



Unlocking Hidden Value in Bioscience

Introduction

The recent report from the Bioscience Innovation and Growth Team (BIGT - established by Government and the bioscience industry), "Bioscience 2015," stated as one of its key recommendations the need to ensure that sufficient and appropriate funding is available to enable the creation of a sustainable UK Bioscience sector by 2015¹. Whilst the report focuses on the support that Government can provide to the sector in order to secure a successful future for UK bioscience, it acknowledges that, "Most of the responsibility for achieving this vision lies with industry." To date, industry has not delivered.

There are a number of reasons for this failure, not the least of which concerns the industry's access to and use of funding. Within the financial markets, a number of factors have combined resulting in an increasing funding gap for bioscience companies - particularly those seeking to secure follow-on finance after a seed round. In seeking to close this gap, companies are finding that they have to resort to alternative approaches to those traditionally employed. This article explores some of the ways through which emerging companies can sustain and improve their finances at the same time as improving their attractiveness to current and future investors.

Current State of UK Biotech

For some time, the UK has been the leading European country in the bioscience industry, ranking second only behind the US in world terms (fig. 1, over page).

Country	Total number of companies 2002	Public companies only					
		Number of public companies	Industry market cap (€ millions)	Revenues (€ millions)	Employees	Number of biotech marketed products	Number of pipeline products
USA	1,457	307	205,000	26,986	191,000	74	872
UK	331	46	9,377	2,933	22,104	10	194
Switzerland	129	5	7,285	1,748	8,158	8	79
France	239	6	536	250	9,655	6	31
Germany	369	13	488	513	13,386	1	15

Source: Ernst & Young for European company data (2003); BIO, 2003 for US except for number and revenues of public companies re: BioCentury; Pharma Projects March 2003 for pipeline and BioCentury, for number of marketed biotech products. Marketed products (including small molecule drugs) for UK bioscience companies number 38.

Fig. 1: US and European Bioscience Industry

¹ "Bioscience 2015. Improving National Health, Increasing National Wealth." Bioscience Innovation and Growth Team, November 2003.

The majority of companies within the UK sector are less than 15 years old with only 8% being public companies. Despite the relatively early-stage of these companies, the industry has been moderately productive in generating development candidates, with at least 23 in Phase III clinical studies (fig. 2).

However, this tale of success masks some uncomfortable underlying fundamentals. The performance of the US Biotechnology industry far outstrips that of the UK and its success is resulting in a drift of companies and talent towards that market. In addition to this success-driven pull, the challenge posed by established European sectors such as Switzerland, France and Germany is being supplemented by countries such as Ireland, Singapore, Malaysia and India who are determined to develop leading Biotechnology clusters of their own.

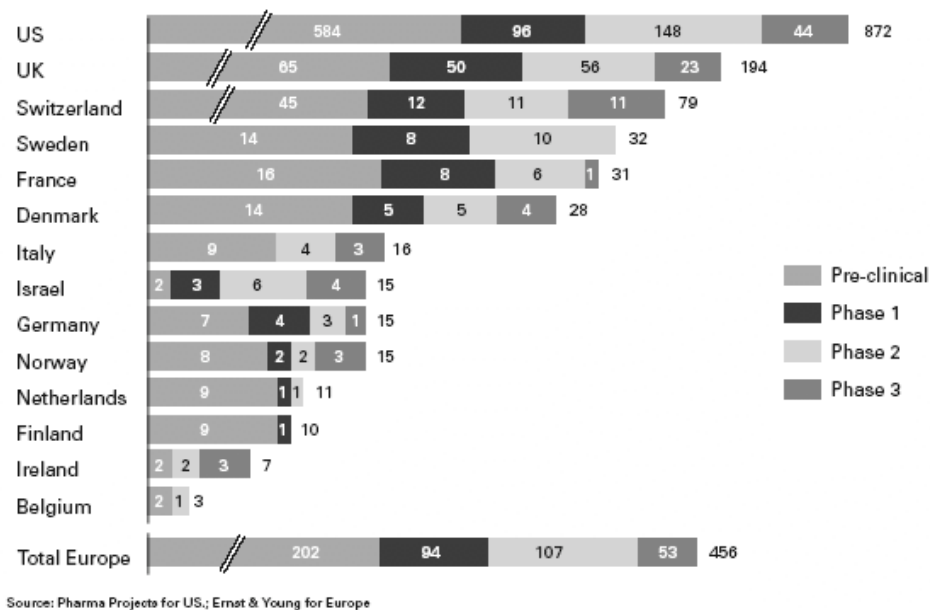


Fig. 2: Product Pipelines for Worldwide Public Biotech Companies

Despite its performance in generating development candidates, the UK sector has largely failed to deliver the type of profitable, growing companies that investors expect and that the industry critically needs in order to become sustainable. Organic growth provides only part of the answer to this need with both consolidation (to generate viable entities) and the removal of weaker players being necessary supporting pillars in the evolution of the sector.

The current downturn in the bioscience financial markets and the consequent virtual closure of public markets has resulted in a significant funding crisis for not just the UK sector, but also the European industry as a whole. The EU Commission’s Biotech Finance Forum estimates that there will be a €1 billion funding gap for European biotechnology companies in 2004. The gap is particularly evident for those companies seeking to secure funding beyond their initial seed rounds. Numerous funds exist to support the introduction of new entrants to the sector with finance being relatively readily available for start-up companies based on sound technology platforms. However, the ability of these companies to attract investors beyond the seed round

is compromised by the conservative view of venture capital and the demand for rapid returns in a sector that cannot escape the long-term nature of drug development.

However, companies have more power than they might think to change their situation through pursuit of viable, commercially focused business models based upon sound technologies.

The Need to Exploit Hidden Value

The failure of the bioscience industry in the UK to deliver a sustainable sector hitherto has had significant impact within the investment community with venture funds reluctant to provide support in the same manner as previously. Instead, their focus has become more heavily targeted on the generation of financial returns. CEO's have less freedom than in the past and are now living a paradox whereby they are expected to achieve more with lower levels of investment in a world where drug development costs continue to spiral. Similarly, investors are encouraging their portfolio companies to remain focused on their core capabilities with the consequence that they restrict them from fully exploiting their technology platforms. All of this continues in an environment where investors are seeking to drive rationalisation in the sector, expressed through an approach of, "Merge or die."

Within this context, there is a real need for company executives to find ways to generate revenues far earlier in their lifecycle than previously. Achieving such a result makes companies more attractive to both existing and new investors. For those companies seeking Series A or B finance, who are likely to be most vulnerable to the current funding gap, this can often represent the difference being securing their future and not.

Realising Hidden Value

Several options exist that allow bioscience organisations (or indeed emerging companies in any industry segment) to realise value at an earlier stage in their lifecycle than otherwise.

□ **Exploitation of non-core assets**

Almost all emerging companies have assets that are not being utilised which can potentially be revenue generating. Normally these assets are dormant due to a lack of either resource or capability within the organisation. Critically, the key to successful exploitation is through finding mechanisms whereby such peripheral assets can be exploited without interfering with the core objectives of the company. The most likely route to success lies through engagement of organisations with the ability to understand the value of these hidden elements and the capability to exploit them without impeding the progress of the company as it pursues its central tasks.

□ **Collaboration with Partners**

Emerging companies frequently shy away from partnerships fearing dilution of or interference with their intellectual capital and the potential for distraction from their chosen pathway. However, identifying and securing partnerships at an early stage can have the opposite effect promoting clarity in the development of technology platforms and allowing companies to focus on their own strengths whilst their partners provide support in other, weaker areas. As a result efficiency and effectiveness can be improved. There are potential pitfalls nonetheless. Partners must be carefully chosen in order to ensure, not only that they possess the right skills and capabilities, but that they also share a similar approach to doing business.

□ **Exploitation of synergies**

Beyond the use of simple partnerships to plug capability gaps, companies can improve their chances of success through collaborations focused on delivering synergistic benefits. Experience has shown that it is rarely the case that a single product or technology will result in a successful business long-term. Success is more likely to be secured through a willingness to integrate the best parts of complementary technologies in order to produce something that is more than the sum of its parts. Of course, this approach depends upon intimate collaboration between organisations in pursuit of a common objective - something that is difficult to achieve in a sector whose companies have historically viewed all outsiders as competition - but the benefits to both sides are manifest.

The obvious question that arises is, "Why has the industry not pursued such an approach before now?" There are numerous reasons for this. For too long, investors were prepared, grudgingly or otherwise, to continue to fund under-performing businesses - a situation that no longer pertains. In the past, company executives were encouraged by their investors to adopt a conservative, inwardly focused approach for fear that they may become distracted from the key tasks facing the business. With the historic poor performance of their portfolios, investors are now taking a broader view.

Frequently in the past, when considering deal making, company management and boards were not prepared to accept lower longer-term returns in order to secure the short-term future of the business. There are many companies that no longer exist who ignored or turned down deals that they saw as not valuing their technology sufficiently highly.

All of this has been exacerbated by a lack of commercial management expertise in many early-stage companies. This is not surprising since these companies have normally been run by their founding scientists, who have spent their careers in academia, or by big-company executives who have similarly been shielded from the realities of small business finance. However, fault does not lie here, rather it has been the industry's failing in not providing sufficient support to these management teams.

In this situation then, is industry any more ready or better equipped to meet the challenge now than it has been in the past? The answer is both yes and no. As has been mentioned, investors are starting to take a different approach to their portfolio companies. However, this change is not happening quickly enough and CEOs and their executives are still having to spend too much of their time on fund-raising activities and investor management.

With the continued development of the sector, there is a growing pool of management talent within bioscience. This new generation of management is more commercially focused and less conservative than previously. As a result, they are more likely to be pragmatic in their deal making and focused on progression against plan. Sadly, this pool remains relatively shallow when compared to the number of early-stage companies in the sector and as a consequence, many of the sins of the past are being revisited.

Ultimately, the answer can only lie with company management. They are the ones who have to chart a path to success - they cannot rely on their investors to do so for them. The consequences of pursuing the types of approach advocated here will mean that the make-up of the bioscience sector will change over the next 5 -10 years. A more open approach to partnership and collaboration in search of synergies will naturally result in more M&A activity. However, the net effect should be that whilst the chances of an individual company surviving will be reduced, those merged entities that do succeed would be bigger and stronger as a

result. Rather than “Merge or die”, companies should be focusing on the concept of “Merge and succeed.”

Conclusion

Although investors and Government continue to support new entrants to the bioscience sector, second and third-stage funding remains difficult, costly and time-consuming to obtain. In this context, the generation of revenues from hidden assets will be key to the survival and prosperity of emerging companies. Companies need to focus on generating returns more efficiently and effectively through maximising their technology advantages with a willingness to exploit non-core as well as core assets in ways that do not dilute focus.

Within this context, there must be a new approach to co-operation and collaboration in order to realise those synergies that exist across the sector. There must be a readiness to embrace this approach in order that the flagship profitable, growing companies that the sector needs for sustainability will be generated. If this can be achieved in combination with the type of environment envisaged and sought by BIGT then the future for bioscience in the UK is indeed a bright one.

About This Article

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Neil was born, raised and educated in Scotland and now runs the Essential Science office near Glasgow.