HOUSE OF COMMONS SESSION 1997–98

SCIENCE AND TECHNOLOGY COMMITTEE

Third Report

GLAXO WELLCOME AND SMITHKLINE BEECHAM: THE MERGER PROPOSALS

Report together with the Proceedings of the Committee, Minutes of Evidence and Appendices

Ordered by The House of Commons *to be printed*
3rd June 1998

LONDON : THE STATIONERY OFFICE
£8.80

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The Science and Technology Committee is appointed under Standing Order No 152 to examine the expenditure, administration and policy of the Office of Science and Technology and associated public bodies.

The Committee consists of 11 Members. It has a quorum of three. Unless the House otherwise orders, all Members nominated to the Committee continue to be Members of it for the remainder of the Parliament.

The Committee has power:

(a) to send for persons, papers and records, to sit notwithstanding any adjournment of the House, to adjourn from place to place, and to report from time to time;

(b) to appoint specialist advisers either to supply information which is not readily available or to elucidate matters of complexity within the Committee's order of reference;

(c) to communicate to any other such committee and to the Committee of Public Accounts, to the Deregulation Committee and to the Environmental Audit Committee its evidence and any other documents relating to matters of common interest; and

(d) to meet concurrently with any other such committee for the purposes of deliberating, taking evidence, or considering draft reports.

The following were nominated Members of the Committee on 14 July 1997:

Mr David Atkinson
Mr Nigel Beard
Dr Michael Clark
Mrs Claire Curtis-Thomas
Dr Ian Gibson
Dr Lynne Jones
Mr Nigel Jones
Dr Ashok Kumar
Mrs Caroline Spelman
Dr Desmond Turner
Dr Alan W Williams

Dr Michael Clark was elected Chairman on 30 July 1997.

The cost of printing and publishing this Report is estimated by The Stationery Office at £1,900.00.

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THIRD REPORT

The Science and Technology Committee has agreed to the following Report:—

GLAXO WELLCOME AND SMITHKLINE BEECHAM: THE MERGER PROPOSALS

1. On 30 January 1998 Glaxo Wellcome plc and SmithKline Beecham plc announced that they had entered talks with a view to merging and that SmithKline Beecham had terminated its merger talks with American Home Products (AHP). City reaction to the proposal was enthusiastic; share prices in both companies shot up. The deal would have created the world's largest pharmaceutical company and, in terms of market capitalisation, the third largest company overall. On 23 February 1998, after twenty three days of talks and before we had examined the participants, SmithKline Beecham announced that the negotiations had been terminated amid suggestions that Glaxo Wellcome had failed to abide by earlier agreements and rumours of insolvable differences between the two boards.

2. Our interest in the merger resulted from its potential impact on the UK's science base. Both Glaxo Wellcome and SmithKline Beecham are giants in terms of their research and development (R&D) expenditure: in 1997 they ranked first and second, respectively, in the Department of Trade and Industry's R&D Scoreboard and between them accounted for more than a fifth of all private sector expenditure on R&D in the UK.[1] Although both companies have over 90% of their sales overseas, much of their R&D is conducted in the UK.[2] In 1997 SmithKline Beecham spent some £293 million, or 35%, of their total R&D budget here:[3] in Glaxo Wellcome almost 50%, or some £500 million, of global R&D spend was domestic.[4] Both employ significant numbers of scientists, clinicians and technicians in the UK (over 4,600 are employed by Glaxo Wellcome and just over 3,300 by SmithKline Beecham[5]) and both fund much external R&D activity. Glaxo Wellcome told us that it currently spends "*over £16 million per year on our support for basic research in academia, most of which is in the UK ... we provide for the training of 260 PhD students in 56 UK universities ... over the last 10 years we have endowed 11 Professorships in British universities at an average cost of £1 million. In addition we spend some £33 million a year with UK universities and hospitals in the conduct of clinical research and therapeutic trials*".[6] Similarly, SmithKline Beecham told us of "*a range of collaborations, including individual studentships, consultancy agreements, research grants, the Shared Equipment Initiative and leading participation in multilateral LINK schemes and Foresight Challenge Awards*" where they provide both a financial and an intellectual contribution to the UK science base. They also provide for the training of about 270 students (both under- and post-graduates) and spend about £7 million per annum on research in UK universities.[7] The sheer size and breadth of the two companies' R&D operations leads inevitably to the conclusion that, if the merger had resulted in even a small change in expenditure, there would have been a ripple effect throughout the entire UK science base.

3. Both Glaxo Wellcome and SmithKline Beecham pointed out that each was a strong company in its own right and therefore that merger was not essential to either but that they were drawn to consider the option because of the significant improvements in R&D productivity and efficiency that might result.[8] Sir Richard Sykes, Chief Executive of Glaxo Wellcome, told us that he entered the talks with the vision of "*creating a pharmaceutical company that would be second to none in the world, that would have the resources and the skills to put into all the modern science and technology that we have access to today, to produce medicines of value in the future which we could bring to people throughout the world*".[9] Similarly, SmithKline Beecham told us that by bringing together "*two very strong companies, both acknowledged as research leaders in their own right ... there really would be very tangible advantages*" and that

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[1] *SET Statistics 1997*, Office of Science and Technology, Table 4.12.
[2] pp. 3 and 14.
[3] p. 14.
[4] Q. 46.
[5] pp. 1 and 5.
[6] p. 2.
[7] p. 14.
[8] QQ. 2, 3 and 58.
[9] Q. 13.

the specific rationale was to generate a much stronger research and development engine.[10] Both were equally adamant that the merger was designed not to enable the companies to reduce their combined R&D budgets but, by combining the budgets and redeploying them, to make the new company's R&D operations more efficient and competitive than either existing company's.[11] It had been agreed that any savings made in R&D as a result of eradicating duplication would have been put back into R&D operations. Both companies told us of the complementarity between their research operations that would have meant that each could have learnt from the other, benefited from each other's previous investments, and used their combined expertise to develop new products.

4. Although both companies gave us their interpretation of why the talks failed, the precise reasons remain unclear. Admittedly, bringing together two enormous organisations with distinct organisational structures and many disparate parts would have been an extremely complex process. Unlike Glaxo's acquisition of Wellcome plc in 1995, which was in effect a hostile takeover, this was to have been a merger of equals with the new company forging its own identity rather than adopting the image of one or other of the participants.[12] A combined market capitalisation of around £100 billion meant that the stakes were certainly high and, with much of that value held as intellectual capital, the assets fragile. Sir Richard spoke of different approaches, different cultures and different styles of management that could not be reconciled.[13] Mr Leschly, Chief Executive of SmithKline, told us that Glaxo Wellcome had changed their minds on points which had already been agreed which resulted in a loss of trust on the part of SmithKline Beecham's board.[14] The net result is that both companies have decided that the risks of merger outweigh the potential benefits.[15]

5. Had the merger gone ahead on the agreed terms, where reduced administrative overheads would have enabled more resources to be devoted to scientific research and the overall R&D budget maintained, both companies believe that there could have been a beneficial effect for the whole of the UK science base.[16] **The creation of a R&D powerhouse, able to compete across the world, and conducting the bulk of its research in the UK would have reflected well on the UK science base and given important signals about the quality of its output. We share a sense of disappointment that an opportunity to create a national champion with R&D at its heart has been lost.**

6. However, as both Sir Richard and Mr Leschly told us it is better that both companies remain separate than that the merger proceed without producing the desired returns.[17] Had the merger been unsuccessful, the UK could have lost two strong R&D companies without any tangible benefit and the contributions which each currently make to the wider science base would have been jeopardised.

7. We had some concerns that the failure of the merger talks would have a negative impact on the ability of two companies to work together on collaborative projects. However, Mr Leschly assured us that there was no reason why the two companies should not continue to have a good relationship and we are glad to hear that, post-merger, a new collaborative research project is under consideration.[18]

8. Both companies were confident that, despite the failure of the merger talks, they would maintain and enhance their respective positions in the global pharmaceutical industry and would remain active supporters of the UK science base. This can only be to its benefit.

[10] QQ. 54. *See also* QQ. 55–58.
[11] eg. QQ. 15 and 60.
[12] Q. 104.
[13] QQ. 7–11.
[14] QQ. 95–101.
[15] QQ. 16 and 120.
[16] QQ. 3, 4 and 66.
[17] QQ. 6 and 120.
[18] QQ. 121 and 124.

Conclusion

9. The benefits of merging the R&D activities were emphasised by the Chief Executives of both companies. But twenty three days after the start of discussions those advantages were set aside—we were told because the management styles and philosophies of the two companies were so different as to be irreconcilable. However, the two companies had known one another well for many years. The Chief Executives were on such good personal terms that Sir Richard could ring Mr Leschly in the middle of SmithKline Beecham's negotiations with another company—AHP—and, as a result of that telephone call, those negotiations were dropped and new negotiations between SmithKline Beecham and Glaxo Wellcome were urgently embarked upon. If the two companies were so trusting of one another at that point what incompatibility could have been revealed in the subsequent twenty three days that was not apparent at the beginning? That was not made clear.

10. There appear to be two alternative conclusions to be drawn from the evidence before us. Either

(a) there had not been adequate initial assessment of the potential advantages or feasibility of the merger; or

(b) the substantial advantages to be derived from merging the two R&D programmes were as great as stated but were abandoned because of the incompatibility of the management of the two companies.

11. Either way the judgement of the senior executives must be called into question. They readily embarked on an adventure with major national assets and then equally readily abandoned the enterprise less than a month later without a clear cause consistent with the claimed advantages. It must be a cause for public concern as well as concern to shareholders that neither of the Chief Executives nor the boards of the two companies have been held publicly accountable for this course of events, nor have adequate explanations been forthcoming despite our inquiry.

PROCEEDINGS OF THE COMMITTEE RELATING TO THE REPORT

WEDNESDAY 3 JUNE 1998

Members present:

Mr David Atkinson	Mr Nigel Jones
Mr Nigel Beard	Dr Alan W. Williams

In the absence of the Chairman, Dr Alan W. Williams was called to the Chair.

* * *

The Committee deliberated.

Draft Report (Glaxo Wellcome and SmithKline Beecham: The Merger Proposals), proposed by Dr Alan W. Williams, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 3 read and agreed to.
Paragraph 4 read, amended and agreed to.
Paragraphs 5 to 9 read and agreed to.
Paragraph 10 read, amended and agreed to.
Paragraph 11 read and agreed to.

Resolved, That the Report be the Third Report of the Committee to the House.

Ordered, That Dr Alan W. Williams do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select committees (reports)) be applied to the Report.

Several Papers were ordered to be appended to the Minutes of Evidence.

Ordered, That the Appendices to the Minutes of the Evidence be reported to the House.

The Committee deliberated.

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MINUTES OF EVIDENCE

TAKEN BEFORE THE SCIENCE AND TECHNOLOGY COMMITTEE

WEDNESDAY 1 APRIL 1998

Members present:

Dr Michael Clark, in the Chair

Mr David Atkinson
Mr Nigel Beard
Dr Ian Gibson
Dr Lynne Jones
Dr Ashok Kumar
Dr Desmond Turner
Dr Alan W Williams

Memorandum submitted by Glaxo Wellcome plc

THE IMPACT OF PHARMACEUTICAL INDUSTRY CONSOLIDATION ON RESEARCH AND DEVELOPMENT

The UK pharmaceutical industry is one of Britian's success stories. Although the UK market accounts for just 3 per cent of the world pharmaceutical market, no fewer than five of the world's twenty top selling medicines in 1996 originated in British pharmaceutial research laboratories. UK pharmaceutical exports in 1996 exceeded £5.3 billion, resulting in a trade surplus of £2.25 billion. There are over 75,000 people currently employed in the industry in the UK, many of whom are highly qualified scientists and technologists, with a further 250,000 employed in related industries.

The pharmaceutical industry is heavily dependent on science and technololgy and invests over £2 billion annually in research and development within the UK. On average, it costs about £350 million and takes between 10 and 12 years to bring a new medicine to the market. This high level of investment in scientific infrastructure and R&D is accompanied by high risk. When a compound fails in the later stages of the development process, costs amounting to many millions of pounds must be written off.

Research-based pharmaceutical companies must manufacture and sell their products in a worldwide market place in which the requirements of healthcare providers are steadily increasing. In addition to demonstrating safety and efficacy, successful new medicines must also offer real therapeutic value; they must cure disease or bring about significant modification of the disease process. To achieve this, companies must harness a much wider range of science and technology than ever before in order to understand disease mechanisms and discover novel medicines. The attainment of critical mass in R&D and the spreading of research activities across a wider spectrum of therapeutic areas has been an important driver of the increasing number of mergers and acquisitions which the industry has experienced over the last five years. A second important driver is the need to increase market share, in a highly fragmented global market-place, in order to create the revenue needed to fuel the medicine discovery and development processes.

Glaxo Wellcome

Glaxo Wellcome is the world's largest pharmaceutical company, with a world market share of 4.9 per cent (in-house data). The company employs nearly 55,000 people worldwide, has 57 operating subsidiaries and supplies medicines to over 150 markets. The geographical distribution of our sales, which in total amounted to almost £8 billion in 1997, is set out in Figure 1. Our largest markets are in North America, Europe and Japan, but it is the emerging markets of Asia Pacific, Latin America and Eastern Europe that offer the greatest potential for growth into the next century.

Figure 2 shows that our sales are spread over a number of different therapeutic areas. Importantly, our newer products, those launched since 1990, now provide over a third of sales and are growing strongly. This growth is more than offsetting the reduction in sales of older products, such as Zantac, as they face increasing generic competition.

The dynamo for our continued success is Research and Development, in which we invested £1.15 billion in 1997. We conduct R&D in a number of countries, but the majority of our staff and our largest facilities are in the UK where we employ over 4,600 people at our Medicines Research Centre at Stevenage and in the Development and Medical departments at Ware and Greenford. Over 80 per cent of these employees are graduate or doctoral scientists, clinicians and technologists.

Our research activities cover a wide spread of disease areas. We have some 60 major research projects aimed at discovering new medicines for cardiovascular diseases and critical care, central nervous system disorders, inflammatory and metabolic diseases, oncology, asthma and other respiratory conditions, gastrointestinal disorders and bacterial and viral diseases. At present we have 100 compounds in the development process and our aim is to launch three significant new medicines per annum by the year 2000.

Glaxo Wellcome is strongly committed to collaboration with university researchers at the cutting edge of science and medicine. We currently spend over £16 million per year on our support for basic research in academia, most of which is in the UK. An important element of this investment is the support we provide for the training of 260 PhD students in 56 UK universities, and we are currently expanding our university collaborative research in the field of human genetics. Over the last ten years we have endowed 11 Professorships in British universities at an average cost of £1m. In addition we spend some £33 million a year with UK universities and hospitals in the conduct of clinical research and therapeutic trials.

We are keen to encourage an interest in science in our young people and spend about £5 million per annum in support we give to schools and undergraduates for science education and training in the workplace.

The Merger Between Glaxo and Wellcome

In 1995 Glaxo merged with Wellcome. One of the main attractions of the merger was the opportunity it provided to produce an R&D organisation fit for the 21st century.

Significant synergies were realised by combining the research organisations of the two companies. Each had strengths in particular therapeutic areas that the other did not have; for example, Wellcome was particularly strong in virology, while Glaxo excelled in the respiratory field. In addition, the culture and traditions of the two companies were very similar. These factors contributed to a relatively smooth and efficient merger process.

The main benefit of the merger, as far as science and technology is concerned, has been the opportunity it provided to reskill the R&D organisation. New technologies have been brought into the company to enhance our ability to discover new medicines. A Genetics directorate has been created to use the new knowledge that is emerging from human genomics to understand disease mechanisms and so discover more effective new medicines. The efficiency of our screening processes has been improved enormously as a result of our investment in robotic technology and automated analytical methods. Combinatorial chemistry has been introduced into our research laboratories. This area of chemical technology allows the rapid generation of tens of thousands of chemically diverse structures for our therapeutic screens.

The introduction of these new approaches to the discovery of therapeutic molecules, and of advanced technologies, has been made possible by combining the R&D resources of Glaxo and Wellcome. The R&D budget of Glaxo Wellcome has been maintained at the level spent by the two companies together before the merger. However, the funding has been used to much greater effect as a result of the elimination of duplication in research activities and a more efficient use of expensive equipment and facilities.

In the course of the merger, some six hundred employees left the R&D organisations under generous redundancy terms, while 450 new recruits have joined in the past two years. It is difficult to provide hard data on the destinations of those leaving the company, but a number moved to other major pharmaceutical companies, including Pfizer, SmithKline Beecham, Zeneca, Astra and Roche, while others joined biotech start-up companies. A few have set up their own companies to exploit particular technologies or to provide services to the larger companies. Others have used the opportunity to redirect their careers, some becoming consultants to the pharmaceutical and related industries and a number have gone on to enter the school teaching profession.

Following the merger, Glaxo Wellcome provided a grant of £9 million to University College London in order to create a new research unit as part of the College's new "Cruciform" project. The unit is under the direction of Dr Salvador Moncada, formerly Research Director at the Wellcome Foundation. This funding was used to provide new research infrastructure and to create posts for 18 research scientists, including former Wellcome research staff.

A key feature of the new Glaxo Wellcome R&D organisation is the significant increase in interdisciplinary research. New departments and divisions now reflect the totality of scientific and technological expertise required for the execution of research programmes. Research staff are no longer confined by an organisation predicated upon the academic disciplines and this meeting of the disciplines has led to important synergies which are benefiting our research programmes. This change in research culture was driven to no small extent by the opening of our new Medicines Research Centre at Stevenage.

THE GLAXO WELLCOME—SMITHKLINE BEECHAM MERGER DISCUSSIONS

It was announced on 30 January that Glaxo Wellcome and SmithKline Beecham were in detailed discussions with a view to merging the two companies. The proposed merger would have created the world's leading pharmaceutical group, based in the UK, with the largest research and development organisation in the global healthcare industry. On 23 February the merger discussions were terminated by SmithKline Beecham. The proposed merger represented a compelling opportunity for both companies and Glaxo Wellcome was disappointed at the outcome.

Glaxo Wellcome is Britain's largest company by market value and a world leader in pharmaceuticals. We will continue to invest heavily in research and development, both by strengthening our in-house resources and through partnerships with smaller companies which provide access to new skills and technologies. Our strategy does not depend upon growth by merger or acquisition, but we will continue to explore any appropriate opportunities to maintain and enhance our competitive position within the global pharmaceutical industry.

CONCLUSION

The increasing cost and complexity of pharmaceutical R&D, and the consequent need for scale, is likely to lead to further consolidation of a highly fragmented industry. The impact of individual mergers on R&D operations will inevitably depend upon the particular circumstances of the companies concerned. However, since R&D will continue to be the basis for future growth, successful mergers are likely to be those which seek to build more effective R&D operations, rather than simply aiming to reduce costs. Some rationalisation and restructuring of operations is inevitable as two global R&D organisations are merged, and clearly management will be strongly influenced by the past performance and future potential of individual units. In this regard, the UK is well placed as a result of its long tradition of scientific and technological excellence and its outstanding track record in drug discovery and development. However, it cannot be taken for granted that the UK will remain an attractive location for pharmaceutical R&D in the future. The serious shortage of funding for scientific facilities in our universities over many years, together with weaknesses in science teaching at every level of our education system, are now causing major problems for pharmaceutical companies seeking to recruit R&D staff in the UK. The problems have been highlighted in the Dearing report, but unless they are urgently and effectively addressed, there is a danger that the UK's long-standing strength in pharmaceutical R&D could be eroded. This would make UK R&D facilities more vulnerable to future consolidation in the global pharmaceutical industry.

Glaxo Wellcome is strongly committed to the UK science base and will continue to work with government and the scientific community to ensure that British science and technology flourish in the 21st century.

27 March 1998

Figure 1: The geographical distribution of Glaxo Wellcome sales of £7.98 billion in 1997.

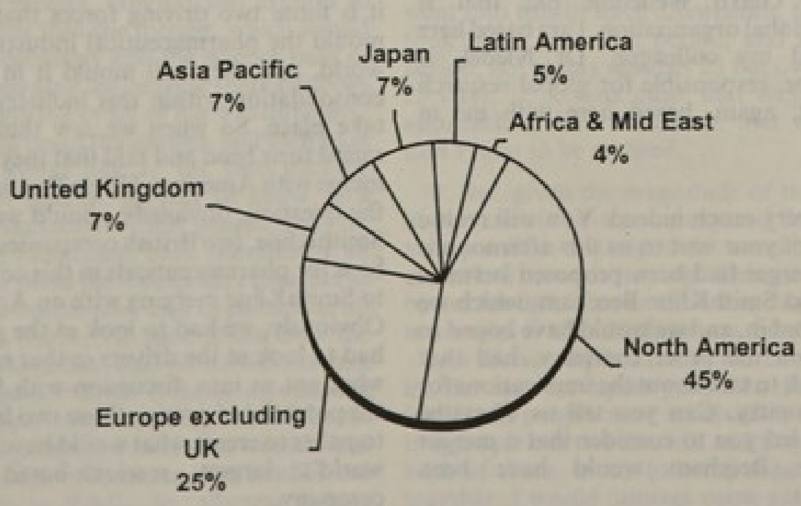
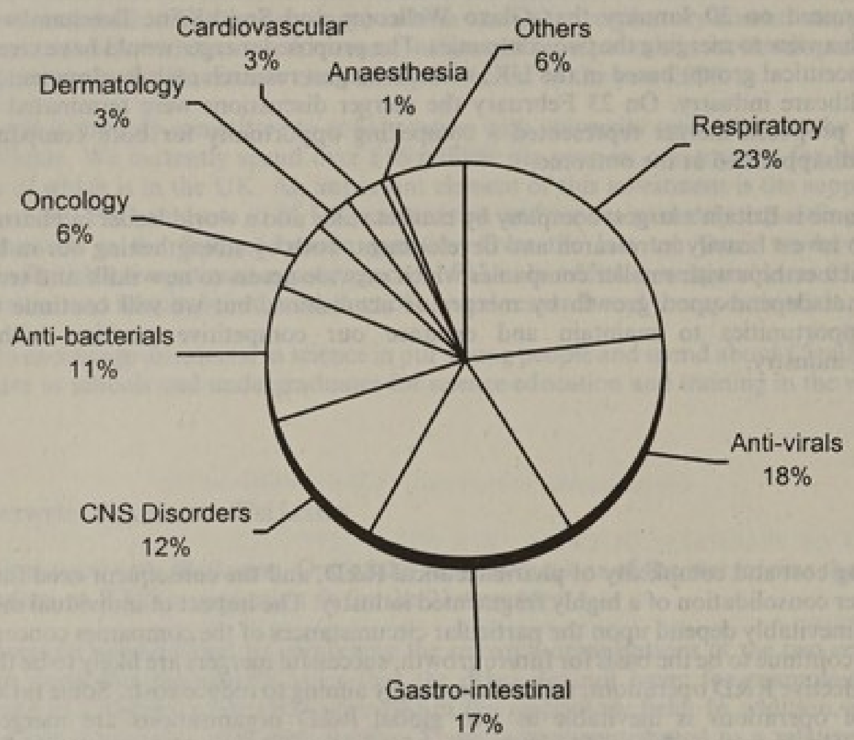


Figure 2: Glaxo Wellcome sales by therapeutic area in 1997.



Examination of witnesses

SIR RICHARD SYKES, Chairman, DR JAMES NEIDEL, Executive Director, Research and Development, Glaxo Wellcome plc,were examined.

Chairman

1. Sir Richard, may I, on behalf of the Science and Technology Committee, thank you and your colleague very much for coming along this afternoon. I know it has not been easy for you, with regard to your diary, and that means we appreciate it all the more. I wonder if you would just care to say a word or two about your position in your organisation and to introduce your colleague to us?

(*Sir Richard Sykes*) I certainly will, Mr Chairman. Thank you very much for the invitation. My position is Chairman of Glaxo Wellcome plc, that is Chairman of the global organisation. I am based here in London. And my colleague, Dr Niedel, is Executive Director, responsible for global research and development; again, based here with me in London.

2. Thank you very much indeed. You will realise that the purpose of your visit to us this afternoon is the fact that a merger had been proposed between your company and SmithKline Beecham, which we were most interested in, and we would have hoped to have seen you and the other company, had that merger gone ahead, to talk about the implications for science in this country. Can you tell us what the factors were that led you to consider that a merger with SmithKline Beecham would have been beneficial?

(*Sir Richard Sykes*) I think, if we go back to 1995, the merger at that time between Glaxo and Wellcome created in this country one of the largest research-based pharmaceutical companies in the world, dedicated to prescription medicine. So in 1997 we spent £1.2 billion on research and development, and we had less than 5 per cent of the global market share of prescription medicines in the world. What we have to do is that we have to be constantly alert, if we are to remain competitive in a global environment, to the driving forces in our industry, and those driving forces today are, on the one hand, science and technology, and, on the other hand, economics. And it is those two driving forces that will continue to mould the pharmaceutical industry throughout the world, and they will mould it in such a way that consolidation within this industry will continue to take place. So when we saw that SmithKline had raised their head and said that they were intending to merge with American Home Products, we had to ask the question, obviously, should we be merging with SmithKline, two British companies strengthening the base for pharmaceuticals in this country, as opposed to SmithKline merging with an American company. Obviously, we had to look at the pros and cons, we had to look at the drivers in that merger, and that is what got us into discussion with SmithKline about the potential of putting those two large organisations together to create what would have been certainly the world's largest research-based pharmaceutical company.

[**Chairman** *Cont*]

3. Thank you very much indeed. Clearly, there would have been benefits to the pharmaceutical industry, probably to patients that were wanting drugs that could be produced by your companies, and you did say, in your answer, that one of the driving forces was the science base of your companies. Do you think the science base of your companies would have benefited from the merger, and if they had then it would follow, would it not, that the science base of this country would have benefited from the merger?

(*Sir Richard Sykes*) Could I ask my colleague, Dr Niedel, to address that.

(*Dr Niedel*) I think, as Sir Richard has said, science and technology was one of the driving forces, and when we look at the pharmaceutical industry in the future there are a few forces that are shaping it; one is the Human Genome Project, the fact that human genetics, and genomics, is changing the way we discover and develop drugs, and, importantly, over the next five to 10 years, will change the way medicine is practised. And I think we, as a company, we as a combined company, if the merger had gone ahead, would have been leaders in that area, and that would have reflected well, obviously, on that area across the UK. Secondly, technology is having an enormous impact, and I know many of you, in your backgrounds, have had laboratory careers, and if you remember the chemistry laboratory of even 10 years ago it was largely a single chemist, working at a hood, with some reflux and beakers, and things. Chemistry, of course, now is done by robotic, computer-based, micro-processor-controlled approaches, combinatorial chemistry. That technology is expensive; for instance, we have invested in it, SmithKline Beecham had not made quite as large an investment as we had, and so they would have benefited by sharing that investment. There are other technologies as well, screening technologies, technologies for assaying genetics, etc.

4. But, Dr Niedel, I wonder if you would care to answer the question, would the science base of your company and the science base of this country have benefited from the merger?

(*Dr Niedel*) Yes, I think so.

5. Then, my final question, before Dr Gibson asks a question: if the science base of your company, and if the science base of the country, would have benefited from the merger, how do you explain to people in this country that the merger, which would have benefited the economy and the science base of this country, has been aborted because there has been dispute about the pecking order of five top directors?

(*Dr Niedel*) Let me begin the answer, and then I am sure Sir Richard would like to get into pecking orders. I think that science, as you all know, is a fragile, it is an intellectually-driven pursuit, and so, whereas the science base could have benefited if we had been able to put those two companies together in a way that all of the employees, and in particular all of the employees in R&D, felt good about how the company had come together, that would have been a very positive outcome, I think. I think, as we went through those 23 days, it was less clear that we could put the company together in a way that would have maintained the morale, enthusiasm, the intellectual drive of the people in R&D. So, whereas it was potentially very positive for us, as a company, and for this country, I think, after 23 days, we had significant misgivings.

6. Which would you think was most fragile, Dr Niedel, the science that you are talking about or the ego of directors?

(*Dr Niedel*) It is definitely the science and the intellect, I think. Ego may have played some role getting us into it, but ego was not part of getting out of, walking away from the merger.

(*Sir Richard Sykes*) I think it is important to understand that when you try to put two companies of the size and complexity of Glaxo Wellcome and SmithKline Beecham together, when you consider that those two organisations have different cultures, different management styles and, as Jim has said, they rely to a very large extent on intellectual assets, on highly educated, skilled people, and that means that management has to be so cognisant of the fact that the management of that new company would have to clearly recognise the critical importance of working together as a unified body to take that new company forward and realise the vision. Because that is what it is all about, this is about a vision, a vision for ten years in the future, it is not about cost-cutting tomorrow, it is about creating something for the future. And it is that issue, at the end of the day, it is getting that agreement between management that led to the breakdown of the discussions. And let me say that it is much better to do it at that stage than it is to get into a marriage where it all starts to break down when it has taken place, because I think then the damage could have been much greater.

Mr Beard

7. I understand what you are saying to me, Jim, but you had gone through this process already, with the Wellcome arrangement, and you are saying to the Chairman that this came to you after 23 days of looking at this; what was there at the end of 23 days that you could not have anticipated, given your previous experience?

(*Sir Richard Sykes*) So we went, obviously, into this process with our eyes wide open; we realise what the dangers are, we realise the risks, but, of course, we also see the tremendous benefits, at the end of the day, by putting these two organisations together. We went into this to have discussions, those discussions took place over that period, and it was over that period, not at day number 23 but over that period of 23 days, it became clear that there were different approaches, different issues, that would not allow that vision to be realised.

8. But, given the magnitude of the vision and the importance to your company and SmithKline, was it not possible to negotiate round these? If you embarked on this saying:"This is really a world-beater for us", it looks almost as though you gave up too easily, if after 23 days you then jettisoned it?

(*Sir Richard Sykes*) It may feel like that, but, again, let me impress upon you, two Boards of highly intelligent people were involved in this process, not two people but two Boards, and they tried very hard, both of them, to try to bring these two companies together. I would impress upon you that that is the

[**Mr Beard** *Cont*]

case; a lot of thought, a lot of time, a lot of effort went into this. At the end of the day, we differed in that approach and we believe that it was not possible to bring the two companies together in a way that we would have got all the benefits and the vision that we had anticipated at the beginning.

9. And what were the stoppers then, what were the stoppers that you had not anticipated?

(*Sir Richard Sykes*) I think you have to accept that two Boards recognised that this could not come to fruition, for the reasons that I have given, and that is what I am prepared to say about it.

10. But I do not think you have given any reasons, with respect?

(*Sir Richard Sykes*) I have given you a reason. We could not believe that if we could not get the management structure right to lead the new company into the future we could actually realise the vision that we had created in our minds for this new company.

11. Sir Richard, what I am getting at is, what was there in the management structure that proved so intractable that this adventure had to be aborted?

(*Sir Richard Sykes*) Because you have got different cultures and different styles of management in two companies. If you are going to bring them together to form a new company, you have to have a balanced management structure that is working together as a unified team to realise that new organisation. You cannot have a management structure that is not unified, the rest of the organisation, all that intellectual capital, will start to disappear, it will all start to go; and then, what is there left.

12. You knew all that at the beginning?

(*Sir Richard Sykes*) No, you do not know it at the beginning, you might see it as a potential risk at the beginning and you see the great benefit. We work through that process, to see if we could not deal with that potential risk; the answer, obviously, was that we could not.

Chairman: We may come back to that.

Dr Gibson

13. I am interested in vision, too. Were the visions of the two companies different and the two management styles, or whatever. Did you have different visions in terms of research and development, for example? And £88 million in 1996 from British business went into the university sector, was there any disagreement between the two companies about extending that, retreating from it, or what? Was it issues like that that you got into, the vision in the future for the research and development base in the Human Genome Project, or immune chemistry, whatever it was?

(*Sir Richard Sykes*) Remember, these discussions take place at a very sort of high level; no detailed discussions took place. When I talk about a vision, I talk about creating a pharmaceutical company that would be second to none in the world, that would have the resources and the skills to put into all the modern science and technology that we have access to today, to produce medicines of value in the future that we could bring to people throughout the world. That is the vision. It takes a long time to get to that vision.

14. So there was no difference between the two companies in the scientific thing?

(*Sir Richard Sykes*) No.

15. I share that vision, in terms of the Human Genome Project, as you know. But, anyhow, I wanted to ask about the levels of research and development activity within the two companies and expenditure and the manpower levels in the two companies; were there differences in the discussions there; did you want to get rid of 3,000 people and they wanted to get rid of 5,000, for example? How heavy was the discussion at that level; and do not tell me it does not happen because it does happen, even in visionary politics it happens?

(*Dr Niedel*) There was little disagreement, I think that we and SB share a quite common vision about where science is heading, and, as you know, they have made quite a large investment into genomics, genetics, ours is a little smaller, we have made a lot of investment in technology; we saw great complementarity, and I think we saw a very good fit in the R&D organisation. In terms of duplication, which you were hinting at, with 3,000 or 5,000, I think one of the things that was very clear was that we had all agreed, and I mean I had agreed, the people in SB had agreed, Sir Richard had, etc., that this was not about cost-cutting or losing jobs in R&D, and, in fact, that was very clear from the beginning; this was about two complementary organisations, that if put together would have been a world-beater. And, in fact, we would have found some duplication in R&D, but it would have been things like, we learn that both we and SB have to write a new clinical trials system, that will cost us between £25 million and £50 million in the next two years. You only need to do that once; if both companies do it separately there is £25 million or £50 million that cannot be reinvested into some scientific programmes. So that sort of duplication we would have weeded out. I have already mentioned, for instance, combinatorial chemistry; well we have made a huge investment and we could spread that into the SB organisation really with no cost, whereas they may have to expend additional revenue to achieve that. So that is where we would have had savings in R&D, but the savings would have been that sort of duplication and it would have been put back into the R&D organisation, and that was really a basic tenet, as we began the discussions.

Dr Kumar

16. Can I just press upon you, Sir Richard, what Mr Beard was saying, and, I am still not clear about the vision, the two different visions; I have your interpretation but I do not know of the two different visions you are talking about that existed. How far did you actually get; did you get 51 per cent agreement; or did you get 70 per cent; or did you get 49 per cent; because there must be, somewhere, some markers you were putting down that led you? Obviously we want to know at what point—was it 70, 80 per cent down the road—you pulled back? Was it

[**Dr Kumar** *Cont*]

as close as that? We want some figure from you that you can say that you got as far as that and then the whole thing collapsed, so some measure of evaluation from you?

(*Sir Richard Sykes*) You cannot put a quantification into something like this. Remember that SmithKline were in discussion with American Home; we came into this very late and very quickly once that information had been made public. So we had discussions with SmithKline, it was important to put out a communication, otherwise, of course, we would not be here discussing this today; that communication was very important to let people know that we were in discussions. It was only at that time that we started having detailed discussions about how we could possibly bring those two large organisations together; we are talking about teams of people, doing due diligence, working through that process in research, in development, in manufacturing, in information technology, in the operating companies throughout the world; we both operate in something like 70 countries around the world, we have something like 80 manufacturing plants, there is a lot of complexity, but dealt with at that level. But, of course, to pull all that together, to deal with all that intellectual asset, you have to have leadership, you have to have a process, you have to have a vision, and if you cannot do that then bringing it together would not justify the risks that are involved, at the end of the day, if you cannot reap the benefits. All this is about risk and benefit. When you bring two large organisations together, there is always going to be risk, because people's jobs are at stake, people's livelihoods are at stake, but if the benefits outweigh the risks then it has got to be worthwhile, at the end of the day. And it is an issue of risk/benefit, and we got to a point where we did not believe the benefits outweighed the risks.

Dr Gibson

17. Were the trade union organisations involved in these discussions, too?

(*Sir Richard Sykes*) Not directly, at that stage.

18. Do you recognise that they have some part to play in this whole process?

(*Sir Richard Sykes*) Absolutely; and if this merger had gone ahead, obviously, then they would have been firmly at the table, in the discussions.

Dr Jones

19. I would just like to pick up on my colleague's line of questioning, in relation to your previous experience with Wellcome; and, of course, although it was designated a merger, in effect it was a hostile bid and the Trust had to agree to sell their shares. This is actually a merger of two large organisations coming together by mutual agreement; that failed, but the hostile takeover succeeded. Are there any lessons in that?

(*Sir Richard Sykes*) There are serious lessons to be learned. Of course, with the Wellcome bid, you are quite right, we had a commitment from the Trust for their 40 per cent ownership, which, of course, when they got the money, created the largest medical charity in the world. Then it was just a question of time before we paid £9.5 billion to acquire the Wellcome organisation. In this case, this would have been called a non-premium merger, no money would have changed hands at all. So, therefore, the two companies would have come together to form a new company, and hence all the excitement about, one, the cost savings that you get out of an organisation like that without actually spending money in acquiring the organisation. So it is much more difficult to get the balance in a merger than it is in a takeover.

20. So might that lead to perhaps a different type of bid in future?

(*Sir Richard Sykes*) It could, but you have to recognise that, today, if you take Glaxo Wellcome, it is capitalised on the market at £60 billion; if somebody wanted to buy Glaxo Wellcome today they would probably have to pay £70 billion to £80 billion. If they paid £80 billion, £75 billion of that is intellectual capital; the tangible asset value of Glaxo Wellcome today is less than £5 billion. So all that money has to be dealt with somehow, and that means you have got to have very significant cost-cutting to deal with that tremendous sum of money that is being paid to acquire that organisation. It is almost impossible.

Dr Turner

21. I take it then that the fact that there was a hostile element in the Glaxo Wellcome merger accounts for the fact that, rather than getting overall synergy and growth in research and development, as you were looking for with the merger with SmithKline Beecham, the history of the Glaxo Wellcome merger was that, in fact, both companies, when they were separate, had growth and expenditure on R&D of between 13 and 25 per cent per year prior to the merger, and then negative growth for two years after the merger? So did that represent paying the cost of the merger; and does this have an implication for what would happen to research and development in any future merger or takeover, or some sort of hybrid animal, whatever we get?

(*Dr Niedel*) Let me just describe what happened. In 1994, if you combined the spend of Glaxo alone and Wellcome alone, on R&D, it was just a little under £1.2 billion, and, you are right, that over these ensuing three or four years we have held that fairly constant; as a percentage of revenue, we have also kept it constant. So both companies spent roughly 15 per cent of revenue on R&D, and this year, 1998, our spend is about, in fact it is, exactly, 15 per cent of revenue. And so what you are seeing is that both companies would have faced a revenue problem, Zovirax disappearing from Wellcome, Zantac disappearing from Glaxo. And so, simply because we are a business, we have to live within our means, if we had been two separate companies, both separate companies, I think, would have also flattened out their R&D spend, it would have been prudent business fiscal practice. We combined the two companies, we have been able to go through that in a very smooth way, and the outcome, I should say, is that, if you look at the productivity, which is really what is important, the productivity of R&D in the

[**Dr Turner** *Cont*]

combined company is now three-fold greater than in the two companies separate. So the synergies, the complementarity, that we captured by bringing those two companies together, has led to a three-fold increase in productivity, in terms of approvals, submissions, new molecules being discovered and taken into development for disease, and we have the data to support that. So that was what we were looking for, that increased performance, it does not necessarily require an increased spend, but what we were looking for was increased performance; we have got a three-fold increased performance out of the combined R&D organisation.

22. And was that apparent increased performance, as measured, definitely not a function of work that had been started years before coming through at the end of the lead time?

(*Dr Niedel*) Of course, it is a combination of all those things. When I talk about submissions and approvals, much of that work would have begun six or eight years ahead of time. But what we have done is we have tracked molecules coming out of research and going into development, and that is very much a short-term measure, those are programmes, in fact, the programmes that started since the merger are now bearing fruit, and last year we brought 18 new molecules into development, and the vast majority of those were programmes that had begun since the beginning of 1995. In 1994, the year before the merger, the two companies had brought six molecules into development. So just on that one measure there is exactly a three-fold increase in the output of the research phase, and the output of development is keeping pace with that.

23. And this increased productivity has been increased with a smaller spend on R&D?

(*Dr Niedel*) No, it is a constant spend, at about £1.2 billion; this year, our spend is just a little over £1.2 billion.

Chairman: A constant spend, a higher output?

Dr Jones

24. An increase in real terms; real terms?

(*Dr Niedel*) Yes, in real terms, because of inflation; it has been constant in absolute terms.

Chairman

25. A constant spend but a higher output and increased productivity?

(*Dr Niedel*) A constant spend, a three-fold increased output, greater productivity.

Dr Williams

26. I would like to ask Sir Richard: you have portrayed the breakdown in the merger talks during those 23 days as being sort of rival philosophies, as it were, or management styles or management structures, that when it came to analysing in detail somehow these two very large giants could not be merged. But the portrayal that I read at the time, in the financial press, the heavy newspapers, was very different; it was not a case that these large giants could not fit together, it was just that these five people, or two people, perhaps, at the top of the two structures, had these different visions and just could not sort out their differences. Did you find that the merger talks was an intensely personal affair, as well as being about these multi-billion companies?

(*Sir Richard Sykes*) No. In fact, I believe that everyone involved in this process negotiated in good faith through the entire three-week period. The negotiations that I was involved with personally, and I am sure it is true of others, were always very good negotiations, always conducted extremely professionally, relations were always extremely good, and there were not, in my opinion, any personality clashes involved here. And these decisions were being made not by two people, in fact, I do not think two people ever got together at any time in this process, it was always groups of people, and, of course, at the end of the day, the decisions are made by Boards, not by individuals.

27. Was part of the difference the difference between the company that was London-based, or British-based, whereas in SmithKline Beecham's case the leading people there wanted to be United States-based?

(*Sir Richard Sykes*) There is a difference in culture in those two organisations and there is a difference in management style, and, as I say, those are very significant issues, at the end of the day; somehow they have to come together. I do not think we went into this saying we have to end up as a Glaxo Wellcome, I do not think SmithKline went in saying, "We have to go and we have to be a SmithKline", we have to be something in-between, and it is getting that agreement and getting that unity that is so important, if you are going to succeed in a combined organisation.

28. I have to say, at a personal level, I do not know whether I speak for the Committee here, but I feel some sense of disappointment that this—what would have been a British-based, the world's largest, or whatever—company did not come about. I can see that Glaxo is still a very large organisation and with a very big business, but in terms of SmithKline Beecham where does this leave them, in that having been courted twice, as it were, into near mergers, does it not leave them very vulnerable to another possible takeover bid?

(*Sir Richard Sykes*) I think you have to address that question to Mr Leschly. But, as I said at the outset, remember, these organisations have to be driven today; if we want to be successful in ten, 15 years' time we have to be spending significant amounts on research and development today, simply because the Human Genome Project, the whole drive of genomics, pharmacogenomics, genetics and pharmacogenetics, are going to drive medicine in a very different way than we have ever seen medicine in the past. If we invest today, we will be there in ten years' time, and we will be very, very competitive in that environment. And so it is a question of how quickly to get there, how much power one can put behind that, simply because there is so much information available today, the technology is there to achieve the ends. And, therefore, our strategy is clear; this was obviously a tactic to reach our

[**Dr Williams** *Cont*]

strategic goal much quicker than we could do alone, we can still reach it, we can still do it, and I am sure that is still true for SmithKline.

29. Can I just ask, finally, is it possible for merger talks to re-open, or are there Stock Exchange rules that prevent that, over a certain period?

(*Sir Richard Sykes*) No. There are no Stock Exchange rules that would prevent merger talks re-opening, and they certainly could re-open. There are certainly a lot of rules regarding what can be said by companies when they enter into a merger discussion, and that is why, of course, not a lot was said during this time period, because there are very strict rules, from the Stock Exchange, about what can and cannot be said by companies who are actually in merger discussions. But that could re-open. Again, there are no inhibitions on that process starting again.

Mr Beard

30. Sir Richard, you mentioned earlier how important good morale and security are to harmonious working, to get the best out of a research and development organisation, and yet the process of merger is a very destabilising period, where people are not too sure whether they are going to inherit the same job; or whether someone is going to come in from the other company and they will be made redundant; or whether certain teams are going to be kept on, or whatever. How did you overcome that, in the Wellcome/Glaxo merger?

(*Sir Richard Sykes*) Through communication. I think the critical issue here is to communicate, communicate and communicate, to make sure that people understand what is the vision, where are you trying to go, what are you trying to achieve, and how are you going to do it. So we quickly put together a group of people that were a mixture of Glaxo people and Wellcome people to form an Integration Committee, and that Integration Committee then quickly set about pulling all the research, all the development, all the manufacturing, all the operating companies together, and, in fact, those two companies were given regulatory approval in March of 1995, and, I can tell you, by the end of 1995, with a few exceptions in manufacturing, because it takes a lot longer to do that, most of the functions within the two organisations were acting as one and they were actually working together. So it is very important to make quick decisions, communicate them, and make sure that everybody understands what the process is, and that way it goes very smoothly, and I think that was true in R&D as well.

31. How long did it take for the R&D to settle down, because there must be a period of turmoil when it is not settled at all and, in fact, the exercise is somewhat counterproductive?

(*Dr Niedel*) Yes; and I think, when Sir Richard spoke about risk/benefit, obviously the risk is what we are describing right now, is how badly do you destabilise the organisation. Just to give you some measures, we began integrating with Wellcome in the middle of March, I think it was 16 March, and by 30 or 31 July, all of the research people in the company knew what their job would be, who their boss would be, where they were located and what project they would work on; so very quickly we tried to give stability by making sure that the people who were staying knew exactly what they were doing. At the same time, there were some people who left, and it is documented in the paper we submitted; those people were treated fairly, they got what we think were quite reasonable and generous redundancy terms, and I think how you treat the people who leave also influences morale. By the end of the year, R&D had a meeting of the senior management, it was clear that we had coalesced again and were feeling quite positive. And we track a number of measures, and one of the measures, for instance, is turnover, how many people are leaving the company. Before the merger, in 1994, in fact, in the early nineties, that number was generally just a little above 5 per cent; in 1997, it was 3.9. We track things like absenteeism, illness, we have a company that deals with employees' stress, called EAP, so we track our employees—it is all anonymous but at least we get the numbers, and so we track that. By those measures, the morale, the enthusiasm for the organisation today is as strong or stronger than it was in 1994, and that is reflected in the productivity, you do not get a three-fold increase in productivity if the employees in an intellectually-driven activity are not pleased with their work surroundings.

32. In that case, you, Glaxo, were in charge of the organisation; in this prospective case you would not have been, you would have been much more a partnership. Would not that have brought in added difficulties?

(*Sir Richard Sykes*) Yes, of course, it is much more difficult when you have got two sides that have an equal say in how the process is brought together, and, of course, mergers are always more difficult, it is recognised that they are going to be more difficult than takeovers. But, of course, in a takeover, when you buy something, you want to make sure you are getting value for money, you do not want to destroy it. So, in the case with Wellcome, we said to everyone, both in the Glaxo organisation and in the Wellcome organisation, everybody has to be matched so we can say we want the best of both organisations, and that is what you would have to do in a merger as well.

Chairman

33. Thank you, Sir Richard. We are going to go back to Dr Turner, but, just before we do, we have listened very carefully to all the comment you have made about the breakdown of your talks, but could I just draw your attention to a press release issued by SmithKline Beecham after the breakdown of talks on 23 February, in which they said, amongst other things: "Glaxo Wellcome indicated that it was not prepared to proceed on the agreed basis ... despite considerable effort on the part of SmithKline Beecham ... Glaxo Wellcome has been unwilling to proceed on the agreed basis." Now, you are free to comment, or not comment, just as you wish, but that is a press release that the other company did issue. Would you care to comment, Sir Richard?

(*Sir Richard Sykes*) I would just say to you again that as we went through these negotiations we went through them always in good faith, and, of course,

[Chairman *Cont*]

negotiations are negotiations, you might start at a position here, you might finish at a position here, but nowhere through that process was anything agreed until it goes to a Board at the end of the day. And all I would say is that at the end of that time SmithKline were the ones that broke off negotiations, not Glaxo Wellcome.

Dr Gibson

34. Is it true that your shareholders are in revolt?

(*Sir Richard Sykes*) You had better ask the shareholders that; not to my knowledge.

Dr Turner

35. The failure of this merger proposal has obviously led to speculation about further moves likely to happen within the pharmaceutical sector, and, clearly, one must ask whether the same factors are still at work in the industry. Do you think that the British pharmaceutical sector is still sufficiently fragmented to give a need for further mergers, and, if any further mergers should happen in this sector, do you think this would be good, or bad, for the UK?

(*Sir Richard Sykes*) Consolidation will take place in the world pharmaceutical industry, that just does not apply to the UK, and it will take place mainly because of the two pressures that I mentioned earlier, science and technology, on the one hand, economics, on the other. So throughout the world the cost of health care is rising, and, of course, Governments who pay for health care, people who pay for health care, want to contain the cost of health care. Pharmaceuticals, obviously, are becoming more and more valuable in the way they contribute to health care, and therefore they come under pressure of pricing, and that happens in every country in the world. So, as the pressures come down on this industry, and, of course, the pressures in science and technology are the fact that that is positive, because tremendous scientific advancements are being made, and in the technological area, there is going to be pressure to bring more and more of these companies together, because all these events are scalable. If we today go out and build clinical genetic databases, so that we not only know the phenotype of the patient but also the genotype, it probably costs something like £200 million just to get one clinical genetic database; that database can be used by one company or ten companies. So all these very, very expensive activities are scalable, and that is going to actually drive consolidation, simply because this is a very highly fragmented industry. We have today something like 4.9 per cent market share; now, will that be good for the UK, it should be good for the UK, because the UK has a very strong pharmaceutical industry, it has a strong pharmaceutical industry because it has a very strong science base, it has a very strong clinical base. And, of course, provided we keep putting money into that system, providing that the education system remains strong, providing that the research base remains strong in this country, then why would not people invest here, because, at the end of the day, this business is all about science and technology?

36. Can I follow that with a sort of very direct question? Are you looking for an alternative partner to SmithKline Beecham?

(*Sir Richard Sykes*) We have a clear strategy as to where we want to go; if we see that there are tactical ways of getting there quicker then, obviously, we are going to look at them, and I think that is our responsibility. We are committed to Britain, we are committed to the British science base, and if we can put more money into research and development to make this company more competitive in the future then we certainly will.

Mr Beard

37. Sir Richard, between the two companies that were involved in this you had some 20 per cent of all UK civil research and development in your hands, £2 billion compared with Government research funds of £1.3 billion, and so whatever you do is going to have very major implications for the United Kingdom's biotechnology, bioscience and pharmaceuticals industry; and yet the public at large are faced with an off/on, that we have been talking about, and the reasons for the off/on, to be frank, are somewhat abstract, in the way you have represented them. How would you reassure the public that this major national asset is safe in your hands, at this rate?

(*Sir Richard Sykes*) I think you perhaps have to look at, you have to look back and you have to look at how the company has developed in a global sense; it is today the biggest company in the UK, in terms of value; you have to look at our strategy for the future and then shareholders have to make that decision. If I appear to be evasive, I am trying to explain that you cannot just put two companies the size and complexity of Glaxo Wellcome and SmithKline Beecham, 100,000 people, together and just expect it to happen, it cannot happen, it has to go forward in a very, very clear way. We are dealing with a lot of sensitive flowers. In the UK, we employ 5,000 people in research and development, 80 per cent of them have a bachelor's degree, a PhD, or an MD. You cannot just mess people around like that, they have to have a clear vision of where you are going, and they have got to have leadership, and it is very critical that that happens, otherwise the whole thing might be a disaster.

Dr Gibson

38. Do you think mergers are a substitute for capital investment, and the reduced competition? Do you think that is the philosophy behind merging? what is the philosophy behind merging? I know you have the vision, and so on, but in capitalist terms what is the message in mergers? Capital investment goes down?

(*Sir Richard Sykes*) The message in mergers is that if you do a non-premium merger no money changes hands, and, therefore, in this case, it would have been the 60/40 merger, 60 per cent of the company would belong to Glaxo Wellcome shareholders, 40 per cent would belong to SmithKline Beecham shareholders, and that is how you put the two companies together, that is the agreement of the split, but no money changes hands. In a takeover, there you are talking

[Dr Gibson *Cont*]

about a very different situation, but you would end up, of course, with the same company, at the end of the day.

Chairman: Sir Richard, I am sorry to interrupt you but, as you can see, we have a division. I am obliged by the Standing Orders to suspend this Committee for the time being. We are enjoying this session very much and finding it very useful; whether you are or not is another question. But I would be very grateful if you would just bear with us while we suspend for ten minutes and then come back after the division. I declare the Committee suspended until 17.40. Order.

The Committee suspended from 17.30 to 17.39 for a division in the House.

Chairman: Order. We are resuming a minute earlier than I said, but I think everybody is back so we will resume, and may I again thank you, Sir Richard, and Dr Niedel, for your patience in the interruption, which was beyond our control. Mr Beard.

Mr Beard

39. This question involves the presumption that a merger on the greater scale brings greater benefits, and I can see that entirely on the financial side and on the amalgamation of sales forces and others where there are probably duplicate efforts. I find it more difficult to see exactly where you were brought to a stop on research and development, because, for instance, if you have two organisations with work going on in the same therapeutic area, it may well be that it would be very unlikely they are taking the same approach, and by keeping the two going you double the chance of getting somewhere in this area. So what are the criteria for getting the best out of this sort of merger of research and development, because one can see many ways where you could end up with two and two making one and a half?

(*Dr Niedel*) Although the question was brief, the answer could be very long and complex, because you are talking about the fundamental problem of leading a complex organisation like R&D. First of all, if this merger had gone forward, I think your premise is correct, if there were two groups and they had equally good ideas but they were different for cardiovascular or cancer, both of those groups would have kept going. The advantage would have been that both groups now would have had the latest technology available, so that the people in SmithKline Beecham could have had access to combinatorial chemistry, the people in Glaxo Wellcome could have had access to some of the SmithKline genomics. And so what you would have done is taken the scientists with very good ideas, working on good programmes, and given them better tools with which to tackle those problems; so that is the idea of economy of scale, of scale, basically. All of those tools are very expensive, and, as Sir Richard said, the key is they are scalable, which is an important concept, and it is different from the laboratory in the past. If you thought about a scientific laboratory as recently as ten years ago, you would have one leader, two lead scientists, a few technicians, a spectrophotometer, a centrifuge, etc., and so every small cluster of scientists required this cluster of equipment, and so if you were twice as big you needed twice as many of these pieces of equipment. That is not true today, the technologies that we are investing in, you would make one big investment and that can take care of the needs of ten scientists or 10,000 scientists just as easily; once you invest in combinatorial chemistry you can distribute that technology across all of the sites. But the company that we purchased, Affymax, their technology could supply the entire pharmaceutical industry, so you can see that it scales very easily; and that is true for everything, that is true for all of the information systems, it is true for the genetic clinical networks that you would set up. And so I think what you would do is take very fine scientists, working on good programmes, and give them absolutely first-class tools and then let them get on and do it, just as they would have gone on and done it ten years ago, but you give them really fine tools today.

(*Sir Richard Sykes*) I think, another point which is very important is, it is not just a case of throwing money at something like this either, we would have increased our budget from £1.2 billion to £2 billion, but, more importantly, we would have had the skills to take that money and utilise it effectively. So skills are just as important today as money, and skills are more and more difficult to come by; as we are driven by science, the science is actually outpacing the skills that are coming out of our academic environment, and, therefore, they are always trying to catch up. But we are always trying to find those people, and, of course, as big organisations in this country, we are always vying for those highly skilled people that we need to run our businesses. So that is also important. There would have been tremendous synergy there, bringing those skills together.

Dr Gibson

40. Have you any worries about those skills carrying on, because we have been investigating what has been happening to our science base, and we actually have a report coming out tomorrow, and there are worries amongst scientists about what has happened and what needs to happen? You agree with that? So our base is perhaps not sound, five, ten years down the line?

(*Sir Richard Sykes*) Absolutely. You have seen very clearly what came out of the Dearing Report and what the recommendations were, in terms of the science base in this country, it has certainly deteriorated, and what has deteriorated, of course, is the infrastructure. Although today, if you go to Stevenage, which is the Medicines Research Centre that we have, it is probably one of the finest medicines research centres in the world, you would not find equipment that you find there in any university environment. If you go 20 years back, we would have had to have gone to the university to use the equipment, because we did not have it; today, of course, it is the other way round, because that infrastructure has deteriorated. And so, in my opinion, we need to be cognisant of the fact that money needs to be put into the scientific infrastructure to make sure that we create the environment in which to develop our next generation of scientists. That is just one major problem.

Mr Beard

41. Just going back to what you were saying about where the origins of benefit come from when you are merging the research and development—I understand entirely what you are saying—but could you explain why, when you were dealing with the Wellcome merger, after the merger, as my colleague, Dr Turner, pointed out, the growth in research and development came to a virtual halt, compared with what the two companies were doing before?

(*Sir Richard Sykes*) The growth, in the sense that, what we had to do in 1994 was recognise how the changes were taking place in the industry, we knew that, and that is why we went into this process. We had to completely reskill the organisation, and we took that opportunity, during the merger, to take all those scientists and technologists, in this case, to reskill the science base within the company. And, therefore, taking that opportunity means that for a period of time you are going to decrease, or not decrease but hold that investment, and I think you have heard Dr Niedel clearly state that what has happened, of course, by reskilling, changing the technologies, bringing in new technologies, we have now changed the productivity of that organisation quite substantially. But you must understand that both companies were going to lose very substantial sales. If we talk about the investment in R&D being 15 per cent of sales, Zovirax was the biggest product in Wellcome, Zantac was the biggest product in Glaxo, in 1997 alone we lost $1 billion of sales from those two products in the United States, and yet we continued to grow this business.

Dr Jones

42. What happened to your shares, your dividends, in that period when your research base was held steady?

(*Sir Richard Sykes*) They grew at the rate that the company grew at, which was in single digits, low single digits.

Chairman: Sir Richard, we are coming to the end now, but you did appear before the predecessor Committee, I think, in 1995, and you talked about Glaxo Wellcome. The Committee would just like to look back a little bit, and particularly the two Committee members that have given continuity to this Committee, Dr Williams and Dr Jones, each one of them in turn would just like to ask questions about what did happen with the merger with Wellcome, just as a sort of check-up, if you like, to see whether the expectation that you had at that time came about. So, first of all, may I ask Dr Williams, and then Dr Jones.

Dr Williams

43. Already you have gathered from us that we are not very happy about the total research and development budget and that it has been sort of fairly static in total since the merger, but financially and in terms of world sales or share of the world market, how would you rate the result of that merger?

(*Sir Richard Sykes*) I think it has been an excellent success. As I just explained to you, we have, this year, in 1997, grown the sales by 5 per cent, and yet we lost two major patents during 1997, that of Zantac, which was the largest-selling drug in the history of the pharmaceutical industry, and Zovirax, which was also a very significant drug, in terms of sales.

Chairman

44. Please explain "lost"; you lost the patents, you said?

(*Sir Richard Sykes*) They ran out; sorry.

45. Fine; okay. I did not think it was carelessness!

(*Sir Richard Sykes*) It could have been carelessness, but they ran out.

Dr Williams

46. Could I just add one little postscript, as well, and that is that, in terms of sales, only 7 per cent of your world sales are actually in the United Kingdom; what proportion of your research and development is in the United Kingdom?

(*Dr Niedel*) It is about half, and, in fact, if you take the total sales revenues in the United Kingdom, that is almost exactly what we spend on R&D, so all of those pounds go directly into R&D, in the United Kingdom; both are at about £500 million.

47. And what would be the figure for SmithKline Beecham? Are they mainly UK-based, in terms of their research and development?

(*Sir Richard Sykes*) I do not know the answer.

(*Dr Niedel*) I probably knew the answer during the 23 days but I have forgotten. I simply do not remember the figures.

48. I take, and you do as well, great pride, national pride, in the pharmaceutical industry, in really what is a relatively small island, with this company, with its wonderful world sales, yet you retain a half of the research and development; it speaks very highly for the science base in the UK.

(*Dr Niedel*) And my guess is that SmithKline is close to that, although I cannot remember exactly.

Dr Jones

49. Can I take it, from what you said earlier, that you are intending to actually start to increase your spending on R&D in the future?

(*Sir Richard Sykes*) Yes. As we go through 1997-98, we have a year in which we are relatively flat, in terms of increasing our sales worldwide, because of these patent issues with the two big drugs. As we go through the latter half of 1998 into 1999, we have got that behind us, those sales are now washed through the system, and today 83 per cent of our business is about new products, it is about new products that have been introduced since 1990, and they, in 1997, grew at around 13 per cent. So we are back into that double-digit growth rate. When we get back into that double-digit growth rate then we will be putting more of that revenue into research and development.

50. And could I ask what happened to your scientists after the merger; do you have more; or fewer; there seems to be some dispute about exactly the numbers involved?

[Dr Jones *Cont*]

(*Dr Niedel*) In the UK, and I think it is in the paper we submitted, the scientific staff is about 150, just a little less than 150, individuals smaller today than it was in 1994.[1] So, through the merger, about 600 people left the company, over that year, and the next year we hired back about 450 other people. I think the other thing to remember there was, with an organisation that is about 5,000, you have a normal turnover of about, as I mentioned, we have normal turnover of 5 or 6 per cent, so in any one year you would expect about 300 people to leave R&D anyway, and after the merger about 600 people left, and they left for various reasons. Obviously, if you open the premier research centre, as Stevenage is, not just in this country but in the world, what you would like to do is have all of your scientists have access to that, and so we did move scientists from the Greenford site, from the Ware site, from the Beckenham site, up to Stevenage; not everybody chose to make that move, and so some people went out to do other things.

51. So how do you respond to suggestions from IPMS and others that you lost about, I think they said, 2,000 job losses in R&D?

(*Dr Niedel*) No, it is not true.

52. And what do you think is going to happen in the future; are you likely to be employing more scientists? Again, the trend nationally has been, in the last ten years or so, fewer scientists employed in R&D; are you going to buck that trend?

(*Dr Niedel*) It is hard to predict specifically, but my belief is that as we begin to increase the R&D budget a significant part of that, probably half of that increase, will be spent here in the UK, and that will mean that there will be increased scientific positions. One of the difficulties, we talk about these jobs as if they are all equal, and, of course, they are not, there are skills that are in critically short supply, which gets back to the scientific base. Geneticists, which is crucial, it is difficult to find geneticists in the UK, it is difficult to find people in bioinformatics and chemoinformatics, in computing, two of the key disciplines for our industry and probably the health care industry in general. And, in fact, we and SB are co-operating on pulling a consortium together of the pharmaceutical industry, to begin funding fellowships for bioinformatics specifically, because we recognise it is an enormous shortage. So all jobs are not created equal, and, when we look to the future, this idea of being skilled for the future, there are key skills that we will need, and we will look for those, and we and other companies, just to be honest, will go where those skills are, because that is the life-blood of our company, and so if we can find good bioinformatics, chemoinformatics, chemists, geneticists, here, we would much prefer to employ those people here, because of the enormous infrastructure and capital base that we have in this country.

53. And if the merger had gone ahead, would we be in the same scenario, because certainly your memorandum to the Committee, Sir Richard, did mention that there may be job losses?

(*Sir Richard Sykes*) I think, in any major reorganisation of that kind, you would expect to get job losses, but, I have to make it clear to you, the driving force for this merger was to invest in research and development and to utilise the skills of both organisations.

Chairman: I think that might be a good point on which to finish, unless there is another sentence you wish to add beforehand, but it is a very positive point on which to finish. And so it just falls to me now, Sir Richard, and Dr Niedel, to thank you very much indeed, in difficult circumstances, for coming before this Committee to explain a situation that was not entirely clear to us, to make it as clear as could be, I think. We wish you well in the future, as an independent company, until such time as something else might happen. But we have stayed, I think, both of us, namely, yourselves, as witnesses, and us, as a Committee, within all the rules of takeover and Stock Exchange procedures; we have been very careful, as you have, too, not to breach any protocols in that regard. We have found the dialogue with you this afternoon of great value; we thank you once again for your patience during the course of the division and for giving up time from your work to be with us this afternoon; and we thank you both.

[1] *Note by witness:* Glaxo Wellcome today actually employees some 650 fewer scientists and technologists than were employed by Glaxo and Wellcome separately before the merger. While some 600 left during the merger under redundancy terms 450 new scientific staff have been recruited since the merger. However, in addition to those taking redundancy, other members of staff have left the organisation through normal retirements and resignations.

WEDNESDAY 22 APRIL 1998

Members present:

Mr Nigel Beard	Dr Ashok Kumar
Dr Ian Gibson	Mrs Caroline Spelman
Dr Lynne Jones	Dr Desmond Turner
Mr Nigel Jones	Dr Alan W Williams

In the absence of the Chairman, Dr Lynne Jones was called to the Chair

Memorandum submitted by SmithKline Beecham plc

CONSOLIDATION IN THE PHARMACEUTICAL INDUSTRY

1. Introduction

SmithKline Beecham (SB) is a healthcare products and services company focused on pharmaceuticals. SB discovers, develops, manufactures and markets human pharmaceuticals and vaccines, over-the-counter (OTC) medicines and health related consumer products. It also provides healthcare services including clinical laboratory testing, disease management, and pharmaceutical benefit management. Perhaps more than any other healthcare company, SB is at the leading edge of the rapidly evolving technologies which are transforming healthcare.

SB is a British company which makes a substantial contribution to the UK economy. We employ about 8,500 people in the UK from a total of 55,000 worldwide. Our exports from the UK in 1997 amounted to almost £1.2 billion. We have recently invested £250 million in our R&D facilities at Harlow, and have a long track record of support for the UK biotechnology sector.

SB's success is built upon research to discover, develop, manufacture and market new medicines. 1997 spend on R&D was £841 million worldwide, of which about £293 million was spent in the UK. The company's total expenditure on R&D has grown from £390 million at the time of the merger of SmithKline and French and Beecham. Although 35 per cent of our total R&D spend is invested in the UK, our UK sales are only 5 per cent of global sales.

2. SB's Support for the UK Science Base

SB is one of the most active supporters of the UK academic science base. Our support encompasses a range of collaborations, including individual studentships, consultancy agreements, research grants, the Shared Equipment Initiative and leading participation in multilateral LINK schemes and Foresight Challenge Awards. In these collaborations, we are providing an intellectual as well as a financial contribution.

SB is also active in providing sustained training at the undergraduate (approximately 120 sandwich studentships) and postgraduate (approximately 150 CASE PhD studentships) levels. For discovery-associated research activities, consultancies and non-clinical development, our annual spend on the academic science base in the UK is about £7 million. Much of our UK academic research spend is at the individual project grant level, but we have a major collaborative agreement with Cambridge University.

We also make major investment in external clinical development activities and this can include a significant proportion of novel research effort. For example, through the Foresight Programme, SB has come together with the British Heart Foundation, the Wolfson Foundation and Addenbrooke's NHS trust in a £16 million consortium to create the Cambridge Cerebrovascular Centre.

3. Industry Consolidation

There are strong pressures towards consolidation in the pharmaceutical industry. Competitive R&D in pharmaceuticals and healthcare, for the discovery, development and delivery of new and better medicines, now demands unprecedented scale, constant adoption of new skills and stringent focus on productivity. Future success will be predicated on the ability to utilise leading-edge science and technology to understand disease mechanisms and to accelerate the delivery of better medicines to patients across the world.

Leading edge research is becoming increasingly expensive—the cost of R&D for a major new chemical entity has risen tenfold in the past 20 years and is estimated now to exceed £300 million. At the same time, purchasers everywhere are seeking to contain the cost of healthcare. It is this background—the twin pressures of maintaining critical mass in R&D in a cost-constrained environment—that has encouraged consolidation in the pharmaceutical industry.

4. Rationale for the Merger

It was announced on 30 January that Glaxo Wellcome and SmithKline Beecham were in detailed discussions with a view to merging the two companies. The proposed merger would have created the world's leading pharmaceutical group, based in the UK, with the largest research and development organisation in the global healthcare industry.

For SB, the merger would have represented one response to the environmental challenges confronting the pharmaceutical industry. SB is at the leading edge of the rapidly evolving technologies which are transforming healthcare. As a result, we are generating unprecedented opportunities for the creation of innovative drugs, vaccines and diagnostics, as well as generating powerful new approaches to the identification of disease risk and prevention. A key driver of the merger for SB was therefore to create an R&D organisation to expand and accelerate the delivery of new healthcare products to diagnose, prevent, treat or cure disease.

By combining the respective strengths of their existing R&D organisations, the merger of SB and GW would have retained a powerful base for UK science by creating a powerful scientific skills and technology platform from which to discover and develop new medicines. Both SB and GW currently devote significant resource to improving the development processes of new medicines with the aim of reducing costs and timescales.

The merger would have created an opportunity to pool development resources and to draw on the "best practice" in the two companies.

5. Employment Implications

The merger would have represented the latest example of the consolidation that has been taking place in the pharmaceutical industry over the last 10 years. During that time, industry employment levels in the UK have been stable—almost 76,000 people were directly employed in 1990, compared to an estimated 75,000 in 1996. It is inevitable that mergers produce ambiguity and concern for employees until the new organisational structure and individual roles are defined. However, the rationale for the merger was to sustain investment and leadership in R&D, to create an R&D powerhouse, not cut costs.

The Committee may wish to note that the merger of SmithKline and French and Beecham in 1989 did not lead to losses in UK R&D jobs. Pre-merger, SK&F and Beecham separately employed 2,037 permanent staff in R&D, together with 35 temporary staff—a total of 2,072 in the UK. In R&D, SB currently employs 2,025 permanent, together with 201 temporary staff and 1,123 consultants and temporary staff from agencies—a total of 3,349 in the UK.

6. SB's Future

On 23 February the merger discussions were terminated. In the event of mergers in sectors such as pharmaceuticals, it is important that cultures and structures are aligned if the full potential of the intellectual assets are to be realised. It became clear during discussions with GW that the required alignment would be impossible to secure.

SB and GW had agreed the fundamental principles underlying the proposed merger before any anouncement was made. These principles were documented and agreed by SB's Board. We understand from Sir Richard Sykes, as Executive Chairman of GW, that they were also approved by the Board of GW.

The principles were that this was to be an equal merger of two strong British companies, retaining the best people and sharing the best practices of each. After three weeks of intensive further discussion on more detail, GW walked away from those principles, saying they were unable to proceed on that basis.

The potential value of the merger was dependant upon these principles. SB made intensive efforts to return to the agreement in order to deliver the potential shareholder value anticipated. Our non-executive directors met privately to consider all options. Our non-executive Chairman initiated contact with GW's Deputy Chairman. However, GW were not willing to proceed on the agreed basis.

SB's Board decided unanimously that there was no purpose in continuing further discussions since GW had walked away from the agreement. We perceived the way GW wanted to proceed as a takeover. We are not another Wellcome, and we had to act in the best interest of shareholders and employees.

The merger offered a clear opportunity, and represented one tactical means of taking forward SB's strategic vision. However, as an independent entity, the company retains a strong commercial position with excellent growth prospects from an impressive R&D portfolio.

We have indicated above the enormous number of leads being generated by our leadership in new technologies. Competitive success in the pharmaceutical industry will be influenced increasingly by competency in the planning and conduct of R&D. This demands:

— requisite scale and critical mass in R&D
— research leadership in core technologies
— an extensive, global alliance network to ensure proactive capture of an array of new technologies
— superior management of technical complexity both internally and across alliance networks
— positioning the use of pharmaceutical products within a broader framework of integrated healthcare in concert with new molecular diagnostics and the increasingly sophisticated assessment of variations in patient responses to therapy (pharmacogenomics) and differing individual patterns of susceptibility to disease (information-based targeted care)
— attraction and retention of worldclass talent in science, computing and medicine.

SB is confident of its strength in each of these prerequisites. We have an impressive record in adopting state-of-the-art R&D methods and in re-engineering key R&D processes to enhance productivity. We have proven experience in successful development and registration of new products—indeed, we have recently announced that we have 60 clinical development programmes currently underway.

Our launch of new technology-driven initiatives in diagnostics and information-based healthcare makes us a highly attractive partner for collaborations, spanning the full spectrum from advanced research in academia and new entrepreneurial companies to more traditional in-licensing strategies. And the expertise of the company in the emerging areas of molecular medicine and healthcare services also make it an attractive partner for commercialisation of products and services beyond pharmaceuticals such as molecular diagnostics and new services in pharmacogenomics and patient risk profiling.

We also believe SB is well-placed to attract and retain the best candidates in science and medicine. The dramatic pace and scope of today's technological advances means that ever fewer researchers enjoy comprehensive access to the state-of-the-art equipment, faciltities and world-class colleagues needed for leadership in R&D. The intellectual, technical and organisational resources available to R&D personnel within SB rank among the best in the industry. This will be a significant motivational factor in enabling the company to retain, and to attract, personnel with world-class credentials, both as employees and as collaborators.

7. Conclusion

Further consolidation in the global pharmaceutical industry is highly likely. Some rationalisation and restructuring of operations will be inevitable in the merging of global R&D organisations. However, since R&D will continue to be the basis for future growth, successful mergers are likely to be those which seek to build more effective R&D operations, rather than simply aiming to reduce costs. In this regard, the UK is well-placed for future investment as a result of its long tradition of scientific and technological excellence and its outstanding track record in drug discovery and development.

However, it cannot be taken for granted that the UK will remain as attractive a location for pharmaceutical R&D. The serious shortage of funding for scientific facilities in our universities over many years, together with weakness in science teaching at every level of our education system, are now causing major problems for pharmaceutical companies seeking to recruit R&D staff in the UK. The problems have been highlighted in the Dearing Report and by the recent Report from the Science and Technology Select Committee which recommended, inter alia, that "...a real and urgent need for the Government to provide additional resources to resolve the immediate crisis in research infrastrucutre in the UK's universities...be treated with the utmost priority in the Comprehensive Spending Review.

Unless the growing flaws in the UK science base are urgently and effectively addressed, there is a danger that the UK's long-standing strength in pharmaceutical R&D could be eroded. This would make UK R&D facilities more vulnerable to future consolidation in the global pharmaceutical industry. SB's commitment to the UK science base is well-established. We will work with Government, the scientific community and other interested parties to ensure that the rich tradition of UK science and technology continues into the next Millennium.

17 April 1998

Examination of Witnesses

MR JAN LESCHLY, Chief Executive and DR GEORGE POSTE, Chief Science and Technology Officer, SmithKline Beecham plc, were examined.

Dr Jones

54. Mr Leschly and Dr Poste, thank you very much for coming to meet us today. Your appearance before the Committee seems to have generated a considerable interest and you are very welcome here. We have already received your memorandum to the Committee, in which I note you mention our recent report on higher education and the research base, and thank you for that recognition. What I propose to do is launch straight into our questions but if, at the end of the session, there is anything you think we have missed or any points you would like to make, there will be an opportunity to do so. If I can kick off with this question: what were the factors that led you to consider a merger with Glaxo Wellcome?

(*Mr Leschly*) As you know, SmithKline Beecham was a merged company between an American company called SmithKline Beckman and the UK company Beecham, so we have had experience in mergers, and we have had a very successful merger, I think you will agree with me. Over the last eight years we have come from being two good companies to become a major force in the industry. So it was based on that experience and based on the environment we are now living in, where health care is changing dramatically (and I know you are very familiar with this so I will not go into the details) and most importantly the way technology is changing. The way we do research and the demand on research to be productive and develop new medicines is becoming more and more demanding, and at the same time the tools available, what we call the platform technologies that you also are familiar with, those platform technologies have really made a revolution in the way in which we conduct our business. Because of the importance of what drives our business, namely research and development, we are constantly looking for opportunities for how we can strategically position ourselves better for the future. The discussions we have had with Glaxo Wellcome were not something new, we are constantly reviewing opportunities for this. It goes back several years, when we have had other discussions with other companies on how we possibly could impact our ability to further strengthen the engine, if you like. The real opportunity for us with the discussions we had with Glaxo Wellcome was: could we possibly merge two strong engines, the engines being R&D which drive our business. We consider ourselves, as I mentioned before, a very strong company, we do not need to do a merger, we did not ask for a merger, in fact when Glaxo called us—remember that—we certainly said we were interested because we have a fiduciary responsibility for getting into these discussions, and we could see, also based on previous discussions, that there were opportunities here for merging these two engines, not only to become a much bigger research organisation but most importantly to become a more productive and more efficient machine we could drive products through. Maybe I could ask my colleague, Dr George Poste, who can explain to you the real benefits of merging these two engines.

(*Dr Poste*) I have little to add in the broad strategic vein but, as you heard from Sir Richard and my counterpart, Dr Niedel, there is a very close concordance in the vision of how science will impact human health and medicine in the coming years between our respective companies. We have had a lot of discussions about that, many of our scientists know each other well and, as you heard from the Glaxo Wellcome testimony, cost, complexity and scale are now interlinked. The cost of R&D is escalating dramatically, the complexity of much of the science as well as the range of science you have to bring together is growing, so there is an organisational complexity. Then there is this issue of scale and, as Dr Niedel explained to the Committee last time, scaleability. These platform technologies which Jan referred to, such as advanced genetics, combinatorial chemistry and bio-informatics, are becoming dauntingly expensive, and what we call the table stakes, how much money you have to invest even to be a participant in some of these, is in fact alarming for all of us in the industry. Therefore bringing together, as Jan indicated, two very strong companies, both acknowledged as research leaders in their own right, really did merit serious examination and there would undoubtedly be very tangible advantages from not having to duplicate some of those expenditures. Once you have made the level of investment to critical mass, it is then scaleable, as Dr Neidel told the Committee, across a very large number of scientists and a very large number of sites.

55. What made Glaxo Wellcome a more attractive partner than American Home Products, which you were having discussions with at the time you received the call, I understand?

(*Mr Leschly*) We had, as I am sure the Committee is familiar with, very preliminary discussions with American Home Products. I think it is very obvious why we were interested in speaking to Glaxo. SB is a British company, Glaxo is a British company, SmithKline Beecham is owned 65 per cent by shareholders in the United Kingdom, so that fundamentally is a very good reason why Glaxo Wellcome together with SmithKline Beecham would be a better merger. At the same time, as Dr Poste just indicated to you, we have a very good knowledge of how Glaxo Wellcome conduct research. We have, as you maybe are familiar with, an agreement on research with Glaxo Wellcome to do the sequencing and the genome of micro-organisms, so we have over the years worked very closely together with them in many ways. I know Dr Poste knows Jim Neidel very well, so we have a good familiarity with them and therefore were very confident that when we talked to them about merging these two engines it made a lot of sense. That is basically the reason why we considered that a better opportunity.

[**Dr Jones** *Cont*]

56. Obviously Glaxo was an attractive research partner. Was there any Government pressure in this?

(*Mr Leschly*) Not to my knowledge.

Dr Gibson

57. Were there any indications from Government at all that this was a good thing to do for the country, for the nation, for science, for the millennium?

(*Mr Leschly*) I did not, personally, and I do not think anybody from my company had any contacts with the Government. You have to understand that it was very difficult for us to discuss anything out of a very, very small circle, so I personally did not have any contacts with anybody from Government, and to my knowledge there was no pressure from the Government.

Dr Jones

58. Both companies have said the merger created an opportunity to develop research and development, the synergies there, there were a lot of advantages to creating this powerhouse; were there any other benefits which are not related to research and development?

(*Mr Leschly*) The driving force and the vision we have and what really made sense for us was the merging of the research units. We are, quite honestly, not in the business of closing plants and making people redundant and squeezing costs out. Some mergers happen because a weak company merges with a strong company, or for that matter two weak companies merge and they try in a short period of time to squeeze costs out of the system to come through perhaps a difficult period of two or three years and then use that time to have a proper strategic direction. In the case of—and I think I can speak on behalf of both—Glaxo Wellcome and SmithKline Beecham, both companies are very strong companies, neither of us need to do a merger, and therefore when we did it it was with a very specific rationale, namely to generate a much stronger engine in research and development.

Mr Beard

59. Could you say just how the R&D activity within the two organisations would have been different from what it was in the separate ones?

(*Mr Leschly*) Maybe I could refer to Dr Poste who is really in charge of our science and technology.

(*Dr Poste*) I think by definition it would have been bigger. Beyond that, I think it would have benefitted from complementarity, and I come back to my earlier remarks that as long as you can achieve critical mass in some of these key technologies, which you are very well aware of, it is not necessary to duplicate those. As Mr Leschly has just indicated, it was certainly the intent that any cost savings which came about through avoiding having to make duplicate future investments could be redeployed to other areas of R&D, or to the extensive alliance network we have developed with new start-up companies in the UK, with universities and so forth, so this was all a very positive picture. I think the other element is that every company is slightly different. I am not sure whether it was Sir Richard or Jim who mentioned in the Glaxo Wellcome testimony that they are acknowledged leaders in combinatorial chemistry, and they generously conceded we have probably been in the vanguard of the genetics effort. So bringing those two technologies together provides a very powerful complementarity which not only maximises scale but also brings strengths that we did not have from the Glaxo Wellcome stable, and reciprocally the strengths we have in genetics to them.

60. Would you have expected the combined budgets to have been the sum of the two parts?

(*Dr Poste*) Absolutely. I can speak in this context as a Board Member of SB and this was very much central to the debate which went on. As Jan has already indicated, this was not a slash and burn approach with regard to what you would do with the combined R&D budgets, on the contrary it was exactly as you say, this was combining those budgets and redeploying them to be even more efficient and competitive.

61. Was that your experience on the previous merger?

(*Dr Poste*) Yes. Back in 1989 we maintained the combined budget from SmithKline Beckman and Beecham Research Laboratories in the first year and have grown it very productively in the mid-teens range year by year. The R & D budget was £390 million in 1989 at the time of the merger and we have grown to almost £1 billion investment today, of which about £325 million is in the United Kingdom, and we have grown our research staff in the UK during that period from just over 2,000 to just over 3,000.

62. Sir Richard touched on the subject of patents running out when we spoke to him a few weeks ago, and that being one of the driving forces behind Glaxo needing to boost their research and development and why therefore they saw advantages in scale. Are there similar tactics behind your interest in a merger?

(*Mr Leschly*) We certainly have experience of that as well. In 1994—I can tell you the date was March 19th because I am very familiar with that date—the patent went off Tagamet, which had played a major, major role, as you can imagine, as a break-through compound and as an aid to metabolism. That compound went off patent. At that time we had sales of over a billion dollars, today we have sales probably around 200 million, so we have lost 800 million dollars. We lost that within the first six months of the patent going off, so it was a very dramatic reduction, which is the nature of this business. You cannot have a patent and then expect it to go on, so we understand that. So a strategy for us, right from the beginning when we did the merger in 1989, was how could we prepare for off-setting that dramatic reduction, which had a huge impact on our earnings and therefore as you can imagine on the well-being of the whole corporation, by having a flow of new products coming through? That is why the wise men I believe back in the early days of our merger all agreed that we must invest in research and development. The only way we can come through this is by generating new opportunities for new products which really make a difference for patients.

[**Mr Beard** *Cont*]

So we did that and I remember we set a goal. I joined in 1990 as chairman of pharmaceuticals and I remember I said, "Could we possibly set a goal of achieving 25 per cent of sales of new products, as a percentage of total sales, coming from products introduced in the last five years?" I can tell you today, in 1998, 39 per cent of our total sales of pharmaceuticals come from product introductions in the last five years. We exceeded therefore the target of 25 per cent dramatically, and that was due to successful research and development input, a commitment to research, and a big part of that I have to say came from research done in the United Kingdom. If you look at the products which have had success—you maybe know the products—I can tell you the whole array of products which has been the driving force in that period between 1993 up to 1998, that five year period, the majority of these products have come from excellent science done in the UK. We are very proud of that and that was certainly the Beecham heritage. Now we do not differentiate between Beecham and SmithKline Beckman, we are now a new company, it was a merger of equals, and now I have to say that that is the reason why every company which faces patent decline must do that. Lastly, let me say that we are in a very fortunate situation today and that is why we consider ourselves a very strong company today. We do not have major products going off patent in the US before the year 2003, we have a major product going off in 2003, another one in 2006, otherwise we do not have it, and that product which goes off patent in 2003 at that time we expect will be equivalent to 5 to 7 per cent of our sales, a very different scenario from when the patent went off Tagamet in 1994 when it was 28 per cent of our sales. So we have succeeded with our strategy and it is based on a commitment to research and development.

63. How would you answer people who might say: "It is all very well this research and development emphasis but that is a very good cover story for what are really financial difficulties which the merger was intended to overcome"? That the research and development in practice, though presented as the *raison d'être* for the merger, is more a cover story than the substance of it?

(*Mr Leschly*) The nature of research and development is that there is never money enough, and you know that. There will always be opportunities for further investment. We do have, and maybe you can address this in a moment, George, a fantastic opportunity because of genomics and the new way we can identify targets and validate targets to drive new products through. We have more than enough funds to carry our company, with growth in research budget to £1 billion. It is not exactly a small budget, it is a lot of money, probably about £4 million a day, including Saturdays and Sundays, so that is a lot of money being invested. We can drive our business that way. The issue we are dealing with is, can we also find extra funding for issues like the icing on the cake, taking advantage of new leads, and that is something we have major debates on internally, strategically.

64. I believe a merger is notoriously very difficult to bring about, and the human factor in it is one of the most interesting parts of welding teams together, when they may be insecure as to whether they, or somebody else, are going to take the job; whether they are going to be made redundant; or whether their particular line of research is going to continue or not; so you would anticipate quite an upheaval for a period in bringing two organisations like Glaxo and your own together, because there will be all that sort of anxiety permeating the whole organisation. So how soon would it have been before the benefits you are outlining would have come about, because there would have been surely a period of turmoil before they were finally realised?

(*Mr Leschly*) Mr Beard that is a very relevant question because one of the issues we were dealing with was that this was a merger of equals we were establishing, and even in a merger of equals, even if there is total harmony in all management ranks, you have to deal with the very complex matter of bringing these two organisations together where intellectual property is the key driver, and people in the final analysis are essential for success. Even in a merger of equals it takes time. In our experience of SmithKline Beecham's merger, I would say it took us two to three years before we felt we had one company, and I would not expect it to be different in a merger of the nature of Glaxo Wellcome and SmithKline Beecham. We were aware of that and there was no surprise there.

65. You have looked at this from the point of view of chief executive of a major company, from a commercial point of view, but of course there is another aspect to this which is that between the two companies involved you controlled something like 20 per cent of the United Kingdom civil research and development, so there is another dimension and responsibility to these issues. How would that have been benefitted by this merger?

(*Mr Leschly*) Maybe I can refer that question to George, who is really in charge of the administration of our £1 billion.

(*Dr Poste*) Again, although there is a definitive commitment to the stockholders of the company, we are very mindful of a very important responsibility in relation to the science base and the conduct of science in the United Kingdom. I think the records of both companies show that through their very consistent expansion of research and development in the United Kingdom as independent entities, and the commitment that you heard from Sir Richard and from us a moment ago that that investment would have continued, and notwithstanding the vagaries of science (because you can never not be surprised on occasion by how science works) the commitment to grow the R&D has been a commitment which both Glaxo Wellcome and ourselves have made. That does not mean to say that we do not have worries about the science base, as you know from some of the testimony we have given, which this Committee has in turn reflected in its own concerns, so I think we always need to be mindful of that. But in short I think both companies have a magnificent historical record of investment in science in the UK. We have continued to grow our budgets in the UK substantially and with that a continued expansion in the number of university collaborations, the number of case studentships that we support, and a continued expansion in the amount of clinical research we do.

Dr Turner

66. This may be a naive question but your commercial arguments for the mergers are very convincing and I think your argument about establishing a critical mass makes extremely good sense, but I just wonder is there a possibility that you can reach a point where your R&D organisation gets so massive—and had your merger with Glaxo Wellcome taken place you would be one of the handful of the biggest in the world—it becomes less effective, if you like, on a unit basis? That the organisation gets beyond an optimal size?

(*Dr Poste*) As you know, there is a huge body of scholastic literature on this subject with widely different opinions and I do not think anyone has really defined what is the effective size for an R&D organisation at which performance becomes sub-optimal. I think your question is intrinsically correct, the larger the organisation becomes the greater the opportunity for bureaucratic sclerosis and administration becoming strangling and claustrophobic. On the other hand, I think that the benefits of scale do have to be taken very seriously. We are now moving towards an era of big biology in much the same way physics and engineering did before us. I think the trick is to actually then look and say, yes, it may be a research organisation if the merger had gone ahead of 10,000 scientists, physicians and technicians working together, but in reality the network which any given group work with is still comparatively small. Science, as you well know, is becoming very specialised, if not ultra-specialised, so two categories of biologists can barely talk to each other because one works on the nervous system and another works on the immune system. So if you look at the collection of scientists and physicians you bring together to work on any specific project, it does not get dramatically large. So, yes, you have theoretically a large enterprise of 10,000 people but within it you have many, mini-communities, which are you hope entrepreneurial in their own right. When you allow administrative frameworks to basically start crushing innovation, whether that be in government, industry or academia, that is when you start to lose the best and the brightest, and that by definition has a subjective element. Some organisations are very good at running innovative science, whether they are big or small, and others create an environment which is inimical to science, but I do not think any sort of scale *per se* is the limiting factor here.

(*Mr Leschly*) You can go the other way and say, "What is the minimum size you need", because scale is one thing, and I would rather deal with that problem, if you are too small. In industry circles the minimum research budget in an industry like ours, competing in this industry, to be successful as a global player not as a niche player, is probably around £700 million or 1 billion dollars. That is the minimum. There are many pharmaceutical companies who do not have a research budget of 1 billion dollars. Therefore what you can anticipate, I believe, is that there will be a network where companies would be not only interested in but forced into alliances and networks. That certainly can benefit the UK universities; there will be alliances with them. We certainly have that, we have alliances with biotechnology companies in the UK, we are very interested in spreading our network, utilising resources, working together in partnership. Therefore the only way you can offset this enormous demand for research dollars is by being much more flexible and interacting with the institutions. They are very interested in working with us and they are much more amicable to that than they used to be; it is a very different climate these days working with universities and academic centres. So I see that as an opportunity for academic centres.

Dr Gibson

67. Am I right in thinking that your whole being depends on the human genome project coming to fruition? Is that the basic science which drives you and if something goes wrong with that, that you cannot get your hands on it and the drugs do not develop in the right sequences and so on, that will be a problem for you? How would you relate all that to what Glaxo are doing, what others are doing? How much co-operation and competition is going to be involved in the health problems you are looking at? I have heard Dr Poste talk before, so I know some of the drive which is behind this, but can you foresee problems which might drive SmithKline Beecham into a corner and you might lose out?

(*Dr Poste*) You have correctly highlighted genetics combined with combinatorial chemistry and bio-informatics, as we have heard from Dr Niedel. Those have become the key driving technologies. The other thing that they have done is to dramatically expand the number of molecular targets available for drug discovery. There is sustained competitiveness between the major players, but if you look at the way drug discovery used to be done, even as recently as seven to ten years ago, the same companies had to chase the same target because that was the limit of science and medicine at that time. What the genome project has done for SB and Glaxo Wellcome and all major companies has been to dramatically expand the number of targets we have available because, as you well know, the whole essence of what modern molecular biology allows us to do is actually define the basic mechanisms of disease. By understanding the basic mechanisms of disease, therapeutic intervention becomes much more rational. Up until essentially 1995, in the first 95 years of this century, the industry has essentially worked on 500 molecular targets. SB now works on 200 in any given year and that is matched by other companies, simply because the human genome project has just dramatically expanded the number of targets available to everyone. So I cannot theoretically say there is not a target which Glaxo and we are working on too, but I think we have all got much more room for manoeuvre.

68. Are there diseases you are interested in which Glaxo are not?

(*Dr Poste*) Yes, by definition, since this is a business and the nature of the size and scale of the market opportunities provided by the major diseases means that there are obvious overlapping attractions for every company in which diseases they may choose to go after. As you well know, many of the drugs which may act on the same disease still work by very

[Dr Gibson *Cont*]

different mechanisms. One of the real opportunities which has now been opened up, I would argue, is the fact there is this unmatched opportunity in oncology and the neurosciences as a result of dramatic advances in cancer research and the neurosciences, and vital public health initiatives in terms of dealing with the growing challenge of antibiotic resistance which could not have been tackled without the same tools we apply to the human genome project being assigned to look at bacterial genes.

Dr Jones

69. Before I bring in Dr Kumar could I just go back over a point that we were discussing earlier and that is what happened when the patent on Tagamet ran out? You were telling us how there had been accelerated growth in your research budgets. Was there an hiatus when the patent ran out? The reason I ask is because Glaxo told us the reason why their budget had stabilised rather than continued to grow, as it had been growing in the separate companies, Wellcome and Glaxo, was because of the expiry of patents. I wondered whether you had a similar experience?

(*Mr Leschly*) I just happen to have a piece of paper in front of me that says our R&D spend in 1992 increased 11 per cent over 1991; 1993 was 20 per cent over 1992; and in 1994, which was the critical year we are talking about—remember the patent ran out in May so at least we had the first four months, we did not have the impact—R & D spend increased eight per cent. Then we had, of course, the dramatic impact all year in 1995 and the budget increased 5.2 per cent. Then in 1996 it increased 17 per cent. In 1997 it increased ten per cent. I can tell you we had our first quarter result announcement yesterday and we took a little bit of a beating because we announced that we would commit to an expansion of our research budget between 16 and 17 per cent in 1998 over 1997. So the £293 million spent in 1997 in the UK will be in the neighbourhood of £325 million in 1998. In other words, if the numbers are correct here, a 16 per cent increase in the UK. Why do we do this? Because we just happen to have an enormous opportunity with the 60 projects we have in development. The spending level we increased here was not necessarily due to the extraordinary expenses that we have had in the last four or five years in discovery. The benefit of the discovery effort is now moving into development and in development that is where the big money is spent. We have a new product in diabetes, a new product in asthma, a new product in irritable bowel syndrome and new products in osteoporosis and breast cancer. We have a new quinalone that hopefully will be helping us with resistance. Those key products have huge market potential. We have to drive through and we have to start it now, even if the products will not really give a return to us maybe before 2000/2003. That is the nature of our business. We are willing, therefore, to accept that we have to lower our earnings forecast for this year. We had expected a mid-teens growth in earnings share and yesterday we announced that it would be the low teens. It is still very, very good but not as good as the expectations were. That is good management. We have to do what is right for the business and investment in the future.

70. It would be very helpful if you could let us have those figures.

(*Mr Leschly*) Yes, I would be delighted.

71. Were they in real terms or cash terms, the increases you have just quoted?

(*Mr Leschly*) I guess this is an increase in pound terms over the previous year, yes, in cash.

72. You have to take an inflationary allowance?

(*Mr Leschly*) Yes.

73. How were you able to do that when, as you told us earlier, your sales declined so dramatically, 200 million?

(*Mr Leschly*) That is a very good question. I can tell you it was not easy and it was not very pleasant but I remember that year, there were no salary increases across the Board, there were no bonuses across the Board, on the other hand we developed our stock options. This is how you use an incentive system.

Dr Gibson

74. Are you saying within the whole company there were no pay increases?

(*Mr Leschly*) Right across.[1]

75. Right across?

(*Mr Leschly*) At every level, including mine.[2]

76. How were the share options allocated?

(*Mr Leschly*) I cannot give you all the details here. The whole idea was by giving a stock option you were saying "if we are successful five, six, seven years from now you benefit" but you have to pay a price now.

Dr Jones

77. Did that make the company vulnerable during that period?

(*Mr Leschly*) We were very nervous at that time. We were vulnerable in the sense that at that time when I got back just four years ago, I started as CEO of this company in April 1994 and the market value of the company at that time was £12 billion. We were, in retrospect, very vulnerable because as you know we were not a pure pharmaceuticals company. We are very strong in pharmaceuticals but we are also the third biggest company in the world in consumer health care. We had major investments in laboratories. Therefore, we were vulnerable to a possible takeover which then could split up the company and sell the different units. Therefore, we restructured the company, we sold our animal health business, we acquired Sterling, we focussed on what is our strategy for the future to become a health care products and services company focussed on pharmaceuticals. The market value today is around £40 billion up from the £12 billion four years ago, a

[1] *Note by witness:* This information is incorrect. There were no pay rises for Board members but there were increases for other staff. SmithKline Beecham apologises for any confusion caused by this error.

[2] *See* Note 1.

[Dr Jones *Cont*]

dramatic increase. Of course, it is not only due to good management, it is also due to the fact that the market has been very attractive so everybody has made great progress. Today we do not feel we are vulnerable. We do not feel that we have any concerns about takeovers. As I said to you, we feel very confident about the future and as an independent company we will be very successful.

78. And this is a strategy that you would recommend to other companies?

(*Mr Leschly*) Absolutely. I must add that we look constantly for opportunities for how to become even stronger. We cannot just sit back and say "this is good enough". We have to constantly look for opportunities and strategic initiatives that can further enhance shareholder value and competitiveness.

Dr Kumar

79. Mr Leschly, you said that a merger between the two companies would have been a merger of equals?

(*Mr Leschly*) Yes.

80. To what extent would the merger of equals have been in the R&D activities, the overlap of research work that is going on between the two companies? What is the extent of the overlap activities and would it have had an influence on the workforce? Would the R&D have increased, decreased? How much was this part of the discussion? Did that produce the outcome that it has?

(*Mr Leschly*) If I can start and then Dr Poste will continue. When we had discussions with Glaxo there was absolutely total agreement about the vision we had for how to run our research and development. This was not an issue of cost cutting at all. There is no doubt that there was an overlap of activities in certain areas.

81. In what respect?

(*Mr Leschly*) There were overlaps in certain activities, Dr Poste can explain which ones. The clear understanding we had as part of the agreement we had even before we entered into detailed discussions was that if we had savings because of overlap they would be re-invested into the R&D in general. The whole idea was to enhance the productivity of R & D.

(*Dr Poste*) With regard to overlap, one of the very pleasing aspects that did indeed make elements of this attractive was the low level of overlap. Glaxo Wellcome is a first class leading global corporation, they have got absolutely superb science, but it is very fortuitous actually how minimal the scientific overlap is. There are certain companies you could identify with a greater overlap with what SB does but in the case of Glaxo Wellcome there was a very pleasing lack of overlap. Certain technologies, which we have already spoken of, are similar and both companies have to make the same investment. We use the same gene sequencing machines and have people with similar skills but genomics is such a vast project in its own right that it is not really something where you actually have to say "we have got two people and we only need one". It was actually a very pleasing scenario that would have been a relatively straight forward integration which, coming back to the important point that was made earlier, minimises the time of disruption. Inevitably when you bring organisations together that have not worked together there is some period of uncertainty and people are finding their place. When you can actually say right up front that this is a new enterprise which is going to pursue everything it was doing before and grow, that has an enormous stabilising effect on the scientific community.

82. You say "minimal", would "minimal" be four per cent, five per cent, ten per cent? Can you put a figure on it?

(*Dr Poste*) It is difficult because clearly as Sir Richard said when he was here R&D is always geared to a percentage of sales and both companies have got very strong sales and, as you know, this industry invests more as a per cent of its sales back into R&D than any other sector. We run SB at approximately 16 per cent of our sales and I think, although I am not sure, Glaxo is roughly comparable. One would anticipate that would be the level for the new company and since both companies have had a strong heritage of growing R&D one would logically assume that would continue, providing that the sales line increased in proportion.

83. What about the workforce itself? Would it remain the same?

(*Dr Poste*) It would have remained the same initially but once again if you create a company which is a world leader commercially which is already illustrating its commitment to R&D as the driving force, I think you can confidently take it there will be continuing expansion of R&D.

84. Expansion, not a decrease?

(*Dr Poste*) Expansion.

Dr Jones

85. On the question of workforce, you were saying earlier that after the merger between SmithKline French and Beecham you had just over 2,000 staff and you have now got 3,349 but over 1,000 of those are described as "consultants and temporary staff" from agencies, which has been a major change. Could you run us through the reasons for that?

(*Dr Poste*) This is a new category of individuals, much of it is computing where the very nature of the people in the computing industry is that they often move across different industrial sectors. We made a decision that wherever we could get better services from the outside without having to make very large capital investments in it we would. I think in IT you will find in many companies it is now often purchased from large enterprises on the outside. These are permanent contract employees of SB but they actually are linked to other external agencies.

(*Mr Leschly*) I can give you several other examples: the cafeteria personnel, the security personnel.

86. Research and development?

(*Mr Leschly*) The total amount you are talking about, the 3,000 people, includes everybody in the research centre.

87. So it does include that?

(*Mr Leschly*) Sure.

[**Dr Jones** *Cont*]

88. It would be interesting to have a breakdown of that and a breakdown between the consultants who are employed and temporary staff.

(*Mr Leschly*) We can certainly give you more information about that.

89. Is this a phenomenon that is going on in other parts of the industry and that is likely to increase? There is a big demand for people skilled in bio-informatics.

(*Mr Leschly*) I think as a general strategy we need to focus our efforts on where we have our core capabilities. It is very important that we focus our resources on that and then where we can outsource and see that other people can do a better job than us why would we not allow them to do that so we can focus on what we are really good at, namely the core research and development and we cannot outsource that. There are certain aspects of what takes place in a huge research centre as we have just invested in in Harlow, where we just invested a quarter of a billion pounds where we obviously can outsource and we do that.

(*Dr Poste*) That trend is not only as you ask, Dr Jones, with regard to the industry at large but certainly we see that reflected in our US centre at the same time. You mentioned bio-informatics; even though SB is probably one of the largest bio-informatics groups in the world, many of whom are here in the United Kingdom, we are in a setting where certain specialist skills are very difficult to come by and that of course also drives this whole issue of alliances with small companies set up for very specialist entrepreneurial activities. A recent study in the publication "In Vivo" which monitors this shows that over the last five years SB has forged more such alliances than any other company in order to access those types of skills on the outside.

90. This growth that you have explained was expected to take place, was that likely to be directly employed or was it likely to be consultants of this nature that you are talking about?

(*Mr Leschly*) I do not know the exact mix of that but I think we will continue to have a certain mix. The majority I believe will be full-time employed by SmithKline Beecham.

91. You spoke very well of the productivity of your staff in the UK and I note that 35 per cent of your R&D expenditure is in this country.

(*Mr Leschly*) Yes.

92. And 50 per cent of Glaxo's. Have you got any plans to perhaps increase the proportion of your research and development that is spent here, assuming we get our act together in relation to our basic science?

(*Mr Leschly*) I can tell you that we are committed to the success of the science base here in the United Kingdom. We will be more than delighted to work with you and the Government to enhance the tradition here in scientific excellence. If that continues here we do not see any reason why we should not expand here. If that would be at the cost of what we expect somewhere else we would have to look at that and we will certainly do it if it makes sense.

Dr Jones: Thank you very much. We now want to move on to discuss the termination of the merger talks and I would like to hand over to Dr Williams

Dr Williams

93. I have quite enjoyed the comments so far and I was persuaded anyway that two strong companies, both British based, creating this extremely strong asset was broadly a very good idea and I felt disappointed, like many people on the Stock Exchange, and a lot of people felt very disappointed that this did not come about. Why did the talks collapse?

(*Mr Leschly*) Let me tell you what happened and I hope that you will give me a little time and be a little patient with me because I would like to tell you exactly what happened. Let me go back. As I mentioned before we had preliminary discussions with American Home Products. This was in early January. The discussions unfortunately leaked. That was very unfortunate. With the leak our stock price went up ten per cent within four days. The panel requested that if it was true, we announce it, so we announced it. Then on 24 January I got a telephone call from Sir Richard Sykes and I definitely remember the telephone call. Richard I have known for 15 years, I get along with him extremely well. Richard said: "Jan, is it too late?" and I said "it is not too late".

The Committee suspended from 4.49 p.m. to 4.59 p.m. for a division in the House.

Dr Jones

94. Shall we begin?

(*Mr Leschly*) Dr Williams, you asked a very important question, why did the merger fail.

Dr Williams

95. You were on the telephone call of 24 January.

(*Mr Leschly*) I got a telephone call. I want to remind you it was Glaxo who called us. Richard said: "Jan, is it too late?" In that first conversation which was on 24 January I remember clearly saying to Richard: "Richard, before we get into detailed discussions we need to have an understanding of how we can make sure that a merger of this magnitude can come through?" He agreed with that. Therefore, between 24 and 30 January, six days, we had intense discussions consisting of senior management from both Glaxo and ourselves. I was represented together with JP Garnier, our President, and there was Richard Sykes, their CEO, Bob Ingram and John Coombe. The five of us spent basically six days in New York, in London, talking, trying to come to grips with how could this merger and the fundamental principles of this merger take place. We discussed, as you can imagine, the valuation, that was one part of it. The other part was how could this work. We had the vision discussion and we agreed too, very importantly, that this would be a health care products and services company. I cannot go into all the details here but we also agreed, as you can imagine, how to select the best people, not if it was Glaxo or SB but on merit, very importantly. We

[**Dr Williams** *Cont*]

agreed on the best practices, how you manage the company. You have to appreciate the very different cultures between our two companies. We have very different styles. We have a much more centralised organisation, if you like, they are much more decentralised. We had to come to grips with how could this work. We also agreed on the roles of the senior executives, including Richard's role, my role, and other senior executives. We agreed on the Board composition. We agreed on the management committee, equal participation from the two companies. There was to be something called the Merger Integration Commmittee which basically would manage the company in the first year or two co-chaired by Richard and me, equal participation. There was the Pharmaceutical Review Board chaired by Richard, and properly so. The Pharmaceutical Review Board is a committee which decides on resource allocations and prioritisation of our research and development. All of that in a six day period. I am not telling you these were easy discussions. It was basically very little sleep in six days. We came to a deal. With my management team I then presented that deal to our Board and I certainly believed that Sir Richard, being Chairman of the Board, went to his Board and got approval for this deal. Our Board decided—after having reviewed that very carefully versus the alternatives we were looking at—that it was in our company's interest to enter into detailed discussions with Glaxo. At the same time we immediately discontinued discussions with American Home Products. That was announced on 30 January and you saw the announcement. There was limited information in the announcement because of sensitivities to the aspect, as you can imagine. After 30 January, we now entered into detailed discussions based on an understanding of how this could work as a merger vehicle, and approved by our Boards, we now entered into a point called due diligence where the teams worked for the next three weeks on due diligence issues, synergies, regulatory issues, you name it. There were lots of people involved. To the best of my knowledge these discussions went well. I am sure there were problems here and there but overall no major disruption, no major hiccoughs of any type. This leads up to 20 February when on Glaxo's initiative, Richard's initiative, he asked for a meeting. The five of us met in New York and Richard said, not only to my surprise but I have to say to my astonishment, that what we had agreed and was a condition for entering into these discussions "would not work and would never work" and therefore suggested and proposed a major change in what we considered a deal, an understanding of how this would work, a major change. These changes included major changes in senior executives' roles, including my role. More importantly they included a change in what we considered a merger of equals. A merger of equals means that it is not a matter of the Glaxo way or the SB way, it is the best way for the new company. That agreement of a merger of equals in our view had turned into a takeover without a premium. A takeover without a premium meaning that it would not be the best practices, it would not be the best people selected on merit, it would be the Glaxo way and not a new way. We walked out of that meeting. I have to say to you I did not get any explanation and still to this day do not have an explanation of what happened within Glaxo in that 20 day period. It certainly had not occurred to us, it was a complete surprise. JP and I went back to our Board. We then worked for four days in sessions with our Board trying to negotiate and revive the deal on the original conditions that we had negotiated. Those were sessions, specific sessions excluding executives like me, with just the non-executive directors working with non-executive directors from Glaxo to see if we could revive it. The sad thing is Glaxo broke the deal and Glaxo, therefore, in our view destroyed our Board's trust and confidence in their intentions.

96. At that stage could I intervene and ask a second question? I am glad you have put so much on the record there in such candid detail.

(*Mr Leschly*) I think it is about time.

97. In very summarised form, what Sir Richard told us, if I can quote back to you: he said that the merger talks were terminated because it became apparent that there were irreconcilable differences in approach, vision and management structure between the two companies. I think broadly that reflects what he said.

(*Mr Leschly*) Yes.

98. Specifically on management structure you referred to a change in definition of your own role.

(*Mr Leschly*) Yes.

99. These three days of meetings with just the five most senior people, was it part of the problem that you were US based? I am quoting now not from any briefing but from the newspapers at the time. In the merged company you saw your own future, and that of Mr Garnier, as being based in Philadelphia in the United States whereas Glaxo really saw the future being British-based?

(*Mr Leschly*) As I said to you, I cannot speak on behalf of Sir Richard or the Board of Glaxo or the management on why they changed their mind, why they walked away from what we had agreed to. In the discussions we had, in fact the discussions we had and the understanding we had, the deal we had before we entered into the detailed discussions, we did have this discussion, it was very clearly outlined that Richard would be Chairman located in London, I would be CEO located in Philadelphia, where we are today.

100. That was agreed on 5 January.

(*Mr Leschly*) That was agreed on 30 January.

Dr Gibson

101. Was there a written agreement on it?

(*Mr Leschly*) That was agreed in writing. We had that, yes. We do not have an agreement because we did not sign an agreement, we had an understanding and in fact it was printed by Richard himself.

Dr Williams

102. Is it your understanding then that Sir Richard, for whatever reasons, developed or became uncomfortable with that arrangement?

(*Mr Leschly*) I have to say in all due respect, Sir Richard had an absolute right to feel uncomfortable and to change his mind. All I am saying is the conditions under which we entered the agreement were certainly no different from what I tried to explain. There was a complete understanding. Also, I might add, today, interestingly enough, the Chairman of Glaxo is located in London and the Chief Executive Officer is located in North Carolina.

(*Dr Poste*) The three days that you referred to were not just five senior executives, it engaged the full SB Board.

Dr Gibson

103. What was Sir Richard uncomfortable with, that you were still employed?

(*Mr Leschly*) You have to ask Richard about that. I do not think that was the issue. Quite honestly the issue of senior executives, that is important because we need to have an alignment. That was not the reason why our Board unanimously discontinued discussions, that was because of the whole concept of a merger of equals, which is much more important when you are talking about the 55,000 people in our organisation being involved. You know that people are the assets we have, if we do not have people we do not have all these technologies. In our case it was not a people issue. I know there is a lot of talk about ego. What I can say is—I think Richard will agree with me—that we had constructive discussions about this. We certainly had our disagreements, no doubt about it, but overall it was not a personal issue, it had only to do with the fact that something happened that changed, if you like, the understanding of the willingness to continue on what had been agreed to in the deal. Therefore, what I am saying to you is they broke the deal.

Mrs Spelman

104. You have amplified really on the memorandum that you have already sent. The key point I take out of what you have said is that basically they backed away from the basis of the deal as being based on a merger of equals. Is that the key point?

(*Mr Leschly*) That to me is the key point because the merger of equals was from our standpoint the only way that we could assure the long-term value generation. There are huge pounds at stake here, as you know. Somebody has to deliver. It is not a short-term gain in the stock, that does not generate anything. It is how can we deliver medium to long-term. This is an investment business. You can only do that if you have an alignment of management all the way through. We are, I think Sir Richard used the words "sensitive flowers", I could not agree more with him. Of course, nothing to do with him or me but it is something to do with our scientists who are very sensitive flowers. If the very unfortunate thing should have happened that it became the Glaxo way, or for that matter the SB way, I can assure you it would have been very difficult for us to maintain and retain our senior scientists whom we totally depend on and our senior executives whom we totally depend on to manage a complex company like ours.

Dr Gibson

105. In your initial discussions though this must have come up? You are intelligent people. You must have known that there was going to be some kind of argument of this kind.

(*Mr Leschly*) Yes.

106. And yet you say it was agreed at that point and there was a reversal.

(*Mr Leschly*) I told you that, before we entered into the detailed discussions, we needed to have an understanding because all of us have a lot of experience in this, I have been through three mergers, I have a lot of experience, we knew exactly what the issues were. Therefore, before entering into detailed discussions and going public we needed to have an understanding of these issues. We spent six days talking. As I told you, it was not easy. The issues you are talking about were brought up, they were on the table, it was not something that came up after ten days, 20 days. I have to accept that it is better that Sir Richard and Glaxo changed their minds before the merger took place than after. It is very disappointing for all of us but it is better it happened than if we had a marriage which then had not worked out. Then some people would have had short-term gains but that is not what we are after. We are after a long-term success.

Dr Kumar

107. I asked this question of Sir Richard as well and I will ask you. Did you feel that the agreement was 80 per cent, 90 per cent—or what figure would you like to put, was nearly there before they walked away? Would you like to put a figure on it because I asked him and he refused to do so? Would you like to put a figure on it?

(*Mr Leschly*) As you know I would certainly never do anything that Richard would not like me to do, so all I can say to you is we were very close. In my estimation we were very close because we had agreed on all the fundamental issues. We had agreed on valuation, we had agreed on all the things that I explained to you, the roles, all of that was agreed upon before we entered into the detailed discussion. You can put a percentage on that but with my experience in mergers I can tell you normally when you go public you have a chance to come through. If we had kept the deal we probably would have been able to come through. The deal was not kept. I have to admit there are different cultures. I am not suggesting to you that Sir Richard is not right. There are different styles.

Dr Jones

108. Dr Poste said that you had a close concordant vision however.

(*Mr Leschly*) We did have that in science and research. We did not necessarily have the details worked out for how to operate the company. They

[**Dr Jones** *Cont*]

are very geographically organised so they operate in geographic areas and we work in a more divisionalised way. I have to admit to you there were certain things that we had not worked out. The fundamentals, the critical issues enabled us at least to have the framework of a merger of equals to make that happen and to my understanding, and certainly that was our Board's view, and that is much more important, our Board and our non-executive directors were very much in favour of this based on these commitments. It did not work out. You can imagine the impact on our executives and specifically our non-executive directors who had the responsibility for this, that the trust and the confidence had gone. Then it was very, very difficult to make a merger so complex and with 110,000 people working. We also have a responsibility for 55,000 people.

Dr Gibson

109. When Richard Sykes phoned you up and said that it could not work and would never work you certainly did not think of calling upon our Prime Minister who can sort these things out, did you? It was so important for the nation.

(*Mr Leschly*) I was astonished.

110. Did you not think of another way to manoeuvre back together again?

(*Mr Leschly*) We tried. Do not forget that. We tried for four days, not only the executives, I was at a meeting together with my Chairman, Sir Peter Walters, Sir Richard was together with Sir Roger Hurn. The four of us met. After we had had this very surprising meeting we tried to come back but the answer was it would not work, it would never work under the deal we had made. We were not prepared—that should be very clear, we do not need a merger, we are a very strong company—to have a takeover without approval, absolutely not. That is not in the interest of our shareholders and it is certainly not in the interest of our 55,000 people, believe me.

Dr Jones

111. Sir Richard told us that no personality clashes were involved and it was never one-to-one between himself and yourself; it was always groups of people. Is that your view of the situation?

(*Mr Leschly*) You can imagine that I had a very good relationship with Richard and I expect to have a very good relationship with Richard in the future. It was a very tough meeting on 20 February, as you can imagine. The message we got "it will not work, it will never work" that hurt a little bit but that is behind us now.

112. A little while ago you very pointedly I thought said that it had been agreed that the vision was a health care products and services company.

(*Mr Leschly*) Yes.

113. Was there any disagreement subsequently on that vision?

(*Mr Leschly*) That was agreed because when one day we would announce the merger of the two companies it was very important that there were no mixed signals. Glaxo have successfully had a very clear strategy focusing on pharmaceuticals, to be successful in pharmaceuticals, and they have certainly accomplished that. We have a very different heritage. Beecham, as you all remember, was very much a consumer health care company. It started off in antibiotics, became a major force in antibiotics, was not really what I consider a fully-fledged strong pharmaceutical company. SmithKline Beecham is a very different animal. We have now restructured the company so it is a health care products and services company realising that the focus is on pharmaceuticals. That is a different strategy. We are involved in molecular diagnostics, we are involved in building a health care services group, we are involved in what is called pharmacy management, etc., relating to disease management. We are a slightly different company than Glaxo. We are very successful with that strategy. If you suddenly sit together at the table and say "what is the future strategy", it should not be SB strategy, it should not be Glaxo strategy, what is needed to compete in our environment in the future. I am sure you are all aware there are so many changes and with molecular diagnostics and with patient profiling, with the ability to identify responders and non-responders, it is going to have a major role in how you select drugs in the future. This country cannot survive the bills of the NHS without getting into disease management, identifying higher cost, high risk patients, how to intervene, how to measure outcome. We are in that business. When Richard and I sat with our management team and said "What is the agreement here? Is it just pharmaceuticals and therefore we have to get rid of all the rest or is it this?", if it had been the first we would not even have been talking. We did agree that it would be a health care products and services company. Did Richard Sykes change his mind in the 20 days? He did not tell me.

114. I notice in your submission you say that you are a highly attractive partner for collaboration, your company, and you are also an attractive partner for services beyond pharmaceuticals.

(*Mr Leschly*) Yes.

115. Is that the difference between your company and Sir Richard's?

(*Mr Leschly*) It is a difference but a difference that we could easily work out if we had an aligned management in a merger of equals. Our concern was naturally, Chairman, that if there had been a takeover based on what was proposed at that famous meeting of 20 February I can assure you it would not have been a strategy that we had agreed to. In a takeover who is in the driver's seat? That is the person who takes over.

116. You also somewhat disparagingly comment in your submission: "we are not another Wellcome". What do you mean by that?

(*Mr Leschly*) That is true. The Wellcome situation was obviously a hostile takeover. In a hostile takeover you pay a premium and to pay back that premium you obviously need to do certain things that you do not have to do when you do not exchange cash in a merger of equals. I have to accept that they have been very successful in the Glaxo Wellcome merger, it has worked out, but there is no doubt who has been in the driver's seat.

Mr Beard

117. Both you and Sir Richard previously have been very frank in describing what went on. At the heart of this inquiry is a contradiction that I still do not feel is resolved after so much evidence. On the one hand one could interpret the outcome of events as saying: "there were great expectations but when we went into them in more detail they melted away, they were insubstantial, therefore we called it off". That is not what either of you have been saying. Essentially both of you have said, and you said quite clearly this afternoon, there were very, very substantial benefits, benefits of scale, benefits of complementarity and those are all there and you are still claiming them. On the other hand, you have just been outlining the reasons why it was called off. I have to say that compared with the benefits which have been described the reasons for calling it off look rather trivial, they seem somewhat out of balance, they are out of proportion compared with the outline of the benefits that you gave earlier. I wonder if you would like to comment on that. Again, going back to the point I raised when we were talking earlier, you are in charge, along with Sir Richard, of a very large proportion of a major national asset. If somebody is looking in and they suddenly hear this story as it is unfolding how would you answer them when they say: "is this national asset safe in their hands"?

(*Mr Leschly*) I understand what you are saying and I would like to refer that question of the national asset related to the research base, the administration of its enormous funds, developing drugs and maybe, George, you will respond to that, please.

(*Dr Poste*) There may be a subtlety that I am missing and if so I apologise but I think it is in part what I responded to earlier. Both of the companies engaged in this debate have prestigious records of accomplishment in research and development which accounts for the international acknowledgement of the UK as being a leader in pharmaceuticals. There would indeed be tangible advantages that you emphasised, and we acknowledge, as Glaxo Wellcome, to bringing the two organisations together, but again under the circumstances of a merger because R&D does not exist in isolation, R&D is part of the totality. If you have a situation where you are not dealing with a merger of equals, where as Mr Leschly has pointed out it is not the SB way or the Glaxo way, you are genuinely trying to shape a genuine new culture.

Dr Jones

118. A third way.

(*Dr Poste*) By contrast, if you are ending up for all intents and purposes in a hostile acquisition—notwithstanding the fiduciary responsibility we have to our shareholders to ensure that a premium is paid—the internal cultural environment that has been seen time and time again, whether it be in the pharmaceutical industry or not, following an acquisition, the dominant party, ie the acquirer, is able to impose the overall framework of its culture and it is quite appropriate, since they paid the acquiring price, to do that. I would argue that under those circumstances a genuine scientific asset of this nation would be irreparably damaged.

Dr Williams

119. Is there a way of reviving the merger talks? We did ask Sir Richard Sykes and he pointed out that there was not any Stock Exchange prohibition on further talks or what have you and I think it is very disappointing what happened at the final stage, a very advanced stage anyway, and maybe the differences were not that deep. Maybe there is a way of reconciling whatever went on that weekend towards the end of the talks.

(*Mr Leschly*) I think the short answer I can give you, Dr Williams, is theoretically we could go back but I do not see a possibility of merging the two companies. As I said before, our Board, and that is the important thing, our Board and our management—and it is not just two or three people, management goes deep here—have lost trust and confidence in our ability to work together with the management in Glaxo and that is essential for this. You can say that is not a reason but I have to tell you that is a very, very important reason for bringing this together. Without that trust and confidence we cannot generate the value, it will destroy value, believe me it will destroy value. Are you aware on this Committee, by the way, that 70 to 80 per cent of all mergers do not generate value?

Dr Gibson

120. Yes, we are.

(*Mr Leschly*) 70 to 80 per cent do not generate value and here we are saying we have had this wonderful increase in market values, an enormous increase, short-term based on speculation. Who is responsible for generating the value? That is the management of the two companies. That is not something that is going to happen overnight. That is a long-term process. I am sitting back and taking all the blame, you must admit, for why we do not do this merger. I am saying I am the one, together with my management team, together with Glaxo management combined, who should now generate all this value. I feel and our Board feels that risk is too big compared to being a strong company who, as you must admit, has done very well and has no reason to believe it will not do well in the future. You have to compare these two. If you look at the value generation we will do as an independent company and Glaxo as an independent company, the success we will have, the support we will give to the science base in the UK will not be diminished through that I believe. If you look at those two compared with a merger that fails, we are much better off as two independent strong companies.

121. Do the scientists move between the two companies? Would you hire someone from Glaxo?

(*Mr Leschly*) If they are good, yes. Absolutely. We always do that. We move around and there is nothing new in that.

(*Dr Poste*) The world is bigger than events at the moment. We have obviously strong professional and collegial ties to our colleagues from Glaxo Wellcome and we will continue to have. We are both engaged in one of the most dramatically complex endeavours in research. There is enormous respect for our colleagues who do that in any company. There is a

[Dr Gibson *Cont*]

constant dialogue and exchange. People move between companies and will continue to move between companies. Even post-merger Jim Niedel and I have been discussing a collaborative research project. I think this is an issue at the macro level between the two companies at the level of research and development and if a sensible opportunity arises and it is good science we will certainly look at it and always look at good people.

Dr Jones

122. Sir Richard himself said at our last hearing that you were still collaborating on various projects and he mentioned research fellowships for bio-informatics. Can we see perhaps the companies putting this behind them and continuing to collaborate in ways which are beneficial to a science base?

(*Mr Leschly*) Chairman, I can tell you, you will be surprised to hear I had dinner with Sir Richard the other night.

Dr Gibson

123. Who paid?

(*Mr Leschly*) No rumours now.

124. Fifty/fifty?

(*Mr Leschly*) Sir Richard is Chairman of the British Pharma Group and I am a member of the Board. We met with the DTI. We had a great dinner. I can assure you there is no reason why we should not have a good relationship with Glaxo in the future. This is behind us. We are in business, we have to do what is right. I do not think this is a personal issue whatsoever.

Mr Jones

125. Sir Richard told us that further consolidation within the global pharmaceutical industry was inevitable. Do you agree with that? To what extent has the increase in the number of mergers and acquisitions over the last five years reduced fragmentation in the UK?

(*Mr Leschly*) I think I fully support what Sir Richard said, that there will be a consolidation over time. I already mentioned that when I talked about the minimum level of resources available to survive in this complex industry. It is also interesting for the British pharmaceutical industry that six years ago there were six companies in the UK. There was Glaxo, there was Wellcome, there was SmithKline Beecham, there was Zeneca, a spin-off from ICI, there was Fison's and there was Boots. Boots has been absorbed. Fison's has been absorbed. Wellcome has been absorbed. We have three left. The good news is that together we have approximately ten per cent of the world market. I think Zeneca, Glaxo Wellcome and ourselves are very powerful companies, we work very well together in the industry and we have, I believe, a very major influence in what is happening in the industry which is very important. I do not see any threat to those three companies, they are very powerful, all three companies, so there is no weakness left.

126. Do you think that the same factors that made you consider the merger are likely to spur other pharmaceutical companies to consider a merger in the future?

(*Mr Leschly*) Our company merging in the future?

127. Yes, your's and any of the others?

(*Mr Leschly*) I cannot speak on behalf of them. We have a very clear strategy and we have always said, and will continue to say, we have no need to do a merger. On the other hand, I certainly believe we will constantly look for opportunities for how we can enhance our overall value and increase our competitiveness. Would that lead to a merger? I can say we have no thoughts about that today. On the other hand, I cannot guarantee in the future but it is probably unlikely.

Dr Turner

128. You would not rule it out?

(*Mr Leschly*) There are very limited opportunities to do a merger of the nature that we were talking about with Glaxo and SmithKline Beecham. These were two strong British companies. We certainly have a commitment to Britain in that sense, we are very committed to the research base here and therefore our options are not that big.

129. What would happen if a major offshore player were to enter the British stage and tried either to offer a merger or a takeover with either of the three remaining British players? Would that change the game altogether do you think?

(*Mr Leschly*) I have to say concerning Glaxo and SmithKline Beecham, and I believe to a certain degree Zeneca, I do not think there is any threat of that, I really do not think so.

Mr Jones

130. You are obviously very, very experienced in mergers. Can you tell us what the criteria are for getting the best out of mergers between companies which have significant R&D activity and where a substantial amount of the value of the companies is held as intellectual capital?

(*Mr Leschly*) I have experience in mergers and I have experience in acquisitions and I can see the difference. The most important thing is to motivate people to make sure that people get enthusiastic about working for the company and that applies to R&D and any other part of our company. Explaining the mission for what we are trying to do is absolutely essential. Then, I have to admit, it is very important, certainly in the SB culture, that we incentivise the organisation, that we pay for performance and make sure that when performance is achieved our employees, not only the shareholders but the employees, also get a part of the success. To me that is the essence of a merger. That can only happen in a merger of equals. In a hostile takeover you can imagine there are A players and B players and it is the A players who take over. They may be happy. I was a B player when we were acquired by Bristol Myers when I was President for Squibb, and there are not that many executives left from Squibb in the new Bristol Myers Squibb.

Dr Jones

131. But you made it yourself?

(*Mr Leschly*) I was the one who left.

Dr Jones: Mr Leschly and Dr Poste, thank you very much; you have been very patient with us. We have kept you far beyond the time that we initially indicated we would. It has been a fascinating afternoon. I am sure that our Chairman, Dr Clark, is very sad to have missed being here with us. I pass on his apologies. Thank you very much.

Supplementary Memoranda submitted by SmithKline Beecham plc

Additional Information Requested by the Committee

R&D SPEND

SmithKline Beecham's R&D spend has increased from £393 million in 1990 to £841 million in 1997—an increase of 114 per cent. The details are included below:

Year	*R&D spend (£ millions)*	*Percentage increase over previous year*
1990	393	—
1991	432	10
1992	478	11
1993	575	20
1994	621	8
1995	653	5
1996	764	17
1997	841	10

6 May 1998

SMITHKLINE BEECHAM: ANALYSIS OF R&D STAFF-SCIENTIFIC AND NON-SCIENTIFIC

	Regulars	*Temps*	*Consultants/Agency Temps*	*Total*
1990				
Scientific staff	1921 (CDM = 53) (Sec = 144)	59 (CDM = 3)	0	1980
Non-scientific staff	381	17	0	398
Total	2302	76	0	2378
1998				
Scientific Staff	1855 (CDM = 79) (Sec = 139)	182	1113 (CDM = 73)	3150
Non-scientific staff	170	19	10	199
Total	2025	201	1123	3349

NOTES

1. There has been some movement between R&D and other functions—this has not been taken into acount, but would not skew the overall figures.

2. Clinical Data Management staff have been included within the scientific grouping, though many in the function are engaged in data entry. Total numbers for Clinical Data Management are given above in parentheses.

3. Because of the way figures were reported it has not been possible to isolate secretarial support staff from the total numbers reported as scientific. Using the current proportion of secretarial staff to total numbers of staff, an approximation of the number of secretarial staff included in the scientific figure is also shown in parentheses.

12 May 1998

Memorandum submitted by the Institution of Professionals, Managers and Specialists

INTRODUCTION

1. The Institution of Professionals, Managers and Specialists (IPMS) is a trade union which represents 78,000 scientific, technical and specialist staff in the Civil Service, research councils, other public bodies and an increasing number of private companies. Our membership ranges from laboratory assistants to chief executives and directors of public sector research establishments. Thus, although we have no direct membership interest in either Glaxo Wellcome or SmithKline Beecham, we have a legitimate and longstanding interest in protecting and developing the UK science base. We also work very closely with MSF, which has a large number of members in both companies, through the Science Alliance. The Science Alliance is an informal grouping of scientific unions, also including the Association of University Teachers (AUT) and National Association of Teachers in Further and Higher Education (NATFHE), representing working scientists on the issues that affect them, whether generated from the corporate sector or from government.

2. Our submission focuses, first, on the wider importance of the R&D activity by Glaxo Wellcome and SmithKline Beecham. Second, we identify areas of uncertainty which need to be resolved before the proposed merger of the companies. Our submission is a brief one, but we have consulted colleagues in MSF on the implications of the merger and we are wholly supportive of their concerns.

R&D

3. The DTI's R&D Scoreboard published in June 1997 showed that Glaxo Wellcome and SmithKline Beecham were the only two UK companies to feature in the top 50 international companies by R&D expenditure in 1996. SmithKline Beecham had increased its R&D budget by 17 per cent compared with 1995, amounting to 9.6 per cent of sales. Glaxo Wellcome had reduced R&D expenditure by 3 per cent, but this still amounted to 13.9 per cent of sales. Together, the companies account for more than one fifth of R&D spending in the UK and employ more than 4,000 R&D staff. This is important because:

— The link between R&D expenditure and both corporate and wider economic success is now widely recognised. The R&D Scoreboard shows that the world's top 300 companies successfully increased sales in line with their increase in R&D expenditure. Within the UK, an analysis by BZW shows that companies that spend more on R&D tend to be more highly rated by the stockmarket. Taking a wider view, and comparing the R&D Scoreboard with the research and experimental development statistics produced by the Office for National Statistics, it is clear that there is relatively little R&D in the UK pharmaceutical sector that is not funded either by Glaxo Wellcome or SmithKline Beecham. However, UK business as a whole invests less in R&D as a percentage of GDP than our major international competitors (see Annex 1). No doubt this position would deteriorate further as a result of any cut in R&D from the companies' merger.

— The expenditure is also used to fund R&D activity in other parts of the economy. Although the scale of financial support is not transparent, it is accepted that Glaxo Wellcome is a major supporter of schemes such as the joint research equipment initiative and the Realising Our Potential Awards. As the Dearing Report showed, there is a pressing need for substantial further expenditure on research infrastructure in universities and the capacity of government to meet this need under current expenditure constraints is severely limited.

— The activities of top ranking research organisations, such as Glaxo Wellcome and SmithKline Beecham, have a high public profile and send out important signals to graduate scientists about their future employment prospects. Science overall in the UK suffers from a poor image largely due to the relatively low status, low pay and job insecurity of scientists compared with other professionals. This problem can only be compounded by the current uncertainties in what is strongly perceived as the better end of the science labour market, which may well influence the future supply of high quality science graduates into R&D.

— Public sector science has been subject to successive rounds of cuts and efficiency scrutinies, as documented in IPMS evidence to the Committee's Inquiry into the Prior Options Review, and budgetary pressures are set to continue. The decline in real terms in net government expenditure on R&D is set out in Annex 2. In 1997 the research councils generally received increases in their budgets below the prevailing rate of inflation. Under the Government's two year moratorium on expenditure there is no new Science Budget for 1998–99, thus elminating the possibility of an end of year adjustment in allocations, as has been the case in recent years. Consequently, scientists in government are currently faced with a real terms cut in their budgets and the need for some very difficult decisions.

KEY ISSUES

4. Against this background, more is needed than the general assurances so far given by the companies about their future intentions:

— Will the R&D budget be maintained? There is already recent experience in Glaxo Wellcome of reducing R&D expenditure. Will further cuts be more likely if SmithKline Beecham is a partner rather than a competitor?

— Even if R&D programmes are sustained, what guarantees are there against scientific job losses? When Glaxo merged with Wellcome in 1995 there were about 2,000 R&D job losses even though the R&D budget was not cut. On this basis a merger with SmithKline Beecham could, according to Research Fortnight, result in as many as 3,000 research job losses worldwide.

— What are the longer term implications? R&D is an investment for the future, but a merged company with a dominant market position may lose the incentive to keep investing in R&D at the same rate as the separate companies do currently.

Annex 1

BUSINESS ENTERPRISE R&D (as a percentage of GDP)

Year	*UK*	*Germany*[1]	*France*[2]	*Japan*[3]	*USA*[4]
1988	1.47	2.07	1.35	1.93	2.00
1989	1.49	2.07	1.41	2.06	1.96
1990	1.51	1.98	1.46	2.15	2.00
1991	1.42	1.81	1.48	2.12	2.07
1992	1.42	1.70	1.51	2.03	2.01
1993	1.44	1.62	1.51	1.90	1.88
1994	1.38	1.54	1.47	1.87	1.80
1995	1.34	1.51	1.44	1.95[p]	1.85[p]

Source: Office for National Statistics

Notes:

1. There are breaks in series between 1990 and 1991, and 1991 and 1992.
2. There is a break in series between 1991 and 1992.
3. Data from Japan are adjusted by OECD.
4. Excludes most or all capital expenditure. There is a break in series between 1990 and 1991.

p. Provisional

Annex 2

DECLINE IN GOVERNMENT R&D FUNDING (real terms 1985–86 to 1998–89)

	£ million base year 1994–95				
	Outturn		*Plans*	*%*	*%*
				Change	*Change*
	1986–87	*1995–96*	*1997–98*	*86–87/95–96*	*86–87/97–98*
OST[1] & Research Councils	875.4	1239.5	1223.0		
HEFC	1112.8	1017.7	981.0		
TOTAL SCIENCE VOTE	1988.2	2257.2	2204.0	+13.5	+10.9
Civil Departments	1612.6	968.2[2]	876.0[2]	−39.9	−45.7
Defence	2975.4	2106.9	2040.0	−29.2	−31.4
TOTAL DEPTS	4588.0	3075.7	2916.0	−33.0	−36.4
Indicative contribution to EU	147.3	334.9	349.0		
GRAND TOTAL REAL TERMS[2]	6723.5	5667.8	5469	−15.7	−18.7
GRAND TOTAL CASH TERMS[2/3]	4350.1	5667.8	5718	+30.3	+31.4

Source: 1997 SET Statistics Tables 3.1 and 3.2

Note:

1. OST forms a very small percentage £25.4 million in 1995–96, equivalent to just over 1 per cent of the Science Vote.

2. Excludes NHS, which is included in DH R&D return from 1995–96.

3. Cash terms taken from table 3.1

Memorandum submitted by Manufacturing Science Finance

1. MSF and Science

Manufacturing Science Finance (MSF) is a multi-industry union spanning the public and private sectors with over 400,000 members. The union brings together scientific workers in universities and professional scientists and engineers in Industry. We also have scientific membership in the National Health Service, Research Councils and Independent Research and Technology Organisations. With an estimated 100,000 members engaged in science, R&D and transferring innovation to marketable goods and services, MSF is the largest union in the private sector for scientific workers and is organised in many of the key areas of the next generation of scientific and technological advance.

2. MSF and the Pharmaceutical Sector

MSF is the largest staff and scientific union in the pharmaceutical sector with 10,000 members in total. We are established in most of the long established pharmaceutical companies located in the UK. MSF represents clerical and administration, scientific and technical, and some craft grades.

In the Glaxo Wellcome and SmithKline Beecham (SB) we represent 5,000 members. MSF has had a long and constructive relationship with Glaxo Wellcome which pre-dated the merger that formed the company.

In SB, MSF had very successfully represented the interests of our members employed in the Management and Scientific Common Interest Group nationally and the SB Pharmaceuticals and Animal Health Technician Group since 1975. Unfortunately, in 1990, shortly after SmithKline and Beecham merged, the Company gave notice that it was withdrawing recognition from MSF. At the time of derecognition MSF had around 600 members in the technical and managerial areas. MSF retained some consultation rights for the site at Irvine.

Recently, MSF has successfully re-established a dialogue with SB and have worked together on the European Directive on the Patenting of Biotechnology Inventions. In addition, MSF was in talks at the time of the latest merger announcement with SB over forging a constructive working relationship to represent employees who had been transferred from West Middlesex NHS Trust and are now working in the Company's clinical laboratory in West London.

3. Terms of the Inquiry and Summary

MSF would like to thank the Committee for the opportunity to submit evidence to your Inquiry. We believe that you have focused on a key issue relating to this merger. The reporting of this merger has focused on the creation of the world's largest pharmaceutical company and the fees that may accrue to the bankers and lawyers. The UK Pharmaceutical Industry is widely viewed as a manufacturing success story. This is based on the industry's reputation as a high-tech, high-investment, high-wage, skills intensive, value added industry.

The UK has a number of truly global competitors: Glaxo Wellcome, SmithKline Beecham (Anglo-American) and Zeneca. These companies occupy three of the top 10 positions in the DTI Scoreboard of investment in R&D. The sector is responsible for output worth £12 billion and has a positive trade balance of £2.1 billion.

At a time when overall employment in the manufacturing sector declined from seven million to just over four million, employment in the pharmaceutical sector expanded by 5,000 and presently stands at 75,000 people.

We believe that innovation is the cornerstone of this record of success. These are two great British companies and we are concerned that if this merger was to take place and the financial engineers, rather than the engineers of a UK manufacturing success story, take control of the new company, this could have a detrimental effect on the UK's science base.

We are not against the link up between the two companies, rather we are unconvinced about the business rationale behind the merger and have sought urgent meetings with the Chief Executives of both companies in order that we can obtain a better idea of their corporate strategy so that we can effectively explain this position to the employees which MSF represents in both companies. This is not a question of a trade union defending restrictive practices and opposing change.

4. Background to the Merger Proposal

The Pharmaceutical Industry is highly fragmented and a process of consolidation took place during the 1990s. Merger and acquisition activity has taken place worth $37.9 billion in 1994 and $34.7 billion in 1995.

In the early 1990s, Glaxo was hugely successful, generating the best cash returns in the Industry. Glaxo responded to this position by distributing value added as dividends which was well above the average for the sector. Glaxo and other pharmaceutical companies have found it increasingly difficult to maintain such levels of dividends payments as patents expired and investment in R&D bought declining returns particularly through a failure to develop new "blockbuster" drugs.

As a result companies like Glaxo and SB have become victims of their own success and are impelled to try and find through acquisition and merger increases in earnings which once came from organic growth. From this perspective, it becomes easier to understand the business motives behind the proposed merger.

5. CONCERNS

We do, of course, take great pride from the possible creation of a UK owned global champion. But at the same time there are issues of great public concern. Primarily, we have concerns in five areas:

What will be the effect on scientific employment of this merger?

Forecasts of job losses caused by this merger vary. They range up to 20 per cent of UK employment or between 4,000–5,000 jobs. The two companies claim that no plans have yet been made and add that any forecasts are being alarmist. But in the words of a statement from Glaxo Wellcome to employees: "It is unavoidable that when two companies of the size of ours get together there would be opportunities for improved efficiency and inevitably some job losses".

The balance of any job cuts, whether this would fall on administration, manufacturing or R&D, or on employees of Glaxo or SB is also open to speculation. Although it is estimated that the bulk of £1bn savings are likely to be found in manufacturing which accounts for 50 per cent of Glaxo's head count and 36 per cent at SB.

From our own sources and business reports we have identified the following R&D facilities in the two companies:

GLAXO WELLCOME AND SMITHKLINE BEECHAM
COMBINED R&D FACILITIES

Glaxo	*Constituency*
Beckenham	Beckenham
Dartford	Dartford
Greenford	Ealing North
Stevenage	Stevenage
Ware	Hertford and Stortford
SB	
Harlow	Harlow
Weybridge	Runnymede and Weybridge

We are not in the business of spreading undue alarm and therefore will not speculate on R&D sites that we fear may close. In addition, the Glaxo site at Stevenage and the SB site at Harlow have both been subject to major new investment programmes and are "state of the art" R&D facilities. It would be an act of industrial vandalism if any merged company closed either of these facilities.

However, the nature and balance of work being conducted between thee facilities may alter to the detriment of one or the other with a consequential effect on status and employment. Examining the merger which created Glaxo Wellcome we can witness that although Beckenham remains as a R&D facility, it is a much smaller operation and lacks the prestige of Stevenage in the new operation. We estimate that over one thousand jobs were lost from the Beckenham site. Although some of these jobs were relocated, the overall effect was to reduce the total level of scientific staff employment when compared to the figure at the time of the merger.

Also, one reason for the merger is to generate internal savings. Where functions could be usefully combined we are sure that any newly merged company will seek to make that gain. This merger will result in "paste and cut" with the various sites. This may affect existing R&D facilities.

Because these companies are major employers of science graduates we would be concerned at any further reduction in employment opportunities. Science is already viewed by many young people as an insecure career with relatively poor levels of remuneration when compared with other professional occupations. Employment on R&D performed within UK Businesses has already declined from 176,000 to 139,000 or by 21 per cent over the period 1989–1996. [Source: First Release—Business Enterprise Research and Development 1996: ONS (97) 325—14 November 1997].

2. *What effect will this have on the UK's science base?*

Glaxo and SB between them spend almost £2 billion on R&D. To put this in perspective this is over 20 per cent of private sector expenditure on R&D; two-thirds of total UK investment in pharmaceutical R&D; twice the total level of investment on R&D in the engineering sector; over 50 per cent above the level of science expenditure in Research Councils and by the Office of Science and Technology. Even a small reduction in expenditure will have a ripple effect throughout the whole science base.

An examination of R&D productivity in the two companies produced by Dresdner Kleinwort Benson highlights a relatively poor record of innovation and concludes that the cash brought in from new drugs would not cover the amount invested to produce them. In fact, the size of the new company will mean that it will need to have a remarkable record of innovatory success to meet promised earnings growth from Glaxo's Sir Richard Sykes.

It is unlikely that the new company will move quickly to reduce overall expenditure on R&D. The Companies claim that the reason for the merger is to create a "truly world-leading organisation with the largest R&D capacity and expenditure is the driving force for the merger discussions". The truth of this commitment will be seen by investment decisions in future years and whether the rate of growth in R&D expenditure matches the trend of expenditure if the two companies were to remain independent.

Once again we wish to highlight the effect of the merger which formed Glaxo Wellcome on R&D expenditure.

Year	*Glaxo*	*Wellcome*	*Combined £ million*	*per cent change*
1991	399,000	221,200	620,200	
1992	475,000	229,700	704,700	+13.6
1993	595,000	254,000	849,600	+20.6
1994	739,000	325,500	1,064,000	+25.2
1995	858,000	346,300	1,204,300	+13.2
1996			1,200,000	−0.4
1997			1,161,000	−3.0

Source: DTI R&D Scoreboard. Combined expenditure reported from 1996.

Here we can see that the Company can honestly state that it has maintained levels of expenditure on R&D. However, the growth in expenditure on R&D in the years prior to merger was between 13 and 25 per cent. In effect, Glaxo has subsumed the Wellcome R&D budget to provide costs savings in the first two years after merger.

3. *Why are the Companies refusing to consult with representative trade unions?*

The Chief Executives of both Companies are presently declining to meet MSF claiming that the regulatory constraints prevent them from making any further comment at this time. The precise nature of these constraints have never been properly outlined and European law gives recognised Unions rights to consultation.

MSF has challenged Glaxo to explain what "regulatory constraints" exist to prevent a premilinary exchange at this time. This general issue had previously been raised with Mr Alistair Defriez, Director General of the Panel on Takeovers and Mergers who gave a written assurance that there is nothing in the voluntary code which prohibits prior consultation with trade unions about mergers.

Recent communications from both Companies to Members of the UK and European Parliament indicate that this consultation will take place at business level. This will preclude consultations with Unions at a national level and prevent employees from adopting an overall response to the merger, creating the risk of setting site against site and employee against employee. This uncertainty will have a detrimental effect on scientific effort in the Companies concerned.

4. *Are the companies responding in the right manner to global pressures?*

The companies are claiming that they have to merge to remain globally competitive. But some analysts have questioned whether size is key to success in R&D. Both Glaxo and SB became global players in their own right through organic growth rather than merger or through acquisitions. All the available business evidence points to the fact that acquisitions or mergers have a negative impact on the performance of the companies involved.

For example, one study presented to the Royal Economic Society concluded that the net, long-run effect of takeover bids was to reduce the return on capital of the companies making the bids [Source: *The Impact of Acquisition on Company Performance:* Andrew Dickerson, Heather Gibson and Euclid Tsakalotos—University of Kent, Department of Economics]. Therefore, the effect of the merger will be to reduce the ability of the new company to generate capital to reinvest in R&D.

In short, will competition in a bigger company be more effective in R&D than competition between companies? The merger reduces competition and therefore also reduces pressure to invest sufficiently in R&D. Mergers are often a substitute for capital investment.

Besides, the process of innovation is slightly more complex than cost push. Although, having greater levels of investment is more likely to create positive results, sustaining an environment for research and maintaining a secure, highly-motivated and skilled scientific workforce could be seen to be equally important.

5. *What will be the effect of this merger on other UK based companies in the pharmaceutical industry?*

This merger will act as spur to further competitive mergers and acquisitions in the sector possibly leading to further rationalisation in R&D expenditure and shedding of scientific. One of the UK's few manufacturing successes faces a period of upheaval and uncertainty. This is unlikely to help the research effort in this sector.

FURTHER EVIDENCE

MSF would welcome the opportunity to give oral evidence to the Committee in order to outline our concerns in greater detail.

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