Revised transcript of evidence taken before
The Select Committee on Economic Affairs

FOREIGN TAKEOVERS AND THE PUBLIC INTEREST

Evidence Session No. 1  Heard in Public  Questions 1 - 13

TUESDAY 8 JULY 2014

2.30 pm

Witnesses: Professor Sir Tom Blundell, Professor John Kay and Katja Hall

Members present

Lord Hollick (Chairman)
Baroness Blackstone
Lord Carrington of Fulham
Lord Griffiths of Fforestfach
Lord Lawson of Blaby
Lord May of Oxford
Lord McFall of Alcluith
Baroness Noakes
Lord Rowe-Beddoe
Lord Shipley
Lord Skidelsky

Examination of Witnesses

Professor Sir Tom Blundell, Fellow in Natural Sciences, Sidney Sussex College, Cambridge, Professor John Kay, Supernumerary Fellow in Economics, St John’s College, Oxford, and Katja Hall, Deputy Director-General, CBI
Q1 The Chairman: Good afternoon and welcome to the Economic Affairs Committee. This is our first public meeting of the new parliamentary Session. Today we are hearing evidence on the public interest issue. We are assessing the overseas takeovers of British companies, which has obviously become a very important topic in the light of the Pfizer-AstraZeneca situation, although that is quiescent at the moment. Professor Sir Tom Blundell, Professor Kay and Ms Katja Hall, welcome to the Committee and thank you very much for joining us today. We are being broadcast, so if you could speak loudly and clearly, that would be most helpful. Would any of you like to make an opening statement or shall we go straight to questions?

Professor Sir Tom Blundell: Thank you. I am Tom Blundell. I would like to make a declaration of interest. First, I worked during the late 1970s and 1980s, and recently, with Pfizer. Second, I have also been a consultant for AstraZeneca, through MedImmune. Third, I co-founded a company called Astex in 1999—the second company I have founded—which we sold last year to a foreign company, Otsuka, for $886 million. Although I am conflicted at one level, these interests probably all bear on the issue today, and I wanted to make them clear. The core of this problem is understanding the research innovation ecosystem, which involves academia, clinical trials, small companies and large companies. I think that understanding the dynamics of that is absolutely critical to the discussion today.

Q2 The Chairman: Thank you. Professor Blundell, I wonder whether we can start off by asking you a little more about your first-hand experience of a merger in the pharmaceutical industry, its impact on the research and development base and the extent to which the business model—cutting costs and the like—is an important part of the thinking behind these mergers.

Professor Sir Tom Blundell: From my own experience, I find it very difficult to distinguish an acquisition and a merger. Most mergers that I have been involved in evolved into
acquisitions, where the dominant partner tended to sustain its existence, and gradually the other merged companies either were closed down or became difficult to discern. Pfizer and Sandwich is a good example. That was not a simple merger, because Sandwich was a part of Pfizer for a long time and was the place where amlodipine, Viagra and Norvasc were discovered in the 1980s. It was the source of blockbusters and much the liveliest part of Pfizer when I was there in the 1980s. I was in either Sandwich and Groton every month, so have seen both sides of Pfizer activity. The almost entire closure of research activity in Sandwich—there is still some activity there—was a result, I am fairly certain, of the big Wyeth acquisition, for what was, I think, $60 billion to $70 billion, which was hugely costly. Before that, there were Pharmacia and Warner-Lambert acquisitions in the previous decade. The effect, whether they are acquisitions or mergers, in the current business model of large pharma, was quite clear.

It was evident when I formed my own company in the late 1990s that the pharmaceutical industry was not sustainable. There had been an exponential increase in research but almost constant output—it did not increase at all—of new approved drugs. So the model that we have here is that the company makes an acquisition and then, a couple of years later, it has to close another research centre. That is the general picture that I have seen throughout my involvement.

I was also a board member of Celltech when it was in the FTSE 100. We undertook three mergers that were really acquisitions, and each of the companies was more or less closed down by the end of the period I was involved. Then, of course, CellTech was purchased by UCB. The effect of mergers or acquisitions is that you lose research centres entirely in longer term, and in the transition towards a merger or acquisition you lose research output because of the disturbance and the lack of clear planning during that period.
The Chairman: You sold your business, Astex, to a Japanese pharmaceutical company. Have the same things befallen it?

Professor Sir Tom Blundell: I was very clear that I was absolutely determined not to have Astex sold to a large pharma company from Europe or the US that did not have the one characteristic I saw in UCB, that of being a company with a long-term interest from a family or other investors. I am often wheeled in these days to UCB as a person with a title to talk to the long-term shareholders. It really is more or less a family business, and one gets the feeling that it is sustainable. I am also optimistic about Otsuka, which is very similar to that. I have lived in Japan and can speak a little Japanese. During the purchase of Astex, I even addressed a meeting in Japanese. One can never be sure of the outcomes, but I am more optimistic. A long-term interest, through a family, is a good thing in pharma. Rather than a chief executive who stays for two to four years, given that it takes 14 years or something of that order to get a drug on to the market from early discovery, you need a sustainable and long-term vision. That vision is not, I think, about short-term mergers.

Q3 Baroness Blackstone: This is a question for all three of you. Can you tell the Committee what you think Pfizer’s motives were when it recently bid for AstraZeneca? Was this an accountants’ merger, as the FT described it, or not?

Professor Sir Tom Blundell: I cannot read Pfizer’s mind. However, during the discussions, I had a teleconference with people from Pfizer, who were certainly extremely surprised by the reaction here. When I told them that I had gone to my lab on a bank holiday morning and that all my post-docs and students were talking about was the merger, they seemed very surprised. What Pfizer was thinking may not have been clear, but what was evident was the fact that if Pfizer purchased AstraZeneca and then abandoned the Cambridge move and building, they would still be largely in profit.
**Professor John Kay:** Like Sir Tom, I do not think we can usefully speculate here on what Pfizer’s motives are. However, we can and probably should note that, because of this somewhat anomalous US tax position which means it is unattractive for Pfizer to repatriate cash accumulated abroad to the US, it has, in a sense, an artificial incentive to acquire assets overseas. That may well have played a part—how large a part we cannot know—in the decision on this.

**Katja Hall:** Similarly, I would say that in some ways it is for the board of AstraZeneca to assess Pfizer’s motives. They will obviously have considered the bid on the basis of whether or not it offered good value and was in the long-term interest of the company. On this occasion they appear to have felt that it was not and that it would be better for AstraZeneca to remain independent. That was ultimately the view of the shareholders as well. There is though an important broader point here that we should remember: it is good that the UK is an open country and one that companies want to come and invest in. We should also make sure that it is in companies’ interests to keep that investment here in the UK. That is important. There are obviously particular issues with the US tax system, but I do not think we should let that detract from having an open environment in the UK. Being able to say that the UK is a good place to come and invest and to do businesses in is positive and ultimately helps growth and jobs.

**Q4 Lord May of Oxford:** Would it be desirable to extend the public interest test to include research and development?

**Professor Sir Tom Blundell:** Maybe I could begin to answer that, from the perspective of a person involved at a scientific research level. I co-founded, Astex, with another academic and then brought in an ex-student from my Birkbeck days, which Baroness Blackstone will know about. It therefore began with a fusion of ideas from academia and a large company, although we had only a very small investment at the beginning. We then brought in research scientists
from both Glaxo and Pfizer, and we recruited from just about every large company over the next three or four years; we recruited about 100 PhD scientists altogether. Some of those moved to other small companies after a while; others moved back to academia or their original companies. While we were operating, we had four investments from large pharma of around $30 million each: from AstraZeneca, GlaxoSmithKline, Novartis and Janssen. Without that kind of complex ecosystem, the research that we do in the universities is not going to be translated easily. I am absolutely involved in basic science, although I have always tried to work with companies and tried to translate my research: by consulting, selling my software—while making it free to academics, by the way—and forming companies. The whole pharma ecosystem depends on maintaining these interactions and on the research presence of a large pharmaceutical company, or preferably two or three, in the country. I really do think it is desirable and in the public interest to extend this to research and development.

Lord Lawson of Blaby: You say that it is important to do research in this country. Of course, there is nothing to stop a British company from doing its research overseas: indeed, most of AstraZeneca’s research is done overseas. Focusing simply on takeovers seems to me to miss the point completely.

Professor Sir Tom Blundell: I agree that these are all global companies. AstraZeneca is a Swedish-British company with investments in the US and other places that do research and development. But I look at it from where I am, thinking about how I am going to translate my research. I am still competing academically with anyone and, five years past retirement, publishing a lot, but I would not be able to translate research without close interactions with large pharma. The Cambridge phenomenon shows you that you have to have knowledge exchange on a day to day level. I move between academia and companies frequently. I see it as a priority to keep large companies in this country.
Baroness Noakes: How would a Secretary of State decide which research facilities to protect in this country?

Professor Sir Tom Blundell: I think that question is for those elsewhere, but it is clear that there is a group of companies in each area of research, certainly in pharma, that meet certain large-scale research requirements. In this country, now without Pfizer, it is GSK and AstraZeneca. The next one down—I am talking about bio pharma now; Syngenta is in the agricultural area—is UCB, which I mentioned before and which also plays an important role in this way. They are easy to identify—no problem.

Q5 Lord May of Oxford: My understanding is that Ed Miliband wrote to the Prime Minister suggesting that there ought to be a stronger public interest test. Conversely—I am partly informed on this by the excellent notes that we have—we are informed that John Kay has suggested that it is not a particularly good idea to expect the Government to overrule bad business judgment and the like.

Professor John Kay: This sounds as though it is aimed at me. I struggle with this question. I am quite clear that there are mergers that are against the public interest, and not just on competition grounds. The headquarters effect issue, which Sir Tom has raised, is real. Even in today’s global world, where the headquarters of a company is does matter to the kind of business decisions it takes. I also think that there are just bad mergers and bad owners. I do not think that the Ferrovial takeover of BAA, for example, was of benefit to the country, or the Al Fayed takeover of Harrods, and I think there are bad mergers that are not in the interest of either the acquirers or the acquired.

My problem is Baroness Noakes’ problem: how we find a mechanism for distinguishing the good from the bad that does not simply expose you and the Secretary of State to lots of self-interested lobbying, and to many of my colleagues engaging in what I think of as bogus modelling in order to generate cases for and against the merger concerned. I think we have a
policy dilemma here, and it is a dilemma to which I see no easy solution. I am inclined to think that there are some mergers—I have illustrated one or two—that fall so clearly into a good or bad category that it would not be unreasonable to throw these to either the CMA or the Secretary of State.

The history of the Royal Bank of Scotland illustrates probably all the issues. It was clearly a good thing for the Scottish economy and the life of Edinburgh that the attempt by Standard Chartered and HSBC in the early 1980s to take that company over failed. It failed at that time because of the Monopolies and Mergers Commission action. For many years, the Royal Bank of Scotland takeover of NatWest was my exemplar of a good merger. NatWest was a mess, which RBS sorted out, and no one had been able to do it. The RBS takeover of ABN AMRO was a terrible merger that contributed greatly to the destruction of the company. There are good and bad; it is hard for either a CMA or a Secretary of State to make judgments about which they are.

Katja Hall: Perhaps I could come in on that point too. We would be very wary of extending the public interest test. We think there is a risk that we would end up calling for a new public interest test whenever there is a proposed acquisition or merger. Ultimately, the board is best placed to take these decisions: they know the company, they should judge the value that is added and they have a duty, of course, to ensure that it is in the company’s long-term interest. It is then for the shareholders to decide whether additional value has been realised. The role for government is, first, to make sure that boards and shareholders have the tools they need to do their job properly, and, secondly, that the overall business environment is conducive to growth. That, though, does have to go hand in hand with a very strong industrial strategy.
Baroness Noakes: Could I ask a supplementary on that point? You talk about boards and shareholders. In the case of AstraZeneca, the shareholders were never given a say. Is it a weakness in the current situation that it can be just a board that decides?

Katja Hall: Overall, the corporate governance system that we have in the UK works pretty well. That is certainly the feedback that we have had, and we have talked to our members a lot over the past month or so. We supported the changes that were introduced post Cadbury-Kraft, and it feels to us now that we have a good balance in that the board is clear about its role and the shareholders hold the board to account. So I think we agree on that, Baroness Noakes. But we also support the idea of making sure that the shareholders are active, and the investor forum idea that is now up and running.

Professor John Kay: On that, we have to get the right kind of shareholder activism and engagement. But if one takes the two big disasters in British business over the past 20 years, essentially the destruction of ICI and GEC, the shareholders were actually encouraging the foolish acquisition strategies which these companies pursued.

Q6 Lord Skidelsky: I have two questions really, one of which I want to ask on my own initiative. In thinking about extending the public interest test, should one distinguish between mergers and acquisitions? I know that your evidence earlier suggested that it is very difficult to draw a line, but they are very different conceptually. Is there any way in which that can be embodied in law and policy?

Professor Sir Tom Blundell: Going back to what I said before, I must say that I found it very difficult, because with Celltech we made three mergers. In each company we merged with, the chief executive and the chair joined the board for about a year. After that, they seemed to disappear. Then we did another merger and it became clear that it was really an acquisition. It really is difficult after a while in a company of the sort that I have been involved in to distinguish the long-term motives in the name given to the arrangement.
Professor John Kay: I rather agree with Sir Tom in two senses. One is that although quite often mergers are described as mergers of equals, I would be very hard put to identify one that actually was when we looked at it a year or two later. The other point is that it is pretty easy, in most cases, to turn what is a potentially hostile acquisition into an agreed merger by paying a bit more and providing appropriate sweeteners to some of the incumbent executives. So I do not think there is a distinction there that is really worth pursuing.

Q7 Lord Skidelsky: Then I go on to my other question. Pfizer’s four top scientists argued that pharmaceutical mega-mergers are “devastating” for research. I have another quotation from Dr Mene Pangalos, who argued that the challenge of mergers on this scale is that “ultimately the focus becomes very inward rather than focusing our projects”. Is that not a problem of process of integration, and more of a short-term problem than a long-term one? In the long run, the efficiency gains will trump the problems of integration.

Professor Sir Tom Blundell: In my experience, it is quite often demotivating and causes a lack of clear direction. I watched AstraZeneca’s purchase of MedImmune, for example. It is now the centre. You mentioned Dr Mene Pangalos. MedImmune told us last Wednesday when I spoke at a meeting with him that around 50% of medicines, or slightly more, come from MedImmune, but it has certainly taken quite a long time to feel that it is properly integrated and that things are moving forward.

Lord Skidelsky: Economic analysis usually likes to focus on the long-term outcomes of things and regard them as the ultimate justification, and not to worry too much about the problems of the transition. Is that right?

Professor Sir Tom Blundell: That ignores people.

Professor John Kay: But if we do look at the long term, it is quite interesting to see how the pharmaceutical industry has evolved. If we were having this discussion in the early 1990s,
I think we would have regarded the pharmaceutical industry both globally and in the UK as probably the largest post-war industrial success story.

Since then, it has gone wrong. There are two main reasons why it might have gone wrong. I have a suspicion that there was a bunch of low-hanging fruit that was actually plucked. There was a range of products, which I have described in the past as drugs that essentially relieve but do not cure the chronic illnesses of rich people: depression, stomach ulcers, hypertension and the like. These were drugs that you could sell in very large quantities at very low prices and people would take them for more or less the rest of their lives, and the enormous profitability of the pharmaceutical industry was essentially built on these. We might simply have run out of these kinds of drugs, with the result that the new drugs that are waiting to be discovered, and some that are in the process of being discovered, tend not to be like that. They are either like the therapies we have for AIDS that are used as complicated cocktails of drugs, or they are drugs that are targeted on particular diseases and particular individuals. You cannot recover large profits from these by selling them at $1 a pill; you sell them for $50,000 a treatment, which creates all kinds of problems of its own.

The other problem is what I think of as the financialisation of the corporate sector, in which companies were under more and more pressure to achieve short-term, routine, predictable earnings per share growth. That did not fit the pharmaceutical industry very well but it fitted the business strategy of Pfizer pretty well, with the result that Pfizer emerged from being a really rather second-rate pharmaceutical company until 1990 to being regarded as the global leader.

Jim Collins, one of the few popular business book writers for whom I have quite a lot of respect, wrote his first big book *Built to Last* in the early 1990s, and I have always been intrigued by the fact that in it he made a lengthy comparison between Merck and Pfizer and was 100% in favour of Merck. He documented how Merck's very long-term oriented
business strategy had outperformed the short-term profit orientation of Pfizer over a long period. It is interesting that 15 years later Pfizer had overtaken Merck. Most ironically of all, in a new book called *When Giants Stumble*, one of the examples used was again Merck. That is the change that happened in this industry, which means, I think, as Sir Tom was suggesting, that the traditional business model of the pharma sector is broken.

**Professor Sir Tom Blundell:** I compare Pfizer in the 1980s, when there were 300 people or so down in Sandwich. You had to get on the right end of the train to get off and find it. It was a little operation. It was state of the art science, but it was relatively low-hanging fruit. There are encouraging things occurring now. In some of the areas where we have targets that are similar to those that were aimed at the low-hanging fruit, we now have new technologies, but the difference is the expense. The expense went up exponentially, so there are only certain categories now. Most of us just got out of infectious disease, so all my work on infectious disease—TB—I do with Gates’ money. It has been impossible to do it over the last decade in the pharma industry or even in biotech.

**Q8 Lord May of Oxford:** I have a quick question, more for the CBI, on this general tension between shareholder dividends and maintaining a science base. The CBI has said, “Open markets are an asset for the UK and the CBI does not support protectionism”. It said that the Pfizer offer is “primarily a decision for the board and shareholders of AstraZeneca”. At the same time it said something that is more or less in direct conflict with that: “If a proposed takeover proceeds, it would be vital for the UK Government to receive assurances about the maintenance of research activity in the UK which sustain over time”. In some sense, both these things are true. You also see it vividly going beyond pharmacy. John Browne acquired a terrific reputation by making things look great at BP, by eliminating research and cutting back on safety. It wrecked the company but everybody was happy while he was doing it. It seems to me that these tensions are ineluctable.
Katja Hall: This is a really important issue. We believe that protecting the science base in the UK is crucial. Although we are very sceptical about extending the public interest test, even if it were possible, it is absolutely right that we debate and discuss these issues. It is right that politicians take an interest. This whole issue is about how we make sure that promises stick. We have done a lot of thinking over the past few weeks, and we ended up concluding that the best way forward is transparency and accountability. We think that companies should probably report on any public commitments that they make around protecting jobs, or whatever it might be, on a “comply or explain” basis. They should publish in their annual report what they said they were going to do and then either say, “We have done that, we have kept our promise”, or, if for some reason they have not, explain why not. We think that would be a good way of making sure the promises were made in good faith and were meaningful.

Lord McFall of Alcluith: Could I add to that question? The CBI said that it needed assurances, but Pfizer’s letter to the Prime Minister stated that it would “integrate the operations of the combined company so as to employ a minimum of 20% of the combined company’s total R&D workforce in the UK”. The last experience we had, with Cadbury and Kraft, was that, just a week after promising to keep the Somerdale factory near Bristol open, Cadbury backtracked and closed the plant. How robust do you think the Pfizer commitment to the Prime Minister really is? Professor Kay.

Professor John Kay: We have learnt from experience that these commitments are almost valueless.

Lord McFall of Alcluith: So what do we do?

The Chairman: Is that the CBI’s view as well?

Katja Hall: Obviously any commitments or assurances need to be made in good faith. As I said, we have been trying to think of a good way forward, and we think that this “comply or
explain" model offers a really practical, but also robust, way forward. It works well in other areas of corporate governance and would make sure that companies not only have to be transparent but are held accountable. I guess that would be the proposed change.

Lord McFall of Alcluith: I would sum up what Professor Kay and Sir Tom have said, in my own words, as: we are really going to keep getting taken for mugs until we have some better strategy or thinking. Is that right?

Professor John Kay: On the notion that we can take reassurance from commitments that are made before large mergers, we now have so many experiences of this kind—Cadbury-Kraft is one, but we have a string of them—that we cannot take these commitments seriously any more unless we can find a mechanism of enforcing them. It is very hard to see what that could actually be.

Lord McFall of Alcluith: One thing that you said in your revealing evidence, Sir Tom, was that the work that you do now on TB is with the Gates Foundation, because pharma is not involved. That worries me quite a lot, particularly in the light of the Prime Minister’s comment last week about superbugs risking taking medicine back to the dark ages. There is a black hole here for the common good for individuals when it comes to medicine, and nobody seems to be looking at that issue.

Professor Sir Tom Blundell: I think people are looking at it. The European IMI initiative is addressing it, with combined company and state funding. As to the whole area of infectious disease, if you have medicines that are used occasionally and where you are concerned about resistance—as Sally Davies has said so often recently—they may not be used. No company over the past decade, in terms of bacterial infections anyway, has been very willing to invest in that area; they have pulled out. The threat of not being able to do transplants and other such things that depend on antibiotics may bring us all to our senses. But I do not see a model using the market in the near future. The whole area of infectious disease, whether it
is malaria, TB, E. coli or any other infection, or even in some other research area such as the neurosciences, is not really being tackled under the current business model. We should all understand that this is not just a problem in respect of Pfizer and AstraZeneca; it is a problem about the expense of getting drugs to market, which can be $2 billion-plus. If I take a drug into phase 1, in oncology, I have a one in 20 chance of getting it on to the market. So long as we have a litigious society and an expensive phase 3, we are really going to be in trouble in many areas of medicine. We need to think it through. I have formed companies but personally have no confidence that the present system will deliver without considerable state intervention.

Q9  Lord McFall of Alcluith: Professor Kay, in your revealing article in the FT recently, you quoted Jim Collins but contrasted the philosophy of George Merck, who you quoted as saying, “We never forget that medicine is for the people . . . and if we have remembered that [the profits] have never failed to appear”. By contrast, John McKeen at Pfizer said, “So far as is humanly possible, we aim to get profit out of everything we do”. In terms of the market, McKeen has won and Merck has lost. Sir Tom says he does not see a model using the market for dealing with this huge global problem for humanity, so where do we go?

Professor John Kay: I would start with what some people have called the profit-seeking paradox, which is that the most profitable companies are not necessarily the most profit-oriented companies. That is an idea that I discovered from my own experience of dealing with companies, which I then struggled to rationalise with my economist self for a few years. I ended up writing a book called Obliquity about it. Ironically, for the purpose of these proceedings, the word “obliquity” was suggested to me by James Black, whom some of you will know as the father of the British pharmaceutical industry, who told me that he used to tell his colleagues at ICI that if they wanted to make a lot of money there were easier ways of doing it than inventing drugs. He shook his head and said, “How wrong could I have
been?”. It is really because we do not understand enough about the long-term determinants of profitability. What makes sustainable profitable companies is building great businesses, which is what George Merck did at Merck and Michael Marks did at Marks & Spencer, rather than focusing on quarterly earnings statements.

The second point is about when a market works and when it is bust. The market in pharmaceuticals works really well in producing these anti-ulcerants and anti-depressives. Where it does not work so well is in producing drugs for poor people. People in rich countries rarely get malaria and TB any more. Where I perhaps disagree is that if the problem of antibiotic resistance continues to go, we will get very large amounts of private sector money thrown at producing new antibiotics, but we will not get it easily for antimalarial drugs. If I was Bill Gates, that is the kind of area I would be spending quite a lot of my fortune on as well, because that is the kind of thing that requires public and philanthropic funding.

**Baroness Noakes:** Can I just return to a theme that we have already touched on, relating to the way in which competition drives the mergers and takeovers regime. In your review of equity markets and long-term decision-making a couple of years ago, I think you concluded that the reliance on competition was not necessarily beneficial for the UK. But I think you also said this afternoon that there is no easy alternative. Do you still think it has not been beneficial to the UK and, if so, should we not try and find an alternative?

**Professor John Kay:** I think we should probably try to find an alternative. When I thought about it then, I thought that the Government could simply use the range of measures that were already at their disposal; I mentioned one or two bad mergers, for example, which could easily have been blocked using the regulatory system, either in financial services or in civil aviation, without having to change to having a general public interest test in the Enterprise Act. There are measures that the Government could take to start moving down
the road of being rather more restrictive without necessarily going to the stage of a wider test. That might be the right place to end up.

**Baroness Noakes:** Presumably those tests would be on some form of long-term financial viability as opposed to desirability.

**Professor John Kay:** Yes, they would. You are right.

**Baroness Noakes:** What is best for the UK.

**Professor John Kay:** It is kind of about using tools you have even if not for the purpose for which they were intended. They are tools that are already in your bag.

**Baroness Noakes:** Does the CBI take the view that investors can somehow make up the difference?

**Katja Hall:** We take the view that the basics of the UK corporate governance system are right and work well. In fact, if you look internationally, it is a good system. It is the about how we give boards and shareholders the right tools to encourage long-termism. We have already had quite a lot of changes in the last few years on different issues such as executive pay but are quite happy to look at whether more needs to be done.

**Baroness Noakes:** How could it work for takeovers and mergers?

**Katja Hall:** Some of the proposals could have unintended consequences. The proposals around freezing the shareholder register or having different voting rights, for example, all have unintended consequences, so we are not sure they offer a good way forward. We think we could probably do something around looking at whether the Takeover Panel has enough resources to scrutinise deals post-merger. That seems to be an area that we have not looked at very much: it is very active during a takeover, but does it have the resources to scrutinise the deal post-takeover?

**Baroness Noakes:** They do not have any locus, post-merger, do they?
Katja Hall: They probably have the powers, which goes back to the point about making sure that commitments stick, but do they have the resources to see what happens and follow it up?

Q10 Lord Griffiths of Fforestfach: I want to ask the panel whether they think that UK companies are disproportionately vulnerable to unwanted attention from predators. Do we offer our companies enough protection, for example as the French might?

Professor John Kay: I am not sure the French model is the perfect one. Because we are probably the most open country in the world for these purposes, that certainly makes us disproportionately vulnerable. This is where the investment banks find their prey, as it were.

Katja Hall: We should also remember that openness is not a bad thing—it is a good thing. Combined with a strong industrial strategy, it is something that the UK should protect. Our future is as a global and open economy. We are a trading nation, and that will continue to be the case. I think I am right in saying that the UK still owns much more in assets overseas: £1.1 trillion, which is £300 billion more than the world owns in the UK.

Lord Griffiths of Fforestfach: My instinct says that the case for a competition test is important, and we seem to have benefited from that. But I go back to Professor Kay’s answer to the first question, which certainly strikes a chord with me and may with other members of the Committee. You want the competition test, but on the other hand you know that there are long-term issues that matter for us as a nation. It seemed to me that you ended up saying, “Well, we have the CMA and we have the Secretary of State and so on. My own judgment as to whether certain mergers or acquisitions were successful is that some were failures. Maybe that is the best we can do”. Is there not something we can say that is a little more intellectually convincing than it ending up as a matter of individual judgment in each case?

Professor John Kay: That is the nub of the question, and I have struggled to answer it.
Lord Griffiths of Fforestfach: I find myself with exactly the same dilemma.

The Chairman: Shall we move on to the next question? Lord Rowe-Beddoe.

Lord Rowe-Beddoe: Before I ask that, could I go back to something we touched on earlier and to your answer about the commitments that were provided to the Prime Minister in the letter? I think you said they were valueless and not worth the paper they were written on. If we could change the locus so that this was in France and the letter was written to the French Government, would you have quite the same reaction?

Professor John Kay: No, I do not think I would, because in France I would be pretty sure that the French Government would do a lot of things to make your life very difficult if you reneged in this kind of way. One of the things that was in my mind when I said there were a lot of things the Government could do, without having to change the terms of the Enterprise Act, was a greater readiness to say to companies, “There are a lot of things you will probably want out of government, and if you behave badly you will find it very difficult to get them”.

Katja Hall: I still think we should be pleased we have UK levels of growth and employment and not French ones.

Q11 Lord Rowe-Beddoe: Absolutely, but I just wanted that answer. Thank you. Do you agree—Professor Kay, or any of you—with Lord Heseltine’s view that: “Government should do far more to engage with potential foreign investors ... to secure commitments to developing the UK research, skills and supply base, and in exceptional cases to discourage unwanted investments.”?

Professor John Kay: I think, broadly speaking, I would agree. If “unwanted investment” means something other than the occasional unwanted takeover, I am not sure exactly what an unwanted investment is, although there might be one that I have not thought of. I would
certainly be very happy to see the Government engaging more in the sense in which Lord Heseltine has in mind.

Katja Hall: The Government—in fact all politicians—are right to engage on these important and big mergers involving industries that are strategically important to the UK. We should welcome debate and discussion, find out as much detail as we can and, as I said earlier, make sure that any commitments made are made in good faith and stick and sustain over time. I also think it is really important that this comes back, ultimately, to making sure that the overall business environment is conducive to businesses wanting to come here and invest. This is about skills and access to finance, which need to go hand in hand with a strong industrial strategy, which we have been missing, that provides certainty and stability for companies over the long term. That is particularly important in a sector such as pharma, which is very long term by its nature.

Professor Sir Tom Blundell: Could I just make a comment? Pharma over the past five to 10 years has really changed its view quite radically. I remember when I was involved at SmithKline with Tachi Yamada in the late 90s, looking at the new research structure for GSK. It was a big model, with basic science, therapeutic areas and so on. The model now of course is for large companies to be structured and to work more like a cluster of small companies, so they divided research activity up to get more competition. One of the reasons why GSK invested in our company was to try to get the spirit of small groups working actively together, which is not too different actually from early Pfizer. It is not just a question of the sort of incentives that Lord Heseltine was talking about. It is absolutely critical, given that current model of outsourcing, much more dependence of large pharma on small companies, on clinical trials—which we have done rather badly in during the past few years; there has been a big decrease—and academia. We simply have to put in more infrastructure to support this ecosystem. Recently, the Government have done some rather good things.
For example, BIS has put in funding for the Babraham Research Campus and the Norwich Research Park. There are positive aspects of maintaining large pharma in a new sort of ecosystem model, which I think are equally important to the sorts of developments that Heseltine may have been thinking of.

**Q12 Lord Shipley:** I wonder whether we might discuss further the powers in the Enterprise Act. You mentioned a moment ago the approach of the French Government. Do you think a greater willingness by this Government to use their powers under the Enterprise Act would harm the flow of investment into the UK? This is not just about France: in Australia, the merger review board ensures that foreign takeovers are in the national interest; and in the US, there are systems for scrutinising foreign investment and an outright prohibition on foreign ownership in more sensitive sectors of the economy. Lord Heseltine, in his report, gave the example of Dubai Ports World, which felt compelled to divest itself of P&O’s US port operations when it took over P&O following intense pressure from the United States. Is this simply a comparison with France or are there things to learn, in terms of using powers under the Enterprise Act, from Australia and the US?

**Professor John Kay:** The Enterprise Act does not currently give the Secretary of State or the CMA the powers that we have talked about in relation to Australia or these other countries. Dubai Ports is another example of extra-legal pressure being applied: it was clear that the US Government and Congress did not like the merger, in ways that would have made things unpleasant for Dubai Ports, rather than them using a particular power they had. I think that was the situation in that particular case. We are really back to the Government using the Enterprise Act more vigorously and making competition references, even if there is not really much of a competition argument. I guess they could have referred Pfizer-AstraZeneca on that basis—there would not really have been much grounds for that, but it would have been a nuisance for Pfizer and AstraZeneca if they had. Really, we should be
talking about whether we want to amend the Act and provide explicitly for these additional grounds.

**Lord May of Oxford:** I should probably declare an interest, but I would regard any Australian policy as superior.

**The Chairman:** Ms Hall, do you have a view?

**Katja Hall:** I am not sure that we think that more interference in markets would be a good thing. We have looked at the different systems across the world and we still feel, broadly, that actually the UK system is pretty good. We have talked a lot to our chief executives over the past couple of months about this issue. The view, pretty much unanimously, is that openness is a strength and that we should avoid protectionism at all costs. The role of government is to make sure that we have an open and competitive businesses environment and a strong industrial strategy and then, as I have said, that boards and shareholders have the tools to do their job. That is a good way forward. It is a good way of ensuring that the UK stays competitive and that companies want to come here and to stay here.

**Q13 Lord Carrington of Fulham:** First, I apologise for being late. I had a Question on the Floor of the House, which I rather had to ask or I would have been in trouble. As you will understand, you do not want to be in trouble on the Floor of the House, so I missed the beginning of the questioning. I apologise.

I am still a little doubtful about whether we ought to be bothered who owns these companies, partly because they are public companies and are therefore very largely quoted on the stock exchange and owned very widely in any case. Where they are going to invest in their R&D is going to be a function of the infrastructure that is provided over here, the quality of the people coming into R&D in this country and their willingness to work, and whether they are going to get the critical mass of R&D. More importantly, based on the discussion when I arrived—as I understand what you are saying—big pharma is not going to
be able to afford to fund and to create the R&D and therefore get the patents that it needs going forward. A lot of it, after all, comes down to patents. What we need is a new model for pharma, which is probably not the sort of corporate model that we have had historically. We need to think of something slightly different. It will not be possible to get the research base and the research money that will be required, however big the companies are or wherever they are owned.

**Professor Sir Tom Blundell:** As we discussed earlier, it is very much a question of which therapeutic area and what kind of disease, but there are a number of things that we need to look at. When it comes to early discovery, there are quite a lot of interesting developments in open-sourced drug discovery and there are lots more initiatives involving collaboration in early stages. At the moment, we do not really have a realistic way of taking things from early discovery through to pre-clinical and phase 1. The venture capitalists that I worked with did not fully understand what I was doing to them. They thought they were going to get out in four or five years; if I had any political skill on the board, it was keeping them in for 14 years before we sold it for that very large sum of money. The other thing we need to look at is phase 3 and the industry’s reaction to the highly litigious society we have. It has become very complex, and there are other business models where we could use patients who want to take drugs to try to decrease those costs. Unless we do something about decreasing the costs, the whole business strategy of pharma is going to get narrower and narrower. Getting a new model in really is a very important priority.

**Lord Carrington of Fulham:** That is a very different question from the one about who owns a pharma company. We ought to be saying that it really does not matter who owns these companies, as long as the investment is going in from somewhere, or have I completely misunderstood?
**Professor John Kay:** There are two quite different issues here. One is whether the existing pharma model is viable or broken. One of the interesting things about the whole medical business is that you have both an open-source model and a proprietary systems model. In surgery, we essentially have an open-source model, where there is little in the way of intellectual property. Rather amazingly, surgeons can do almost whatever they like, with minimal regulation and instead, essentially, with peer review of their performance in an open environment. It does not sound like it ought to work, but it does, pretty well. Historically, the big pharma model worked pretty well, too. As I was saying earlier, it worked well from the period after the Second World War to the 1990s, but I do not think it is working well now, partly because of the changes in the economic environment in which the industry is operating and partly because of the changes in the nature of the underlying technology. I think that we do have to look at different ways of doing it.

The second question is whether it matters where the headquarters of a company is. I think it does, because although almost all large companies now are global in their operations, very few large companies do not have a national character about them and a national headquarters. It is clearly true that they retrench towards their domestic base when they are under pressure, that they have a domestic bias in what they do and that where the headquarters of a company is located is really quite important to the vibrancy of that society. I mentioned the rather sad case in many ways of RBS in Edinburgh—there is no doubt that Edinburgh was a better place for having a large, high-level operation in that city and is suffering now, as it suffered earlier from the loss of the Distillers headquarters, for example. These things do matter.

**The Chairman:** Just one quick comment because we have run out of time.
Katja Hall: Let us not forget the automotive sector as a good example of where foreign ownership has created lots of investment and lots of jobs here in the UK. It is quite difficult to generalise.

Professor Sir Tom Blundell: No research though.

Katja Hall: But a pretty big export success.

The Chairman: Regrettably we have run out of time. Thank you very much indeed. You are being followed by the Secretary of State and you are most welcome to stay and hear his remarks.