

BusinessWeek



New Genentech
CEO Clark at
headquarters
in South San
Francisco

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STRATEGY & COMPETITION

Can Roche Leave Genentech Alone?

Now that it has acquired the biotech superstar, success will depend on keeping some distance

By Arlene Weintraub

Pascal Soriot, a senior executive with Roche, says he was wracked with anxiety while boarding a plane from Basel, Switzerland, to San Francisco last March. The Swiss pharmaceutical giant had just acquired its longtime drug development partner, Genentech, and Soriot was on his way to meet the company's CEO, Arthur D. Levinson, credited with building one of the world's most effective pipeline for cancer drugs. The Genentech products that Roche sold overseas, including Herceptin for breast cancer and Avastin for colon cancer, accounted for 40% of Roche's \$42.3 billion in revenue last year. Soriot was awed—and worried. "The first question I asked Art was, 'How do we keep the Genentech spirit alive forever?'" he recalls.

Several of the world's top pharmaceutical companies are spending the final weeks of 2009 digesting some of the biggest acquisitions in their history. Pfizer just closed its \$68 billion merger with Wyeth, and Merck sewed up its \$41 billion purchase of Schering-Plough. Roche's deal was different: It paid \$47 billion to acquire the 44% of Genentech it didn't already own, essentially bringing its most productive unit in-house when the deal closed on Mar. 26.

What all these companies have in common is they must prove to investors and patients that they've learned from past megadeals, which typically generated short-term cost savings but few exciting drugs. "If you look at mergers in the pharmaceutical industry, I don't think we have a long history of successes," concedes Ian T. Clark, a Genentech veteran who will become the unit's CEO starting in January and is serving on the integration team. "Roche knew that the cradle of innovation was the research site at Genentech and that it needed to be handled carefully and distinctly." Investors expect Roche to get it right: The company's American depository receipts have climbed 12% this year, to 41.

For nearly 20 years, Roche executives said that Genentech succeeded because it operated at arm's length, maintaining its own shareholders and

management team and suffering little meddling from its big stakeholder in Basel. Genentech's sales doubled, to \$13 billion, in the five years ended in 2008. And the stock advanced more than 300% in the 10 years leading up to Roche's July 2008 bid for the company. Roche CEO Severin Schwan says the centerpiece of his integration strategy is that he will not impose the Roche culture or way of doing business on the South San Francisco biotech unit. "Most companies think the first thing you have to do after an acquisition is streamline everything," Schwan says. "I have to tell you, this kills innovation."

To keep the ideas flowing from Genentech's labs, Roche left in place almost everything in the research operation, including its senior leadership team. Genentech's scientists will continue to focus on cancer, immunology, and brain diseases. "We have a budget and a completely independent [drug] portfolio that we manage, irrespective of the rest of Roche," says Richard H. Scheller, a nine-year Genentech veteran who continues to serve as head of research. To ensure scientists wouldn't flee from what might now seem like a big, bureaucratic company, Scheller and his colleagues preserved Genentech's university-like culture. The postdoctoral program for fledgling scientists

is intact, as are the Wednesday review meetings where researchers present their work to management. And Genentech still throws after-work parties on Fridays, a tradition that stretches back to the company's founding in 1976.

Roche is following a completely different research path from those of its rivals, which have been reshuffling research and development in a desperate attempt to jump-start innovation and make research more efficient. Companies such as Pfizer and GlaxoSmithKline have set up small R&D units defined by what diseases they're pursuing.

At Pfizer, the changes have been disruptive: The company said in November it would close six research sites. Roche, on the other

hand, is keeping its existing research centers in Basel; Nutley, N.J.; and South San Francisco as independently managed sites. And it's encouraging scientists in all those places to pursue a variety of therapeutic targets—even if their efforts overlap with other Roche sites. Roche scientists from around the world will share results, meeting periodically to decide which molecules have the best chance of becoming drugs. "You need different approaches and cultures and ways of pursuing ideas," Schwan says.

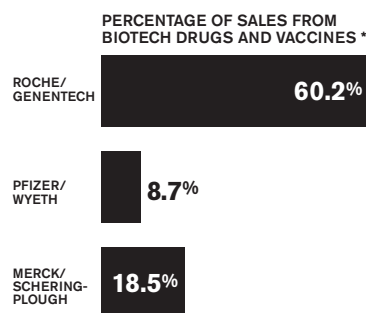
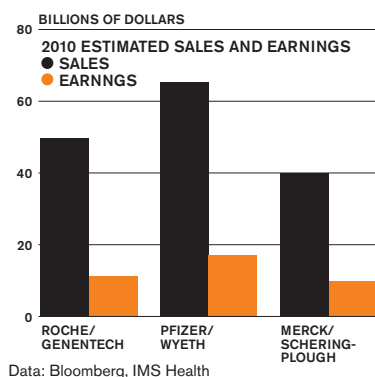


Roche's Soriot worried about fixing what wasn't broken at Genentech

DRUG COMPANY MERGERS BY THE NUMBERS

Roche's Genentech deal helps it compete with newly merged rivals...

...and makes it a leader in biotechnology



*Estimates based on product sales for the 12 months ended June 2009. Roche does not sell vaccines.

The merger will also allow Roche and Genentech to work together on an elusive goal they share: so-called personalized medicine. Roche leads in this area because it is a pioneer in “diagnostics,” or technologies doctors use to determine which patients will respond best to which drugs. Genentech pioneered this approach with Herceptin, a breast cancer drug that comes with a genetic test to pinpoint appropriate patients. When they were separate, Genentech and Roche rarely tried to co-develop diagnostics, because it took too long to work out patent rights and other legal logistics. “Now there’s no intellectual-property discussion, there’s no negotiation—we’re the same!” Scheller says. “You wouldn’t believe how much easier it is.” Genentech has already set up partnerships with Ventana Medical Systems, a U.S. diagnostics company Roche acquired in 2008.

A DIFFERENT COURSE

While Pfizer and Merck have been laying off scientists, Roche has let go

fewer than 1,000 employees, almost all of whom worked in service functions. Analysts predict the company will continue spending more than 20% of sales on R&D, outpacing the 15% or so that most large drug companies spend. Schwan predicts the merger will eliminate \$800 million in costs next year, nowhere near the \$3 billion to \$4 billion in savings Merck and Pfizer expect from their deals. But Roche could turn in double-digit earnings growth because it is so heavily concentrated in high-margin products such as biotech drugs (table). “It has a defensible base business that makes it different,” says Jeffrey Holford, an analyst for Jefferies Group in London. He expects Roche to chart compounded annual earnings growth of 13% through 2013, helped by tax efficiencies gained from owning Genentech outright.

Schwan is so determined to leverage Genentech’s reputation that he rebranded all the drugs Roche sells in the U.S. as Genentech products. Even nonbiotech names such as Valium and

Tamiflu now carry the name Genentech. Embracing an acquirer’s identity is a rare move in the drug industry, but it sends a powerful message to employees, customers, and investors. “If you’re buying an organization because you feel it’s an extremely productive innovation engine with a precious culture, you keep the name,” says Peter Tollman, a vice-president in Boston Consulting Group’s health-care practice.

Genentech’s former CEO Levinson isn’t ready to call Roche’s strategy a success quite yet, but he’s encouraged that none of Genentech’s top scientists have left. “I was apprehensive because our cultures are not perfectly concordant,” says Levinson, who is now chairman of the unit and will join Roche’s board next year. In the end, he adds, he found that “Roche has a deep appreciation for protecting the science.” **| BW |**