force in human affairs.

Two Flops

Just as Sykes's plans to merge Imperial and University College were unraveling, so, up the road in London's financial district, the Glaxo SmithKline merger began falling apart. Shareholders have noticed they have been sold a dud. They want something done about it.

The immediate issue is a new pay package for the company's current chief executive, Jean-Pierre Garnier. GSK wrote investors last week suggesting Garnier should be awarded about 200,000 performance-related shares, worth 2.5 million pounds, and an additional 900,000 share options.

This for a man who last year earned more than 20 million pounds, according to a Bloomberg News survey in July, a sum making him Britain's highest-paid chief executive.

If Garnier were producing results, fewer people might gag at a raise on top of the highest salary in the land. The trouble is, he isn't. GSK's shares have been dismal performers. Compared with a peak in 2000 of 21 pounds, they now stand at just over 12 pounds.

Poor Performance

In the past year, GSK has under-performed the FTSE All-Share Index, the UK pharmaceuticals index, and the Bloomberg 500 European Pharmaceuticals Index. By any measure, relative or absolute, this company is not doing well.

That is not bad luck. The company is built on a flawed premise. Until that changes, its performance is not going to improve.

The flawed premise, driven first by Sykes and now by Garnier, is that the drug industry needs to consolidate. Glaxo first took over Wellcome, then merged with SmithKline. Neither merger has worked.

Since then, GlaxoSmithKline has toyed with buying Bristol- Myers Squibb Co. and, more recently, the pharmaceutical division of Bayer AG. If the pills don't work, keep swallowing.

Two arguments are generally made to justify Glaxo's mergers. One, drug companies need marketing muscle to sell their medicines. Two, they need bigger and bigger research and development budgets to keep pace with the revolution in genetics.

Bogus Arguments

Both are bogus. Although a big sales force helps, doctors are not stupid. Good medicines that work will get prescribed, and poor medicines that don't will not -- and truckloads of free pens won't change that.

The most successful drug company of the 1990s was Sweden's Astra, now part of AstraZeneca Plc, which turned its ulcer medicine Losec into the world's biggest selling drug. It started from a tiny base -- and in another irony lacing GSK's failed merger ran rings around the much larger Glaxo.

Meanwhile, giant research budgets have generated dismal returns. That should be no surprise. Massive, cash-rich, bureaucratic organizations with palatial offices are never the best environment for cutting-edge science.

Garnier has just canceled an R&D update for investors -- presumably he doesn't have enough to say. GSK's pipeline is bare, and its existing products are a motley collection of me-too's, and old, re-hashed medicines. The company has come up with very few innovative products in the past decade.

Disappointing R&D Results

Garnier acknowledges GKS's R&D has been disappointing. He has now split the unit into six parts to make it more nimble and creative. But why stop there? What Garnier should be doing is splitting up the company.

Instead of six research units, why not six brand new, demerged companies, each built around a separate therapeutic area?

For all the management gobbledegook about scale, the industry remains fundamentally simple. Sick people like to be cured, and they will pay good money for it. Find the right medicine, and you will do well. Fail and you won't. Smaller companies are better at innovation, and so out-perform.

If Garnier admitted the company was failing, and proposed a radical de-merger, he might be worth the millions he believes he should be paid.

And Sykes? Maybe his new colleagues at Imperial could find some small task to keep him from mischief -- a management buyout for the library, perhaps, or a flotation of the rugby club.

Or they could set him an essay: ``The British pharmaceuticals industry was destroyed by too many mergers. Discuss.''