OTCs—Opportunity for Alliance

A new kind of alliance structure in OTC medicines is allowing companies to build shareholder value together while remaining independent. Can the rest of industry benefit from this type of creative alliance?

by Mariana Brea-Krüger

Mariana Brea-Krüger is founder and principal of IMI Consulting GmbH in Burgwedel, Germany.

A new form of alliance is evident in over-the-counter (OTC) medicines that may set new horizons for players courageous enough to build and share value together. The deal between Novartis Consumer Health and Reckitt & Colman Pharmaceuticals for the Gaviscon brand in Europe is a first in its class and a good example of this new type of alliance, but there are many more confidentially under discussion. These dialogues explore creating value by sharing infrastructure and know-how.

The Gaviscon Europe deal is an example of building a brand whereby one party brings the technology, its product registration, new product development programs, patents, and low-cost, efficient manufacturing. The other invests and uses its sophisticated infrastructure and provides marketing and advertising support with appropriate and focused sales forces. Together both parties develop the marketing strategy and regulatory and product development activities.

Both Novartis Consumer Health and Reckitt & Colman will share in the risks and rewards of their alliance on a long-term basis—analysts estimate it to be more than eight years—but the Gaviscon brand will remain the property of Reckitt & Colman, its original owner. This may be typical for an in-license, ethical situation. However, in OTCs—where patents have long expired—this is a new occurrence. For Novartis Consumer Health, the deal represents a bold move toward building *another* party's brand. For Reckitt & Colman, it represents a daring move in trust and a strategic "meeting of the minds." All of this occurs without the possessive title or legal structure of a joint venture, simply under the umbrella of a distribution agreement or alliance.

This article shows how alliance partners can build shareholders' value together while exploiting each other's infrastructure in a way fortuitous to the project and both parties. However, it requires risk-taking and courage.

PARTNER & PROSPER

There are many potential strategic benefits and drivers to both parties of this type of new alliance as well as shared risks and issues. (See "Allied Growth.") Both companies can achieve their goals faster, and by combining certain territory sales they have a higher market share. They can better take advantage of corporate Rx-to-OTC switches—own and in-licensed—and they can better capitalize on new product development and technology by sharing each other's best technologies and finding new ones. Additionally, together, they are each more desirable for new licensing and acquisition opportunities.

For Reckitt & Colman, this partnership brings new territories—for example, the Gaviscon brand has never been fully exploited in many continental European countries. Novartis Consumer Health gains from Reckitt & Colman the potential for new outlets and distribution channels because Reckitt & Colman is in mass-market outlets whereas Novartis Consumer Health is not. In the event that deregulation of point-of-sale occurs, Novartis Consumer Health has a partner in the mass-market channels of distribution.

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The partnership also allows both companies to enjoy the benefits of a consumer culture and a pharmaceutical culture because Reckitt & Colman is a household and pharmaceutical products company; Novartis Consumer Health is an ethical pharmaceuticals company with a self-medication division.

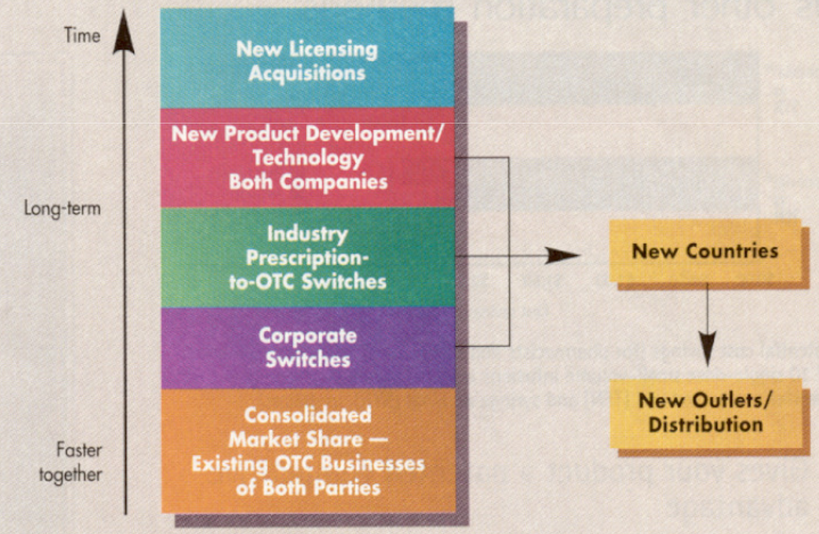
There are potential risks and issues facing both parties in such an alliance. (See "Risks & Rewards.") For the multinational company, the potential negative effect on the pharmaceutical division's cost-structure because of manufacturing volume loss is perhaps the worst risk. That holds true for the midsized company if and when manufacturing volume is transferred to the partner. However, there are many key benefits, including:

- Both parties maintain full ownership of their brands and therefore their assets.
- Both parties maintain separate financial consolidation allowing them the flexibility to exploit other market and business development opportunities.
- Contract dissolution possibilities are defined after a finite period in the event of lack of fulfillment of the agreement.

Any companies developing a creative alliance partnering for OTCs can design their alliance construction to amortize their respective structures. There are many forms of collaboration that would allow the two parties to build shareholder value and pool their strengths, efficiencies, and assets without compromising their independence or diluting their assets. Examples include infrastructure sharing, production cost-benefit sharing, and joint entity/infrastructure sharing. (See "Joining Forces.")

In the Novartis Consumer Health/Reckitt & Colman alliance, the two companies build shareholder value as follows: Reckitt & Colman shares in the profits as the two companies build and grow the Gaviscon brand; the Gaviscon brand's sales,

ALLIED GROWTH



Key Alliance Drivers	Party A multinational	Party B midsized, non-Rx company
1. Establish OTCs in new geography faster	++	+++
2. Volume growth	+++	++
3. Access to new products/switches/technology in pipeline	++	+
4. More critical mass/competitive strength and protection of vulnerabilities in all territories	+	+++
5. Cost-savings/avoidance	+	+
6. Consumer culture		+++
7. Pharmaceutical culture	+++	

\+ Important +++ Very Important

Strategic benefits and drivers of OTC alliances. Both parties can benefit by pooling resources.

and therefore value, grow substantially throughout the estimated eight-year period of the agreement. For Novartis, the profits from the alliance increase shareholder's value in addition to the amortization of its infrastructure—or, in other words, more sales throughput for its organization resulting in better profitability of its other brands.

The industry's more common forms of deals in ethicals have been to develop technology together and use each other's infrastructure to profit from the investment. In-licensing and comarketing/copromotion are traditionally the extent of those creative alliances.

How is this new type of alliance different from a classic ethical comarketing/copromotion? It is the use of each company's full infrastructure—R&D, manufacturing, distribution, marketing, sales, and administration—whereby the traditional deals focus on the sales force but very seldom on use of each other's best component of the full infrastructure or business system.

In OTCs, where building brands is an expensive endeavor late in the product's life cycle, the industry has more often seen simple distribution agreements—in-licensing, salesforce sharing, and, of course, acquisitions. Traditional industry thinking has been: "We are not going to invest to build someone else's brands."

An OTC European situation analysis may explain why Europe is the breeding ground for such new forms of alliances. The OTC industry has no more than 10 European brands—for example, Vicks, Alka Seltzer, Clearasil, and Maalox. The remainder are regional brands with different formulations that are not exploitable across western and eastern Europe in one entity.

Even more difficult than finding European brands is finding technology that has proven itself throughout world markets with new improved product and line extensions. It is equally rare to find an OTC brand that still has patent coverage of one form or another.

Therefore, from a brand and corporate standpoint, one finds a highly competitive, segmented industry whereby most consumers' needs have long been satisfied. Why then duplicate resources in an industry with excess capacities of all kinds? Because intelligent, strategic sharing can save time and costs while building value.

NEW MIND-SET

The pharmaceutical industry, including ethicals, biotech, and OTCs, is currently suffering from excess capacity. Some sources estimate the industry's production and marketing excess to range between 28 and 40 percent of the industry's total base. Analysts estimate that the industry's capacity rationalization opportunity accounts for 45 percent of the total value the industry can create. Mergers have proved to be a solution for excess capacity, but not all companies want to merge or sell, particularly family owned and middle-to-small health care organizations.

Creative alliances in which the excess capability of one player may be the strategic opportunity of the other can generate real returns. The limiting factor is loss of control or ownership. Even out-licensing is a deterrent to greater creative deal-making. The out-licenser clearly loses power for a period of time, and its assets become limited for eventual increased creative deal-making. However, if industry support-

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ed more deals that allowed companies to share control, new forms of alliances that exploit the industry's excesses would be possible. It is strictly up to the deal-makers to sell this concept upward in their organizations.

In spite of multinational-level merger consolidation, Europe has a large proportion of regional companies with limited or no resources in other regions or countries. Among them are Angelini, Esteve, Almirall-Prodesfarma, Schwabe, Schwarz, E. Merck, Gruenenthal, Alpha Wassermann, Servier, and Synthélabo. Those companies are candidates for new forms of creative alliance.

Corporations with no OTC divisions or infrastructure experiencing "switching" of their products are also potential candidates to seek alliance partners with OTC know-how and infrastructure. Whether their corporate cultures will permit them to create these types of new alliances remains to be seen. In the past, creative alliances of this type were unnecessary in a profitable, staid industry. Analysts estimate that this is the reason why so many structural-type deals failed. Was the industry complacent? Perhaps it was.

The now-familiar pressures forcing change upon the industry are lower prices, generics, parallel imports, deregulation, dereimbursement, distribution, and whole-

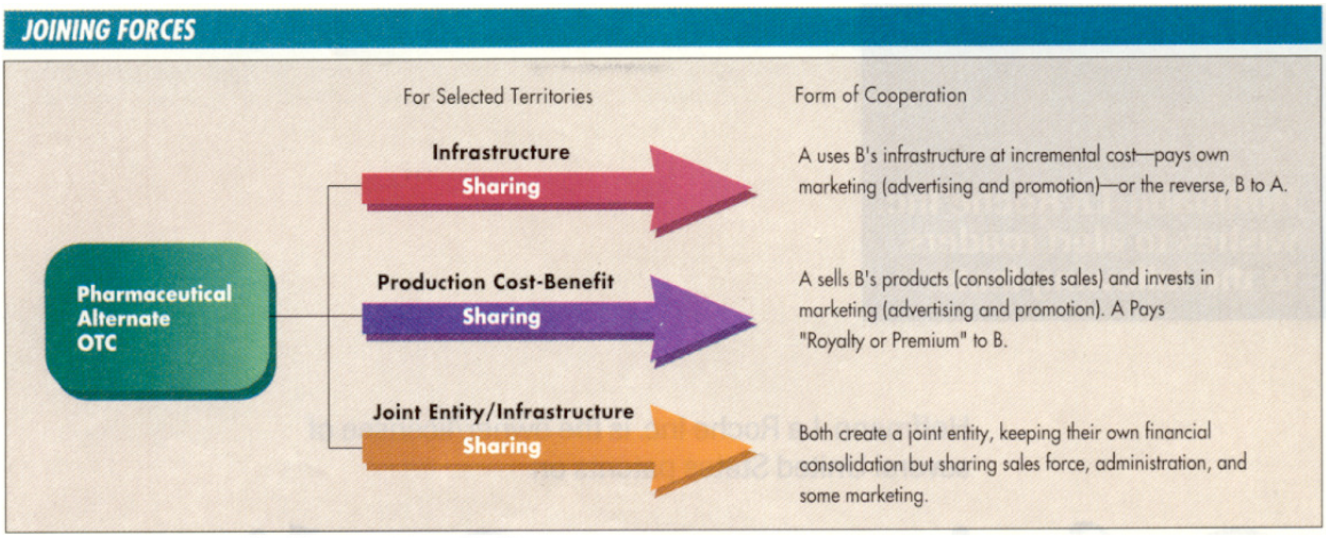
RISKS & REWARDS

Party A (multinational)	Party B (midsized company)
• Loss of flexibility (country and corporate) • Potential negative effect on the pharmaceutical division's cost-structure due to volume lost • Loss of corporate identity in a merged business	• Loss of flexibility (country and corporate) • Potential negative effect on other corporate division's cost-structures due to volume lost • Loss of corporate identity in a merged business

→ The synergistic benefits of such an alliance outweigh the risks to both. The legal alliance structure should allow:

- both parties to maintain full ownership of their brands and assets
- both parties to maintain separate financial consolidation
- flexibility to exploit other (nonthreatening) market and business development opportunities
- dissolution after a finite period in case of lack of fulfillment of the agreement

Potential risks and issues for companies entering an OTC alliance.



OTC alliance concepts and alternate forms of cooperation.

saler's structural changes. In addition, analysts estimate that me-too drugs account for 35 percent of the industry's total R&D spending. Higher returns for R&D investments, more elegant formulations, better economies-of-scale, and, therefore, better cost containment within the low-cost environment are all new objectives driving the industry into change. This new form of creative alliance will spread to ethicals and biotech, but it will require some rethinking and courageous champions on both sides of the partnership.

UNITE & CONQUER

For those parties interested in creating new value-added by combining the strengths and resources of alliance partners, there are many essential factors for the success of nonexchange-of-equity, full-infrastructure-exploitation alliances. They include the following:

- Proven and real technology. No me-too drugs. New technology allowing growth should be the basis for real mutual value creation.
- New geographic regions to share where one partner is not present.
- An objective assessment of whether the corporate cultures are a "match."
- Exploitation of each company's lowest-cost-producing capabilities or creation of low-cost production capabilities.
- Optimization of the sales-force structure, more throughput, but especially a specialized or focused sales force—OTC, Rx, semi-ethical, and so forth.
- Similar corporate cultures capable of working together on trust. Specifically, the philosophies and ways of doing business should be similar, levels of discipline and perfection should be comparable, and strategic creative mind-sets should be compatible on both sides.
- Cost transparency and willingness to share risk.
- Use of the best regulatory team for each market.
- Appointment of operating "champions" on both sides. Specifically, each party should have one person as "champion" who is empowered in each organization to make things happen and to get top management's consensus and reaction.
- Ability to share newly created value fairly and on a long-term basis.

Full-infrastructure, exploitation-type alliances are, however, time consuming to assemble and seal. Both companies must carefully assess all details of the structure, the value they hope to create, and the divorce clauses before the deal can take place. They should never construct deal-making for the sake of deal making.

Alliance-seeking companies should assess the value-creating capability of a number of potential partners. They should assess several deal constructions simultaneously and inform all potential partners that they are investigating several alternatives at the same time.

When should the negotiation become exclusive? When both sides have agreed on the "size-of-the-prize" or the value to be created that either one alone cannot create, and they have agreed that "this" alliance is the best choice. The belief that "we-have-a-good-deal" guarantees the necessary alliance commitment from both parties. That outlook must drive both sides of the relationship in the short and long term.

The new form of creative alliance can spread to ethicals and biotech. In biotech, where the industry will soon be maturing, companies can gain excess capacity and income-generating infrastructures through alliances. Acquisitions are only one possible answer.

For ethical pharmaceuticals, a mature industry with excess capacity in production, sales force, and administration, that form of creative alliance could be a substitution to classic in-licensing. The rationale for in-licensing has been: "We will borrow your technology asset to amortize its lifespan and return it to you at the end of a long period but we will use all our own infrastructure resources."

The new alliance structure goes beyond the classic copromotion and comarketing type of alliance in which mostly sales forces are shared for a limited period of time. Therefore, this type of creative alliance thinking will soon occur throughout the pharmaceutical industry as companies must find new ways to survive without resorting to consolidation. ■