

PERSPECTIVE ON JAPAN PHARMA M&A

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For investment bankers, recent M&A activity inside Japan pharma has been a non-event. No deals-no fees. Could this be a temporary lull or a harbinger of what is to come?

This article briefly reviews the history of M&A in Japan's pharma industry, why there is a shortage of buyers or sellers today, and what we might expect going forward, writes long-time Japan pharma watcher and president of International Alliances Limited P Reed Maurer in his exclusive column for The Pharma Letter. ..

Historical patterns of M&A

Over the past 50 years two major restructurings changed the Japanese pharma industry. The first involved wholesalers and the second, large scale pharma companies.

When I came to Japan in 1970 there were about 1,800 wholesalers, each one with local coverage of the market. Local means one town or even one large hospital. Practically all were affiliated with one of four major companies, ie, Takeda (TYO: 4502), Shionogi (TYO: 4507), Tanabe, and Sankyo, via equity investments. Thus, wholesalers were dependent upon, rather than independent of, manufacturers.

This structure of the wholesale distribution system was not sustainable. To achieve nationwide distribution pharma companies were dealing with 150 to 200 wholesalers. When I joined MSD (Merck & Co) in 1976, their distribution partner, Banyu, was using 180 wholesalers.

A process of consolidation, encouraged by the four major players mentioned above, resulted in 100 wholesalers, but almost all revolve around four groups, ie, Alfresa, Medipal, Suzuken, and Toho. Each of the four has nationwide distribution and is independent of any single manufacturer.

It is remarkable that along the way only one wholesaler ceased to exist by going bankrupt. Think of consolidating a wholesaler industry made up of close to 2000 companies down to four without a blood bath of people and facilities. This is a prime example of an “only in Japan” scenario.

The second more recent consolidation occurred between large pharma companies, namely eight that merged into the four separate entities of Astellas (TYO: 4503) formerly Yamanouchi and Fujisawa), Daiichi Sankyo (TYO: 4568), Mitsubishi Tanabe (TYO: 4508), and Sumitomo Dainippon (TYO: 4506). Non-participants in this process were Takeda, Shionogi, Eisai (TYO: 4523), and Ono Pharmaceutical (TYO: 4528).

The driving force behind these mergers was the need to achieve a critical mass sufficient to expand outside Japan. Thus, in Japan they consolidated facilities and reduced headcount while expanding their operations in the USA and Europe. Important, too, were the additional financial resources available for investment in research to discover or buy new products. In this business, new products are the key to sustainable growth in any market.

Present status

Beyond wholesalers and large pharma companies, there are other players in the pharma market. They include the following with a brief comment about each:

Small to medium sized ethical pharma companies who have not yet focused their resources on any particular therapeutic area. Some of these sustained modest revenue growth via introducing generics. But the generic drug space is a totally different game than promoting ethical drugs.

A few mid-sized companies managed to specialize in certain classes of drugs. Santen in eye care and Maruho in skin care come to mind. This is a space that can drive sustainable growth if the companies provide innovative products.

Generic companies, both large and small, have been beneficiaries of government policies designed to increase the market share of generics to 80% by 2020. Various financial incentives drove both sales and income growth. Now that the goal is in reach, these incentives will certainly be cut back and/or eliminated.

Non pharma companies decided that profit margins and sales potential of drugs was too good to pass up. They therefore jumped into the game with large resources at their disposal. When dreams met reality some exited the business. Beer and food companies are prime examples.

Finally, there are the start-ups launched by academia and entrepreneurs encouraged by the government. There is no doubt that new ideas originate in Japan and that this society fosters innovation via their devotion and loyalty to something new versus old. Unfortunately, there is also a risk averse mentality that inhibits people and financial resources from going into the very risky businesses of discovering and developing new drugs.

What's next?

An answer to this question is acutely necessary for all of the above firms. Since January of this year I talked to a wide variety of people in the pharma industry to determine if anyone has the answer. I learned many people can articulate the issues but come up short when pushed to answer how these companies will survive. The big company model of merging does not create synergies for success in Japan, let alone in other markets, for the small to mid-size companies.

Would it make sense for the non-pharmas to acquire pure pharma companies? In fact, so far it seems they are either exiting or putting their pharma businesses into pure play pharma companies, ie, Kirin into Kyowa Hakko, and Ajinomoto to Eisai.

The generic business model is going to favor large players with low costs and a full line of products. Examples include Teva, Mylan, Nichi-Iko and Sawai. There may be a future for a generic company that innovates in terms of product quality and convenience of dosage.

Present and future start-ups will prosper because of innovative ideas and government support. Maybe local angel investors will also get into the game. However, these financial resources pale in comparison to US experience.

A final word

If you read this far expecting a clear guide to what we can expect in the future, you will be disappointed. But do not forget that no one in 1970 expected a vast number of wholesalers to consolidate into four main players. Nor did anyone 20 years ago expect a merger between Mitsubishi and Tanabe, or Sumitomo and Dainippon.

So, stay tuned. The Japan market is primed for change. Do not fall into the trap of believing nothing changes in Japan.