Case study

Resource strategy at GSK: organising capabilities for innovation and new business

In the technically innovative and global market for pharmaceutical products, GlaxoSmithKline (GSK) is one of the world's largest drug companies – and size can matter in this industry. This case explores the competitive benefits of larger size and how GSK is using its resources to generate new business.

Background

Since the mid-1990s, pharmaceuticals have become increasingly expensive to develop – typically, costing well over $500 million, spread over several years, for one major new drug. After development, these drugs need to be approved by the authorities, then marketed to customers such as doctors, hospitals and government health services – for example, several thousand specialist sales personnel may be required for such tasks in the North American market alone. To support such activities, substantial cash resources are important. In addition, world alliances and other connections between manufacturers can also be highly beneficial: drug companies can use these to support areas where they are both weak geographically and have gaps in their product development programmes. Size helps in the pharmaceutical industry.

Even though size is important, this does not fully explain why the largest companies have chosen to become larger in recent years. In 2009 alone for example, the major US company Pfizer agreed to buy Wyeth, another key US company Merck & Co merged with Schering-Plough and one of the world's large Swiss companies, Roche, finally won full control of the biotechnology company Genentech. There were three main reasons for these and related strategies:

1. *Cost savings*. Economies of scale and scope are often available. For example, sales forces can be combined with the total size reduced, thereby saving costs.
2. *Synergies*. Two companies combined may be able to gain extra benefits just from their combination.
3. *New sources of patents*. Value added in the drug industry comes primarily from new, patented drugs with mergers and acquisitions delivering new sources of opportunity and re-supplying one company that may have a weak pipeline of new drugs.

Some strategists would argue that if *all* the companies become larger then no drug company has developed any particular competitive advantage over another. The benefit cannot simply

be size alone. It is necessary to examine the *individual* competitive resources of each company to see what size and other factors deliver. To explore this, we look in depth at two major aspects of GSK: its range of products and its geographic spread .

Range of GSK products – dominated by pharmaceuticals

With 80 per cent of its revenue from pharmaceuticals, GSK clearly relies heavily on their continued growth and profitability. Both are under threat from two sources. First, it is difficult to find new, patented products. Many drugs come close to market trial but then fail for a variety of reasons. This is not unique to GSK. Other drug companies face similar issues. However, the problem is not just about drug failure but also the heavy investment that must be made prior to that time. Innovation remains a vital strategy for companies like GSK but they have found the need to re-organise to undertake this more efficiently: we examine how they have done this in the section below.

Unfortunately it is not just the supply of new, effective pharmaceuticals that is a problem for drug companies like GSK. The second difficulty is that patents have a limited life before other companies can copy them – usually about ten years. The problem in recent years is that new drug companies, called *generic* drug companies, have been set up by rivals to copy patented drugs quickly – perhaps in some cases even before the patent has expired. Generic drugs have become big business with companies like Novartis – see Case 20.1 – running complete divisions of their companies that are solely engaged in generic drug production. The products are cheap, require little marketing and gain ready acceptance from customers because the prices are much lower.

In addition to pharmaceuticals, the other 20 per cent of GSK turnover comes from consumer health products. This particular product area has been growing faster in recent years for GSK than its pharmaceutical part. There are three main product sub-groups within this area:

- *Nutritional healthcare* with its malt drink Horlicks, Ribena fruit drinks and Lucozade sports and energy drinks. This product group competes primarily in the UK, Ireland and India.
- *Oral healthcare* with Aquafresh and Sensodyne toothpastes and *Poligrip* denture adhesive. This product group competes globally.
- *OTC (over-the-counter) medicines* with Panadol pain reliever and NiQuitin nicotine withdrawal patches and gums. This product group also competes globally except that Panadol is not available in the USA.

Although these may be more familiar to the majority of readers, and they were growing faster than drug products in the period 2006 to 2010, GSK still relied primarily on its pharmaceutical products for its revenue and profitability. The company therefore needed to find

ways of increasing its sales of pharmaceutical drugs. Over the four years to 2012, it has focused increasingly on selling these products to countries beyond the USA and Western Europe.

Geographic spread – moving beyond Western markets

Two-thirds of GSK's turnover came from the US and European markets in 2010. This might seem high but it was even higher in 2007 at 78 per cent. GSK had changed its strategy to target developing countries in Africa and the Middle East alongside those of South Asia and Asia Pacific. The reason for this shift in strategy related both to increased wealth and to growing demand for effective pharmaceutical treatments. It also related to the fact that there has been substantial demand for pharmaceutical products in these countries for many years which GSK did not supply.

Four strategies for the twenty-first century

Following a fundamental re-appraisal of its strategy under its new chief executive, Andrew Whitty, in 2008, GSK identified four areas for further growth:

- cost saving strategy;
- consumer health products;
- geographical expansion;
- renewed pipeline of pharmaceutical products.

The first three above were relatively straightforward. It was the last that was to prove more of a problem.

Cost saving strategy

This was achieved by a substantial restructuring of the whole business. It was done through re-shaping manufacturing processes, streamlining company processes in general (such as reporting lines and administration costs) and through reducing working capital on stocks and work in progress. Between 2008 and 2010, GSK removed £1.7 billion annual costs ($2.6 billion) with plans to increase this to £2.2 billion ($3.3 billion) by 2012.

Consumer health products (CHP)

These had some obvious resource strengths, such as GSK's global dental care and nicotine products. Moreover, it has some other products that might benefit from geographical expansion such as its energy drink Lucozade and its malted drink Horlicks. There were also some problems such as the fact that many of these products competed against formidable rivals: the

US companies Procter & Gamble and Colgate in toothpaste; the Swiss company Novartis in malted drinks with Milo and Ovaltine. At one stage in the company, there was even some suggestion that it would be more profitable for GSK to sell its CHP Division which would fetch billions of dollars. But this strategy was rejected because this division had two priceless competitive advantages: first, it did not rely on patents that would expire to be replaced by cheap generic drugs; second, its well-known brands had a loyal customer base that was a valuable resource in itself.

Geographical expansion

This was achieved by a series of acquisitions, such as a drugs company in Argentina and new pharmaceutical laboratories that were set up in India and China. More generally, GSK has made greater marketing and development efforts to focus on China and South Asia (including India and the Asia Pacific rim), Africa and Japan.

GSK also made a substantial drive into Africa, the Middle East, Asia Pacific, Latin America and other emerging markets. The company began to offer much cheaper products both to generate revenue growth and also save lives and to answer criticism that its pricing policies put life-saving medicines out of the reach of very low-income families. There were three major strategies:

1. Minority shareholdings in emerging market companies: the company spent £21m ($32m) in a joint venture with the Chinese vaccine-maker Shenzhen Neptunus and another £360m ($540m) on a 19 per cent share of the South African company Aspen Pharmacare Holdings in 2009.
2. It struck an alliance in 2009 with the Indian generic drug company, Dr Reddy's. The agreement was to sell more than 100 of the Indian company's products in emerging markets in a range including diabetes, oncology, cardiovascular, gastroenterology and pain management. The advantage of this deal was that it gave GSK a range of cheap generic drugs that could be sold in Africa, the Middle East and Latin America without having to manufacture the drugs.
3. Also in 2009, GSK and one of its major competitors, Pfizer, established a new joint venture called *Viiv* that was 'focused on delivering advances in clinical outcomes and enhancing the quality of life for people living with HIV'. Again, this offered cheap drugs.

Renewed pipeline of pharmaceutical products

This has proved a more difficult strategy to implement. Part of the reason relates to the complexity of managing GSK's competitive resources in the area of organisational capability. To understand this problem, it is useful to look at two phases of its pipeline development: year 2000 and year 2008.

Back in 2000, the recently-merged GSK had a new chief executive, Jean-Paul Garnier. JP (as he was universally known) made a detailed study of the company's drug pipeline. He concluded: 'We had an empty cupboard.' He therefore set about creating a new, vibrant research and development regime in the company. He regarded this as being crucial to the long-term future of any major pharmaceutical company. It would counteract the effects of the generic drug companies and would ensure continued growth at GSK. He recognised that the danger for a large company like GSK was to make its research and development large and bureaucratic: the small bio-engineering companies had been more successful in recent years. Hence, with his new research director, Tachi Yamada, he set up seven 'centres of excellence for drug discovery' (CEDDs) in Europe and the USA.

'Size was getting in the way,' explained Yamada. 'In the bureaucracy, traditional biotechnology expertise was forgotten. Very few companies believed that they were failing in the 1990s. Most are just beginning to realise how bad it is.' The GSK solution was to set up the seven CEDD teams, each no more than 300 strong and multidisciplinary in make-up. Each team had its own library, research facilities, even its own financial director. The smaller structure meant that there were fewer reporting layers so that research could be started and stopped more quickly. One of Yamada's colleagues explained: 'Before we could be stuck for years with a project that was not viable because the visibility was not there. . . . [Now] we can give a Go/No Go decision within six months. For many of our competitors, that takes two years.'

But seven years later, GSK was still not satisfied with its pipeline development. JP, who was himself to retire from GSK in 2008, appointed a new research director, Dr Moncef Slaoui. The new research director explained that the problem was not so much the organisational structure but the need for a change in company culture. 'It's one thing to create an organogram. It's another to change values. We've done well on the structure but more is required on behaviour.' His priority was to scale down the dominance of managers, who had in the past placed too much reliance on large-scale laboratory testing to find new drugs rather than the innovative smaller teams needed in the new GSK.

Dr Slaoui therefore re-organised the teams into smaller units called Discovery Performance Units (DPUs). These groups contain between five and 70 scientists with each group focusing on a particular disease or pathway. Each DPU is responsible for drug development from inception through to early clinical trials. By 2010, there were nearly 40 DPUs with each developing a business plan that typically might also include co-operation with outside research scientists. GSK then has a Discovery Investment Board that reviews the business plans of each DPU and monitors, targets and selects the most promising developments. To ensure that GSK does not rely too heavily on one DPU, no team has annual expenditure of more than 10 per

cent of total annual R&D expenditure. The outcome of this re-organisation of GSK's organisational R&D resources has been that new products launched since 2007 'grew 36 per cent and contributed 7 per cent of pharmaceutical sales in 2010'.

GREEN STRATEGY: GSK has a strong and clear commitment to sustainability issues. This is reflected in the statement in its 2010 Annual Report. 'Creating a successful and sustainable business is about more than financial results. We place great importance not just on what we achieve but on how we achieve it. Running a responsible, values-based business is embedded in our strategy.'

Case questions

1. *What are the key factors for success in this market? And what are the implications of your answer for large and generic drug manufacturers?*
2. *What were the competitive advantages of GSK? Were they sustainable?*
3. *What lessons, if any, on the development of sustainable competitive advantage can be drawn from the case for other companies outside pharmaceuticals?*