

PRIVATE & CONFIDENTIAL

# Beecham Group p.l.c.

Beecham House Brentford  
Middlesex TW8 9BD

RONALD HALSTEAD, C.B.E.  
Chairman and Chief Executive

RH.PVW

29th March 1985

The Rt. Hon. Margaret Thatcher, M.P.,  
Prime Minister,  
10 Downing Street, London SW1.

*Dear Mrs Thatcher,*

Further to my letter of 15th January, I enclose a copy of a letter I have written to Norman Fowler concerning the new target rate of 17% return on capital being imposed on the Pharmaceutical Industry.

I understand that the Limited List proposal will save the DHSS over £75 million and Beecham's share of this is, in fact, over 10%. In addition, the DHSS is proposing a 3% price reduction across all our products in order to reduce our return on capital in line with the reduction to the 17% target base. This new level of 17%, as I said in my letter of 15th January, is ridiculously low even by 1980 standards and with the increasing profitability of industry in general, it is well below the sort of levels which are now commonplace in British industry. Indeed, when the Public Accounts Committee reviewed the DHSS proposals on 19th March, they reversed their previous critical stance of the Pharmaceutical Industry and questioned the Permanent Secretary of the DHSS on the appropriateness of the projected levels and the effect on the Industry.

As I anticipated in my letter of 15th January, the profitability of British industry has thankfully now increased quite substantially since 1980 and I understand that the Review Board for Risk Contracts in the Defence Industry has now been increased from 17% to 20%.

There is a lot of concern in the Pharmaceutical Industry both here and in the USA, and I am sure that our American friends will once again (as in the 1970's) view with suspicion our commitment to industrial profitability and our attitudes to wealth creation. This could well affect their intention to invest in the U.K. as compared with other European countries.

As Chairman of the Industrial Development Advisory Board, I have had discussions with Norman Tebbit and both he and I are anxious to encourage inward investment and a more profitable industrial base in the U.K. We feel that this will be essential for job creation and our future economic viability.

Thank you for inviting me to lunch on 17th May and I look forward to seeing you on that occasion.

With very best wishes.

*Yours sincerely,*  
*Ron*

MANAGEMENT: ROBERT HELLER



## Why Mrs T is guilty of drug abuse

The Thatcher Government believes in market forces more passionately than most marketers — except (as with most marketers) when it dislikes the results. Take the drug industry: as fine and full an example of capitalist competition as you could hope to see. Spurred by the prospect of golden profits, the umpteen likes of Glaxo, Hoffmann-La Roche, ICI, Smith Kline, Beecham, Eli Lilly, etc., etc., strive furiously to be first with winners; weigh in with me-toos when they lose; and at all times bombard their market with messages and massages.

Their only sin, in the Government's eyes, is that they succeed too well. Not that the Inland Revenue agonises over having to collect its take from those abundant profits (Glaxo last year made £252m before tax, £165m after). The rub is that the Government resents its own contribution to that bounty, via the NHS. So it limits the marketing activity (only 9% of turnover on promotion); wants to limit what may be marketed (by restricting the drugs the NHS will buy); and limits the return on capital that companies may earn.

If that's a free market, Margaret Thatcher's a card-carrying Communist. The aim of this bizarrely unfree enterprise is to cut NHS drug costs — though a monopoly buyer who can't beat down the prices of fragmented suppliers must have the negotiating skills of, well, a civil servant. The limits are all pernicious, in practice and theory; but worst of all must be the proposal to restrict drug companies to something, in practice, between 17% and 18% return on capital employed, before tax.

Penalising the most successful is not exactly how supply-side economics are supposed to work. Returns on capital can be boosted in many ways: some virtuous, some vile. But increasing operating efficiency, the very essence of virtuous management, loses its attractions fairly-fast if the net result is to force a price cut. Similarly, investment in new plant or new products must be vitiated if the ultimate return hits a ceiling — particularly one as low as 18%. This, note, at a time when one US multinational (not in drugs) won't even look at anything yielding under 45%; and when a British one (in drugs) has 30% as its aim.

That truth begs the question of whether, with returns on capital tethered down, companies will be able to finance new investment in any case. If Mrs T wants to study the results of restricting returns, there's an example far from dear to her heart: British steel. After the war, steel was the only industry subjected to permanent price control on the basis of return on capital. In 1956, the UK produced 20.7 million tons of steel; last year, output was 15.1 million — against 39.4 million for West Germany. British industry got cheap steel, all right, just as the NHS can enforce cheaper drugs. But the long-term result was totally disastrous — and not just for the steel-makers.

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The Rt. Hon. Norman Fowler, M.P.,  
Secretary of State for Social Services,  
Department of Health & Social Security,  
Alexander Fleming House,  
Elephant and Castle, London SE1 6BY.

*Dear Norman,*

I am greatly concerned about the actions taken by your Department in recent times in negotiation with the Pharmaceutical Industry in general and with Beecham Pharmaceuticals in particular. You are well aware of the major contribution that the Industry and Beecham make to the British economy, yet your colleagues persist in taking arbitrary actions which are damaging to the Industry and to the climate for industrial investment in the U.K.

I am particularly concerned at their most recent actions in attempting to depress the profitability of the Pharmaceutical Industry. The target rate of return on capital of 17% which is now being imposed on Beecham Pharmaceuticals and on the Industry, in today's industrial circumstances, has no credibility. Even application of the Review Board for Government Contracts Profit Formula now makes a nonsense of your figure. Not only do your colleagues insist on its adoption, but they also insist on flouting procedure which is specifically laid down in the Pharmaceutical Price Regulation Scheme. You are aware that this is an agreement between your Department and the Industry, and yet your colleagues have chosen to virtually ignore its provisions.

The precipitous action which is now being taken to immediately reduce prices, backed with threats of laying orders in Parliament, is provocative and reminiscent of the actions of the Labour Government of the 1970's which did so much to undermine British industry. These actions were a prime cause of our industrial decline and British industry is only just starting to recover following the courageous action of the Prime Minister and Sir Geoffrey Howe in eliminating price, wage, dividend, and exchange controls after the election victory in 1979.

At the Annual Meeting of the Centre for Policy Studies on 4th March, Mrs. Thatcher and I both spoke about this period and on the importance of investing in our wealth creating industries. Indeed, she gave the following quote from her visit to the USA:

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"Secondly, they said, Have you looked at the amount you are spending on the welfare state in Europe? Do you not think that you might be spending on the welfare state money which really should go to investing in industry and to job creation? You cannot have it all ways."

The various actions of your Department, if not corrected, will have a profound long-term effect on the Industry and therefore on the British economy. Already the bad faith and lack of confidence engendered has done immense damage to inward investment and has caused Beecham Pharmaceuticals to review its investment plans in this country. In recent years, Beecham Pharmaceuticals have invested over £110 million in this country and we are currently considering a major project costing over £40 million for Irvine in Scotland. This project will result in exports mainly to the U.S.A. of over £60 million per year. Following your actions, commercial judgment would indicate that the project should be transferred outside this country. However, I am concerned about the future of pharmaceuticals and our industrial base in this country and also for the provision of employment. The Irvine project will provide about 150 new long-term jobs and in the short term employ some 500 for the next two years. I am, therefore, sanctioning that this project will continue in Scotland, but my Board has resolved that unless a more favourable climate ensues, this will be the last major pharmaceutical investment Beecham will make in this country.

Your Minister is now demanding an immediate 3% price reduction from Beecham Pharmaceuticals. This is, of course, in addition to a loss of close to £8 million to Beecham arising from the imposed Limited Lists. I have been persuaded to accept this price reduction with great reluctance and misgiving, only because I do not wish to undermine discussion which must take place between Government and the Industry if a viable Industry is to survive and prosper. This is particularly demanding on Beecham as James Diamond, one of my Beecham colleagues, will be leading for the Industry. However, when the target return on capital is corrected, which cannot and must not be delayed, the Industry will certainly insist that the same procedure and its immediacy be adopted to increase prices.

The 3% price reduction will be implemented on 1st May. Because of the turbulence in the market-place predicted for next year, annual sales levels at 1st April 1985 will be utilised in arriving at the new prices.

I would welcome a discussion with you on these matters before too long and in the meantime I have sent copies of this letter to the Prime Minister and Norman Tebbit because of their interest.

With best wishes.

*Yours Sincerely,*  
*Rm*

P.S. I enclose a copy of the speeches made at the Annual Meeting of the Centre for Policy Studies in case you haven't seen them.