

## SCANNING THE PHARMACEUTICAL INDUSTRY ENVIRONMENT IN UNITED KINGDOM

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***T**HE United Kingdom is a member of the European Union that now numbers some twenty five European countries. The United Kingdom proper is made up of Great Britain and Northern Ireland. Great Britain itself comprises the countries of England, Scotland and Wales. This paper will address the United Kingdom's future in the global market place and its capacity to participate effectively in global management processes. The future of the United Kingdom to effectively participate in these areas will be addressed with explanations of: culture, economic conditions, people, geography, political institutions and social structures that make up this historical country. Lastly this writing will address specific issues pertaining to the pharmaceutical industry in the United Kingdom. Specifically addressed issues will include natures of the pharmaceutical industry and its overall participation in the global market place. Conclusions drawn as to the overall performance of the United Kingdom and its pharmaceutical industry to perform in the global market place will be discussed in closing remarks.*

### **Geo-Demographic Profile**

According to World Fact Book (2005), the population of the United Kingdom (July 2004 est.) was 60,270,708. The overall structure of the population had a median age of 38.7 years (37.6 male and 39.8 female). The population growth for the UK has been placed at 29% with 10.88 births/thousand. Life expectancy figures for the UK show a median age of 78.27 years. Other note worthy facts in relation to the population of the United Kingdom include:

- Nationality/Origin – British
- Predominant ethnic groups – British, Irish, West Indian, South Asian
- Predominant religions – Roman Catholic, Church of England, Church of Scotland, Islam
- Languages – English, Welsh, Irish Gaelic, Scottish Gaelic
- Education – 12 years compulsory with nearly 99% attendance and nearly 100% literacy
- Work Force – (2003, 29.8 million): Services – 80.4%; industry – 18.7%; agriculture – 0.9%.

Taken from: Bureau of European and Eurasian Affairs, p.1, May (2005).

The population of the United Kingdom is ranked as the third largest in the European Union and ranks 21<sup>st</sup> in the world overall. The relative population density of the United Kingdom proper is one of the highest in the world. It is said that nearly one third of the nation's population lives in the south eastern urban and suburb sections. The capital city London ranks as the largest city in Europe proper with a population of 7.2 million people (Bureau of European and Eurasian Affairs, May 2005).

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Being an island nation that is so relatively close to the continent of Europe proper, the Islands of the United Kingdom have been subjected to many invasions over the past centuries. These facts have led to a variety of ethnic backgrounds mainly of Scandinavian decent. According to the Bureau of European and Eurasian Affairs (2005), the predominately spoken language is English with the Celtic language persisting in Wales, Scotland, and Northern Ireland.

The history of the United Kingdom is one of very interesting backgrounds that has been played out in many movies and fairy tales exposed to many generations including myself. According to the Bureau of European and Eurasian Affairs (2005), the Roman invasion of Britain brought about development of the cultural contacts shared with greater Europe today. With the fall of the Roman Empire, the country was invaded by Angles, Saxons, and Jutes in the coming centuries. Later in the 16<sup>th</sup> century, the Norman conquest took place and out of this a stronger defensive posture to invasion developed cultivating traits still seen today of: political; business/economic; cultural characteristics; political and economic center of London; system of common law; world respected education system and democratic government.

## **Geography**

According to World Fact Book (2005), the United Kingdom has been called the “dominant industrial and maritime power of the 19<sup>th</sup> century, playing a leading role in developing parliamentary democracy and in advancing literature and science” (World Fact Book, 2005, pg. 2). The United Kingdom geographically can be described as a western island nation to include the island of Ireland. Though the UK is an island nation, its geographic location (only 35 miles to French coastline) decreases the overall isolation from the continent of Europe proper. The UK lies near the vital shipping lanes of the English Channel which is the gateway to the North Atlantic seaways. Recently the UK has been linked to France by a tunnel under the English Channel further decreasing isolation from continental Europe. World Fact Book (2005) also notes that due to a heavily indented coastline no location within the UK is any farther than 125km from tidal waters. This fact in itself links this nation to a strong naval heritage and diverse ethnic backgrounds that make up its history today.

Other notable geographic facts of the United Kingdom include:

- Land area of 244,200 sq. miles - slightly smaller than the state of Oregon.
- Land mass is 71% arable and pasture land, 10% forest, and 19% urban and other.
- Respectively - England totals 130,400 sq. km., Scotland 78,800 sq. km., Wales 20,800 sq. km. and Northern Ireland 14,100 sq. km.
- Natural resources include: coal, petroleum, natural gas, iron ore, lead, zinc, gold, tin, limestone, salt, clay, chalk, gypsum, potash, silica sand, slate, arable land.
- Irrigated land - 1,080 sq. km.
- Natural Hazards - winter storms; flooding
- Terrain - rugged topography of hills and mountains; with low rolling plains in the east and south east.
- Climate - described as moderate, with the prevailing weather being a south to southwest wind with overcast skies.

Taken and cross referenced from: Country Profile 2005; UK and World Fact Book 2005.

## **Economic Conditions**

According to the Bureau of European and Eurasian Affairs (2005), the United Kingdom attains the fourth largest economy in the world and ranks second overall in the European Union. As stated previously, the United Kingdom as a country with only a small amount of arable land has had to become a major international trading power to survive in a global marketplace. It is also said that the people of the UK experience a high standard of living and London ranks only second to New York as a major world financial center (Bureau of European and Eurasian Affairs, 2005). This traditional strength of London is exhibited in the fact that the financial and services area accounts for approximately 70% of the UK's GDP (Country Profile, 2005). Approximately two thirds of the UK economy is attributed to private consumption, with overall level of gross fixed investment averages at 16-17% of the GDP. This low level of investment in GDP is lower than other EU countries which some analysts say yield factors to a poor UK productivity performance (Country Profile, 2005). Country Profile 2005 goes on to explain that this overall level of declining gross domestic products is not abnormal for a developed country, but attributes the UK's decline to these specific factors:

- Long-term decline of the textile and ship building industry.
- Trend for UK's manufacturing companies to contract out non-core production activities to countries with lower productivity costs.

Country Profile (2005).

Even with these declines in the manufacturing sectors, most analysts believe that the UK's economy is one of the strongest in Europe. The UK's overall economy is described as one of Europe's strongest in areas of:

- Low inflation
- Low interest rates
- Low unemployment rate
- Intensive agricultural production with only limited amounts of arable land that still accounts for approximately 60% of the country's food needs.
- Large amounts of energy production through use of core natural resources; with this production accounting for 10% of the GDP.

Taken from World Fact Book 2005.

This moderate to growing economy has made the efforts of UK government to join the European Economic and Monetary Union more difficult. Some feel that the UK is not only holding their own but are excelling in their present economic make-up. Polls throughout the country have shown the majority of Britons oppose the Euro (World Fact Book, 2005).

## **Political and Social Structures**

The political makeup of the UK currently consists of the centre-left Labor Party that has been re-elected the last two terms of 2001 and 2005. The current leader of the Labor Party is Tony Blair. Mr. Blair has experienced harsh criticism for his role in the Iraq war and his party's push to implement the Euro monetary system. It is said that Mr. Blair will not seek re-election and will step down sometime during his third term (Country Profile, 2005).

Unlike the United States, the UK does not have a written constitution. The UK makes use of a body of law that is based upon statute, common law and "traditional rights", formal changes to these must

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come through acts of Parliament (Bureau of European and Eurasian Affairs, 2005). Similar to the United States Senate and House, Parliament is divided into two houses; the House of Lords and the House of Commons. In respect to the social environment, the House of Lords was originally comprised “hereditary peers and life peers”. In 1999, stages of reform brought about most of the hereditary peers losing their seats. The overall mission of the House of Lords is to suggest changes and revisions to laws but this process can be overruled by the House of Commons (Country Profile, 2005).

In contrast to the House of Lords, the House of Commons comprises a democratically elected group of 646 members. With the absence of a constitution some have called the House of Commons an “elective dictatorship” due to the power they achieve through few checks and balances of government (Country Profile, 2005). “This concentration of power is compounded by the first-past-the post electoral system, which often gives the parliamentary majorities to parties that do not enjoy the majority support of the electorate” (Country Profile, 2005, pg.9).

As is well known the UK has a reigning monarchy, Queen Elizabeth, who has reigned since 1952. The real purposeful power resides with the House of Commons but “In theory, the monarch retains the power to call and dissolve parliament, to give assent to bills passed by parliament, to appoint the prime minister, and to sign treaties or declare war” (Country Profile, 2005, pg.9). Country Profile (2005) goes on to explain that this actually is never really the case with the role of the monarch to only provide “royal prerogative” and provide support for the democratically elected parliament (Country Profile, 2005).

Constituent parts of Scotland and Wales are now represented in the overall government structure. Up until 1997, Scotland and Wales were basically represented by a cabinet minister at the national level. Narrowly passed reform has since brought about change to a Scottish Parliament and a Welsh Assembly that handle most of the government functions (Background Note: United Kingdom, 2005).

Northern Ireland was self governed by its own prime minister and parliament from 1921 to 1973. With increased social unrest and violence the British government implemented direct rule in 1973, by placing Ireland under leadership of a London based Secretary of State for Northern Ireland. In the mid 1990’s the “Good Friday Agreement” was ratified with general principles for stopping violence and reform. Progress continues to be made that will allow for a restoration of government to take place in Northern Ireland (Background Note: United Kingdom, 2005).

In relation to social standing, the areas of south-east England continue to outpace the rest of the country in attributes of wealth. This area of England accounts for 30% of the GDP but these areas also contain some of the most poverty stricken areas of the country. Overall, the poorest region of the country is that of Northern Ireland. Its overall development has been affected by years of violence and social unrest leading to high concentrations of unemployment and decrease in industrial productivity. Scotland is said to fall between these two extremes with the southwest containing a great deal of wealth and prosperity (Country Profile 2005: United Kingdom).

## **Cultural Characteristics**

UK business customs are said to be very similar to that of the United States in relation to aspects of class structure, business enterprise, professional development of managers, marketing and finance techniques of businesses and a diverse ethnic participation throughout their marketplace (Doing Business in the United Kingdom: 2005).

Cultural differences do exist in relation to standard U.S. practices in areas of pace and style of the work place with steady contact with business relations being highly important (Doing Business in the United

Kingdom: 2005). According to Cultural Advice – United Kingdom Career Guide (2004), specific attributes of the UK business environment would be as follows:

- **Daily Office Protocols:** A much defined business day that typical starts at 9:00 a.m. and ends at 5:00 p.m. with senior management staying an extra hour in the work day. After office hour socializing in a pub is common.
- **Making acquaintances:** Proper greetings of good morning and a hand shake is expected when being introduced for the first time to a new acquaintance with the hand shake being deemed not necessary in subsequent meetings. Colleagues should be addressed appropriately until a desired relationship is attained.
- **Management Styles:** Typically make use of direct and informal communication. The typical British worker will wait for sound direction from superiors but also feel they should be rewarded for a job well done. There may be some tendency for workers to delay individual decision making until sound specific directions have come from a superior. The organizational hierarchy typically will put financial control responsibilities at the top of an organizations.
- **Boss and Subordinate Relations:** Typically there has been a clear division to these relations. Managers in the past have not been promoted to top positions within a company but it has been more standard to transfer to different companies to attain a higher status. Rank is said to have privileges of separate office floors and corporate events but this may be changing to a more relaxed environment in the last decade.
- **Conducting a Meeting or Presentation:** The protocol of these depends on those attending. A meeting of peers will yield open discussion and flow of ideas and feedback, a meeting that has boss and subordinate relations will yield an environment with a more formal exchange of information.
- **Negotiation Styles:** If sound relationships have been established, British communication styles may be blunt and direct. If relationships are new, time must be given to allow Britons to evaluate the situation. Direct questions may go unanswered and overall business precedents are highly regarded in accepting proposals. Timely written correspondence and promptness is highly regarded.
- **Planning a project:** Britons do not like to be pushed into a decision, hard/pushy sales pitches are frowned upon. Britons may come across as cool and detached. A sound business plan that is presented well with histories of business precedence will be highly regarded.

Cultural Advice (2004) p.101-02.

In summary, the British business environment can draw similarities to that of the American office environment but takes on a much more formal organizational culture. The degree to which these differences are magnified will have to do with the overall conservative nature of the specific industry with a higher degree being characterized in the financial sector.

### **Future of the UK in the Global Marketplace**

The future of the UK to effectively participate in a global economy will depend significantly on the performance and the decision whether to adopt the single currency (Euro). According to Taggart (1998), there had been fear that a linkage to a single EU currency would limit stability and competitiveness in the global marketplace. Advocates of the single currency believed in 1998 that the Euro would stabilize exchange rates and yield a competitive stable business environment for trade. It is a widely held belief that businesses, especially those that could offer FDI, react to a published nominal exchange rate that would occur with the single Euro currency. The UK is not currently a member of the European Economic and Monetary Union (EMU). Critics of the Union make strong points of the performance of the United

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Kingdom outside of this union with opinion polls showing most Britons unfavorable to the Euro. According to *Doing Business in the United Kingdom (2005)*, the Labor party platform has suggested they would be in favor of the adoption but only after a national referendum by the British people. The timing of this referendum is unknown as the decision for this assessment will be based upon five economic tests:

- Sustainable convergence
- Sufficient flexibility
- Effect on Investment
- Impact on financial services
- Effect on Employment

*Doing Business in the UK (2005).*

While the EURO has been adopted by close to 300 million other Europeans, it is said that the real debate has yet to be even started in the UK.

In more recent developments, the European Union has had trouble moving forward with a new European constitution. This situation further exemplifies the troubles that have plagued the EU since the 1998 debate over the single currency adoption. According to a *New York Times* commentary, article written for the *Duluth News Tribune* by Trudy Rubin (2005) "Countries are like restaurants, we could be turning into a chain like McDonalds" (*Duluth Tribune*, 2005). There is a growing fear within the EU that the standardizing of currency and the ratifying of a constitution will lead to countries of the EU (now numbering 25, with Turkey starting to make a move) losing their national identity and decision making power. Specifically to the UK, they have recently been negatively judged as to blame for the EU struggles with implementing economic reform. Prime Minister Tony Blair comments that all members of the EU are to blame for these struggles by "Europe's leaders failing to reach agreement with the people of Europe about the issues that concern them" (*Minot Daily News*, 2005, pg. A6)

Currently, the UK is doing well in areas of foreign direct investment. According to *Doing Business in the UK (2005)* highlights include:

- Most favored inward investment country in the EU
- 40% of U.S., Japanese, and Asian investments into the EU are done in the UK
- Home to the majority of leading global corporations located in the EU
- Large amount of foreign direct investment reciprocated between the U.S. and the UK

*Doing Business in the UK (2005).*

Specifically to Foreign Direct Investment, laws in the UK are similar to laws that are in place throughout the EU. Specific characteristics in relation to FDI include:

- **Using an Agent or Distributor:** Laws here are said to heavily favor the agent and are used sparingly in favor of distributor arrangements.
- **Establishing an Office:** Described as straight forward. Processes include notification and registration with the Department of Trade
- **Franchising:** Accounts for approximately one third of UK retail sales in services industries. Registration through the Office of Fair Trading with mission to promote commerce of a fair product

and service. Generally it is said, the UK consumer market is slow to adopt new products and start-ups may be a slow process.

- **Direct Marketing:** Inexpensive transatlantic communications have made this an attractive entry tool. Marketing firms are required to give the customer clear and comprehensive information about the vendor's goods and services.
- **Protecting Intellectual Property:** UK legal system makes use of strict intellectual property rights protection. Patent and copyright requirements are similar to that of the United States. Common law prevails in the UK for business transactions.
- **Accounting Practices:** Fall under the discretion of the (SSAP) Standards of the Accounting Standards Board..

Doing Business in the UK (2005) Chapter 3, p.1-3, 6.

How will the United Kingdom do in a future economy? I believe these favorable modes of entry and favorable political institutions will continue to promote multinational company growth in the UK. In my opinion, the UK has shown that they are and will continue to be home for the majority of FDI in the EU. Market entry for large amounts of U.S. capital will continue to be favorable due to strong intellectual property right laws, common language and strong financial institutions and practices. Progression in recent times has shown a favorable decrease in areas of political violence and business corruption. In my research, I also find common opinions that the UK supports a strong infrastructure of labor force, technology and manufacturing capabilities. The biggest obstacle facing the future of the UK in the global market place in my opinion is the matter of adopting or not adopting the Euro. Arguments for the Euro are that the stable currency would give stability to exchange rates and translate into an attractive marketplace and a powerful union of all Europe. Opponents of the move feel that the UK could become isolated with the change and lose the strength and flexibility they have achieved by being independent of Eastern Europe.

## **Pharmaceutical Industry in the UK**

As of June 2005, the S & P pharmaceutical index is off .46% versus 5.04% increase in the S & P 500. Drug stocks in general have progressed through this point in the year on a moderately tough note, most analysts however, note that this group of stocks has firmed in the last couple of months and attribute this to good earnings performances.

According Datamonitor (2005), the United Kingdom pharmaceutical market has shown significant growth in the last couple of years with overall market value of \$16 billion. Market forecasts project continued growth to a value of approximately \$20 billion in the year 2008. The UK is said to account for 14.2% of the European pharmaceutical market with its largest sector being comprised of the cardiovascular treatment area that achieves a 23.9% market share (Datamonitor, 2005).

The overall market definition of the UK pharmaceutical market is described to include ethical and over-the-counter (OTC) drugs, healthcare products and animal healthcare products are not included (Datamonitor, 2005). There are common industry wide factors and emerging global trends that affect the nature of the pharmaceutical industry in the United Kingdom:

- Pricing pressures both global and domestic, as the world in general takes a more active role in wellness and economies of scale develop.
- Demographics of the worlds developed countries will yield a population that is living longer and will require increased drug therapies for a longer sustained period of time. Examples of this type of demographic would be baby boomers living longer and requiring high cholesterol treatment therapies.

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- R&D showing promise in treatments of previously incurable diseases will require significant investment for industry benchmarking.
- Increasing cost and accuracy of clinical trials. Along with the speed of product launches (first to market) and price approvals in particular that may be affected by country specific legislation and guidelines.
- Healthcare worldwide industry trend are gradually moving toward managed care and generics. Global brand recognition and new brand pharmaceutical competition will only intensify in the industry.
- Intense battles for intellectual property rights and defense of patent rights on a global scale.
- Government and regulatory legislation both domestic and globally as to drug approvals and labeling.
- Growth in cost and expenses will continually scrutinize overall profit margins
- Worldwide fluctuation in currency and interest rates.

The UK pharmaceutical industry is described as highly competitive. Global industry leaders that have strong production positions in the UK include:

- **Glaxo SmithKline** – one of the top five pharmaceutical companies in the world. This company is base in the U.S. but maintains a large UK presence and attains approximately seven percent of the world's pharmaceutical market. This company is seen as an industry leader in nervous system therapies and vaccines. (GSK) maintains a current profit margin of 14.11% and current 52 week overall return of 16.29% as compared to the S&P return of 5.04% (Yahoo Finance, 2005).
- **Pfizer** is the world's largest research-based global pharmaceutical company. Its portfolio of drugs makes up some 20 of the world's top selling medicines. The company is said to employ 12,000 scientists and invests over \$5 billion in R & D each year. (PFE) maintains a current profit margin of 17.57% and a current 52 week return of -15.67% as compared to the S&P 500 return of 5.04% (Yahoo Finance, 2005).
- **Astra Zeneca Pharmaceuticals** has strong market positions in areas of: research, development, manufacture and marketing of prescription drugs. AstraZeneca is said to be an industry leader in bringing new products to market in high profile illnesses of cancer and gastrointestinal disorders. The company makes its home headquarters in London, UK. AstraZeneca maintains a current profit margin of 14.91% and a current 52 week return of -10.81% as compared to the S&P 500 return of 5.04% (Yahoo Finance 2005).
- **Wyeth** is a global pharmaceutical that ranks among the top 20 largest health care companies. Its core business areas are pharmaceuticals, consumer healthcare products and animal health. Wyeth maintains a current profit margin of 8.72% and a current 52 week return of 17.82% as compared to the S&P 500 return of 5.04% (Yahoo Finance, 2005).
- **Roche Group** headquartered in Switzerland maintains a strong market position in the UK. Its product lines engage in R&D of healthcare solutions..

**Source: Yahoo Finance (2005) and Datamonitor (2005).**

The graph below shows how companies that maintain a major presence in the UK, **Glaxo SmithKline (GSK) and Astra Zeneca (AZN)**, compare to other industry leaders.

**Direct Competitor Comparison**

	<b>AZN</b>	<b>GSK</b>	<b>MRK</b>	<b>NVS</b>	<b>Industry</b>
Market Cap:	66.99B	140.21B	67.31B	116.54B	6.79B
Employees:	64,200	100,000	63,000	81,392	1.38K
Qtrly Rev. Growth (yoy):	13.20%	1.90%	-4.80%	11.70%	10.10%
Revenue (ttm):	22.10B	37.29B	22.67B	29.00B	8.68B
Gross Margin (ttm):	75.55%	78.64%	77.99%	79.78%	72.16%
EBITDA (ttm):	6.41B	12.56B	8.02B	11.74B	129.53M
Oper. Margins (ttm):	23.40%	30.16%	28.86%	36.23%	22.62%
Net Income (ttm):	3.29B	5.26B	5.56B	4.97B	69.23M
EPS (ttm):	1.981	1.834	2.506	2.105	0.53
P/E (ttm):	20.68	26.85	12.19	22.81	25.47
PEG (5 yr expected):	2.08	2.29	4.81	1.69	2.04
P/S (ttm):	3.04	3.74	3.04	4.00	4.02

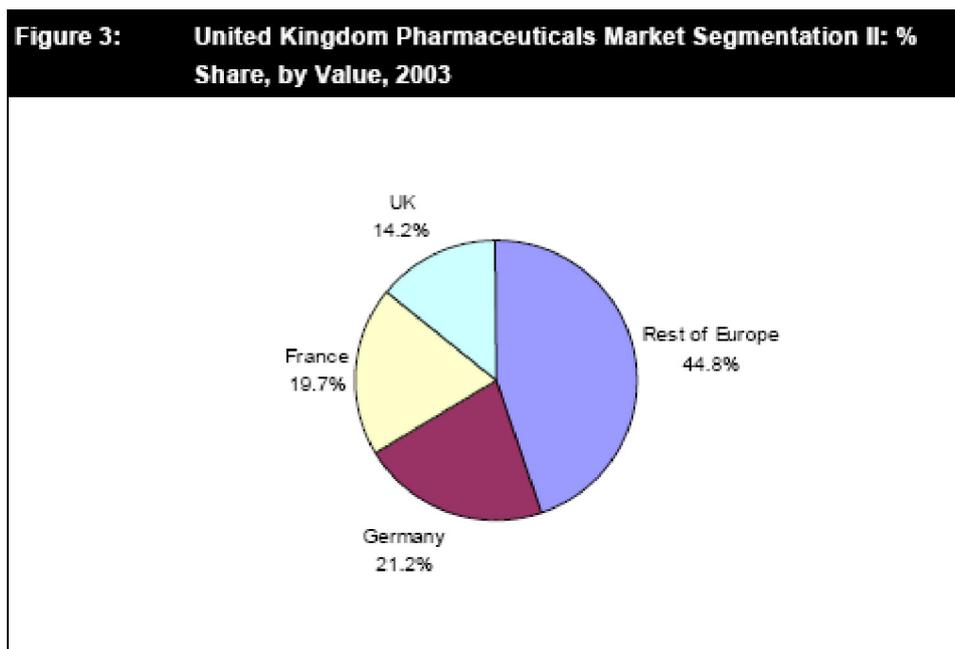
GSK = GlaxoSmithKline PLC

MRK = Merck & Co. Inc.

NVS = Novartis AG

Industry = Drug Manufacturers - MajorYahoo Finance (2005)

The graphs below make up the composition and global presence that the UK pharmaceutical industry maintains.



Source: Datamonitor (2005).