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Margins of pharmaceutical companies are continuing to decline – the future lies in new ecosystems

- **Glaxo is leading the way in growth in Europe; Roche is well underway; Novartis is stable**
- **R&D expenditure continued to rise in 2017 – medicines pipeline grew by one-fifth**
- **New ecosystems, start-ups and digital solutions will massively change the market by 2030**

Zurich, 9 July 2018. The margins of the 21 largest pharmaceutical companies in the world are declining, but they are still growing thanks to blockbuster drugs and new active ingredients against cancer. 40 per cent of the active ingredients that are currently being developed worldwide are cancer drugs. In 2017, the pharmaceutical companies had already earned almost every third Swiss franc from them: sales in the field of oncology rose by CHF 151,3 billion to CHF 160,0 billion. At the same time, sales of blockbusters grew significantly faster than total sales: while the top 21 pharmaceutical companies generated total sales of CHF 520,4 billion in 2017 and thus just 0.4 per cent more than in the previous year, blockbuster sales rose by three per cent to CHF 312,4 billion.

However, the at least slight growth in sales is not reflected in the operating result: EBIT decreased by 2.4 per cent compared to the previous year to CHF 176,0 billion. It should be noted that currency effects played a major role in 2017: adjusted for currency effects, sales increased more strongly by 2.6 per cent, and EBIT was only slightly negative at minus 0.4 per cent, with Roche and Novartis remaining almost constant. The margin declined as well: in 2017, it was still at 26.5 per cent, which was 1.8 percentage points fewer than in 2016 but 0.2 percentage points more than in 2015.

These results are derived from an analysis of the key financial figures of the 21 largest pharmaceutical companies in the world, which was produced by the auditing and consulting firm EY.

“The pharmaceutical companies are becoming increasingly dependent on cancer drugs and blockbusters”, notes Paolo Prisco, Market Segment Manager of Life Sciences Switzerland at EY, when commenting on the figures. “The increase in sales is at a low level due to declining margins. So we need new approaches: the companies must promote innovations even more strongly and develop completely new ecosystems. The future will also be shaped by personalised data-based medicine – a lot must and will happen in this area.”

Jürg Zürcher, head of Biotech in Basel, adds: “Many other industries would be very satisfied with the margins in the pharmaceutical sector. But the decline reveals a problem: there is a tremendous amount of competition in the largest therapy areas such as oncology – in the end, only small pieces of the cake are left. There is much at stake for the corporations. Acceptance of new forms of therapy, and the willingness of health systems to pay, will decide between success or failure”.

The rest of the world is growing faster than the saturated markets in Europe and the USA

Added to this is the fact that it is precisely in the large emerging countries such as China, India and Brazil where the demand is continually increasing. This means that sales performance varies greatly from region to region. While sales growth in the relatively saturated US and EU markets was only minimal, pharmaceutical companies in the rest of the world generated 2.6 per cent more sales in 2017. The companies responded to the demand for the creation of new drugs with increased spending on research and development: the top 21 pharmaceutical companies spent a total of CHF 98,7 billion on this in 2017 – which was 3.7 per cent more than in the previous year. Regarding the two Swiss pharmaceutical companies, R&D spending at Roche grew by 5 per cent, but shrank slightly by 1 per cent at Novartis.

The pipeline of new active ingredients is full to bursting point
The pharmaceutical companies are investing heavily in new products – in 2017, the number of active ingredients in clinical development rose by almost a fifth (19.4 per cent) following growth of just under 12 per cent in the previous year. The number rose significantly from 200 in the previous year to 315 in the last two phases in particular shortly before market launch. In fact, growth in these phases over a two-year period was even 85 per cent.

"The large number of drugs that have been approved in recent months shows that the pipelines of pharmaceutical companies are well filled," says Zürcher. This is good for the patients because new treatment options become quickly available to them thanks to the investments in research and development. Breakthroughs in individual areas stimulate the whole sector and create a positive investment environment". As an example, Zürcher refers to proteins that support the immune system against cancer at the cellular level.

The development of ecosystems is opening up completely new business models
A new EY study has shed light on the industry's trends for the future. It shows that there is still considerable potential for the pharmaceutical industry – even though the markets are highly saturated. The reason is the new possibilities offered by the technology and the associated upheaval in the entire healthcare sector – the future lies in designing completely new types of ecosystems and business models. With the aim of providing comprehensive support for healthcare customers, large corporations are investing in new technology companies that offer, for example, platform solutions and digital distribution channels. One example is Roche, which has built up a sophisticated ecosystem and thus has strong control over the diabetes treatment market.

Although conventional pharmaceutical sales will continue to make up the largest part of the market in the future, the proportion of healthcare IT solutions in the overall market will massively increase. The study predicts a nearly threefold increase by CHF 2.9 billion for Switzerland – so healthcare IT solutions will thus reach a similar level as conventional pharmaceutical sales.

Paolo Prisco, Market Segment Manager of Life Sciences Switzerland at EY, emphasises: “The pharmaceutical industry is undergoing a transformation from Pharma 1.0 to Pharma 4.0 and thus to the “outcome-based approach” – that is to say a model which represents a collaboration of all participants such as patients, doctors, insurance companies and the state”.

Life Science start-ups will capture market share from corporations

However, competition will develop with new entrants on the market as they snatch away market shares from the established pharmaceutical companies. According to the EY forecast, Life Science start-ups will take over between 30 and 45 per cent of the market by 2030. This suggests that pharmaceutical companies would have to hand over most of their shares if they concentrated purely on efficiency measures and adopted innovations from outside the industry instead of developing them themselves. The best scenario for them is when they aim to design and control the whole ecosystem themselves.

Future value achieved by data-driven platforms

“Data-driven business models will permanently change the pharmaceutical industry”, concludes Zürcher. Start-ups are more agile in developing new solutions, which gives them an advantage over large corporations. The crucial role will be to translate data into information so as to provide the best possible treatment methods for the patients. The collaboration across corporate and national borders will be of central importance to the successful functioning of ecosystems, and will provide added value both for patients and companies”.