

**2002 Drug Industry Profits:
Hefty Pharmaceutical Company Margins
Dwarf Other Industries**



**Congress Watch
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Acknowledgments

Principal authors of “2002 Drug Industry Profits: Hefty Pharmaceutical Company Margins Dwarf Other Industries,” are Public Citizen’s Congress Watch Research Director Neal Pattison and Research Consultant Luke Warren, under the direction of Legislative Representative Ben Peck, Ph.D., and Congress Watch Director Frank Clemente. Assistance was provided by Legislative Assistant April Greener.

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The anemic national economy continued to drag down the vast majority of corporations in 2002, but the pharmaceutical industry soared past other business sectors – raking in profits five-and-a-half times greater than the median for all industries represented in the Fortune 500.

In a year when the stock market remained listless and company after company was wounded by accounting scandals, the 10 biggest drug companies maintained nearly the same level of total profits they had in 2001, according to *Fortune* magazine's annual analysis of America's 500 largest companies.¹ As a group, the drug companies had \$35.9 billion in profits in 2002, compared with \$37.2 billion in 2001, a drop of 3.5 percent. [See Figure 1]

By comparison, all companies in the Fortune 500 suffered a combined loss of 66.3 percent in profits from 2001 to 2002. Stunningly, profits registered by the 10 drug companies were equal to more than half of the \$69.6 billion in profits netted by the *entire* list of Fortune 500 companies – when all losses are subtracted from all gains.²

Just as they did in 2000 and 2001, the 10 drug companies in the Fortune 500 topped two key measures of profitability in 2002. Collectively, the pharmaceutical companies in the Fortune 500 reported:

- A profit of 17 cents for every dollar of revenue, compared with a Fortune 500 median of 3.1 cents per dollar of revenue. [See Figure 2]
- A return on assets of 14.1 percent, compared with a Fortune 500 median of 2.3 percent.
- Along with earning the highest rankings in these two categories, the drug industry ranked second among all business sectors in return on shareholder equity, with a rate more than two-and-a-half times the Fortune 500 median (27.6 percent compared with 10.2 percent).

Two top-performing pharmaceuticals recorded revenues and profits that positively dwarfed those of most corporations in *Fortune's* annual analysis:

- Pfizer, with \$9.1 billion in profits in 2002, accumulated the greatest amount of profits of any drug company in the Fortune 500. Its hefty cash flow was largely due to a lineup of “blockbuster” drugs (those with sales of \$1 billion or more) that included the cholesterol medication Lipitor, the anti-depressant Zoloft and the allergy medicine Zyrtec. Pfizer achieved 26 cents of profit for every dollar of revenue, outperforming the Fortune 500 median by nearly 8.5 times.³

(In early 2003, Pfizer also gained ownership of the \$3 billion arthritis drug Celebrex and the \$928 million glaucoma treatment Xalatan when it absorbed Pharmacia, another Fortune 500 drug company that had \$597 million in profits in 2002.)⁴

- Wyeth, with \$4.4 billion in profits in 2002, increased profits by 95 percent over 2001, the greatest rate of increase of any drug company in the Fortune 500. Wyeth, whose antidepressant Effexor achieved \$2.07 billion in sales last year, also markets the estrogen replacement therapy Premarin, the acid-reflux disease drug Protonix, the anti-depressant Zoloft and the allergy medicine Zyrtec.⁵ With profits of 30 cents for every dollar of revenue, Wyeth outperformed the Fortune 500 median by tenfold.⁶

Of the 10 pharmaceutical companies listed in the Fortune 500, only Amgen failed to turn a profit in 2002 – losing \$1.4 billion on total revenues of \$5.5 billion.⁷ Amgen acquired Immunex during the year and wrote off \$3 billion worth of research and development related to that company’s arthritis drug, Enbrel.⁸ This setback appears to be a temporary one for Amgen, according to analysts who classify Enbrel as a “blockbuster” drug and estimate that the company will realize between \$1.2 billion and \$1.4 billion in Enbrel sales in 2003.⁹

It was no big surprise that the drug industry recorded large annual profits in 2002 – it simply was a continuation of a trend that has stretched over three decades.¹⁰ [See Figure 5] Throughout the 1970s and 1980s, drug companies in the Fortune 500 achieved returns on revenue that were two times greater than the median for all industries in the Fortune 500. In the 1990s, the drug industry’s profitability grew to almost four times the Fortune 500 median.

The outlook for the drug industry’s continued profitability is reflected in this excerpt from a *Wall Street Journal* article tracking sales and profits:¹¹

“The pharmaceutical industry has been bemoaning its tarnished fortunes for more than a year, but a report due out today shows that sales last year – while growing more slowly than in years past – were surprisingly robust.

“Prescription drug sales in the U.S. grew 12 percent to \$192.2 billion in 2002 from \$172 billion in 2001, according to IMS Health, a pharmaceutical information and consulting company. In 2001, sales grew 17 percent from 2000. Most industries would gladly suffer through such a slowdown.

“A slow flu season and the recent conversion of the allergy drug, Claritin, to over-the-counter status has meant that winter drug sales have been a bit sluggish, according to Doug Long, an IMS analyst. IMS is predicting that prescription drug sales this year and next will likely grow 10 percent to 11 percent annually and then increase again the following years to achieve an average annual growth rate from 2002 through 2006 of around 12 percent, said Paul Wilson, another IMS analyst.”

Figure 1

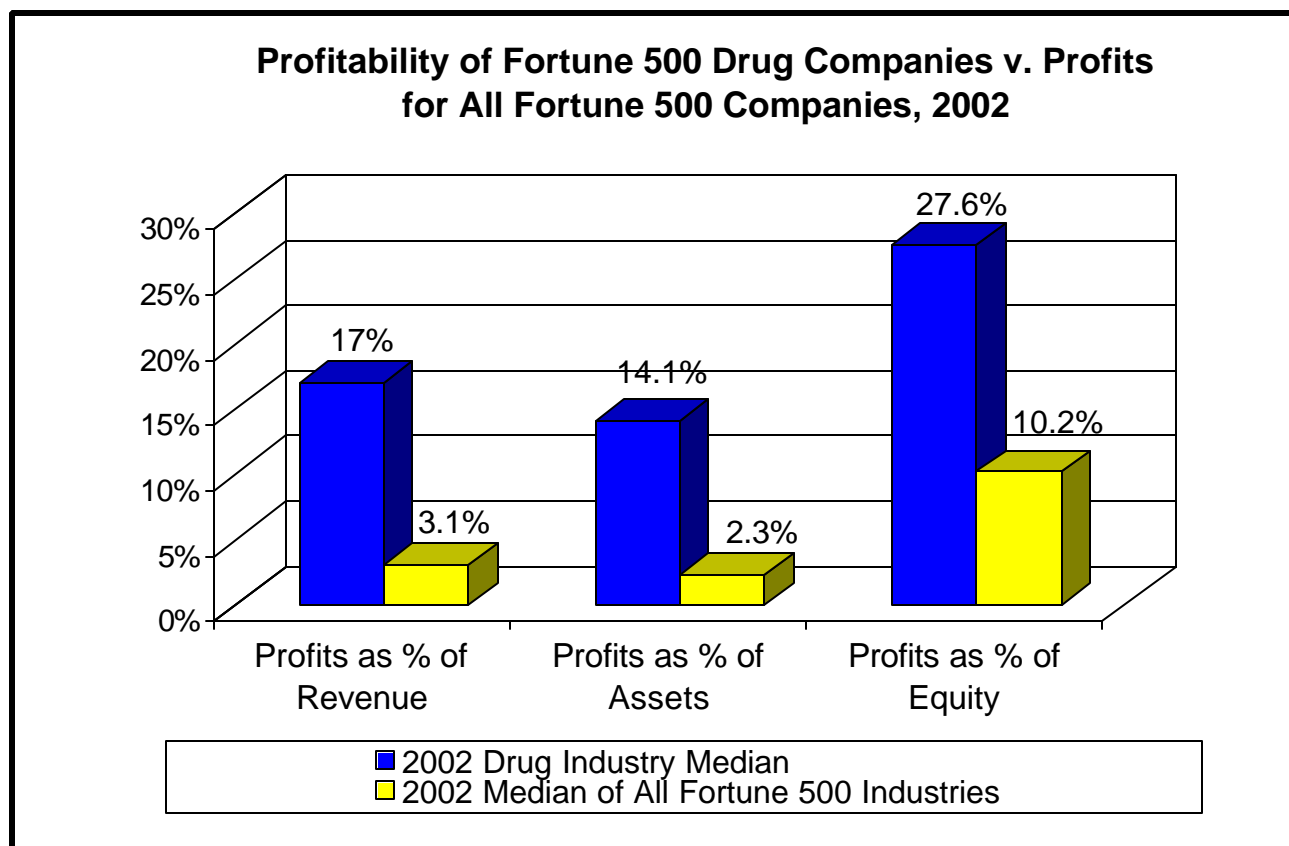
Fortune 500 Drug Companies Profit and Revenue Increases, 2002

Rank	Company	Revenues		Profits		Profits as % of		
		\$ Millions	% Change From 2001	\$ Millions	% Change From 2001	Revenues	Assets	Stockholders' Equity
1	Merck	51,790	9%	7,150	(2%)	14%	15%	39%
2	Johnson & Johnson	36,298	10%	6,597	16%	18%	16%	29%
3	Pfizer	35,281	9%	9,126	17%	26%	20%	46%
4	Bristol-Myers Squibb	18,119	(11%)	1,895	(61%)	10%	8%	21%
5	Abbott Laboratories	17,685	9%	2,794	80%	16%	12%	26%
6	Pharmacia	16,929	(12%)	597	(60%)	4%	3%	7%
7	Wyeth*	14,584	3%	4,447	95%	30%	17%	55%
8	Eli Lilly	11,078	(4%)	2,708	(3%)	24%	14%	33%
9	Schering-Plough	10,180	4%	1,974	2%	19%	14%	24%
10	Amgen	5,523	38%	(1,392)	(224%)	(25%)	(6%)	(8%)
Total		\$217,467	3.7%	\$35,896	(3.4%)			
Median		\$17,307	6.5%	\$2,708	0%	17.0%	14.1%	27.6%

Source: Fortune magazine, April 17, 2003, Fortune 500, pp. F-26 and F-59.

* On March 11, 2002, American Home Products changed its name to Wyeth.

Figure 2



Source: *Fortune* magazine, April 17, 2003, page F-26.

Drug Prices Outpace Inflation

While steadily rising profits may encourage those who work or invest in the drug industry, growing drug costs intimidate many consumers and frustrate employers and insurers. Even as drug costs squeeze insurance plans and personal bank accounts, the pharmaceutical industry rigorously defends its practice of pushing up prices for brand-name drugs.

During 2002, the drug industry increased prices by an average of 4 percent – almost double the rate of inflation.¹² (Of the drug industry’s 12 percent sales growth in 2002, 5 percent came from an increased volume of prescriptions – and a meager 3 percent came from the introduction of new drugs.)¹³

Examples of recent above-average price increases by some of the giants in the pharmaceutical industry:

- Pfizer Inc. boosted the price of cholesterol-fighter Lipitor, the most-prescribed drug in the world, by 7 percent during 2002 (and tacked on an additional 4 percent in January 2003).

- Wyeth raised the price for Premarin, the company's flagship drug, more than 17 percent last year, even amid mounting questions about the value of hormone-replacement therapy.
- Merck raised the price for Singulair, its asthma remedy, by 6 percent in 2002 (and then by another 5 percent in the first quarter of 2003).¹⁴

More Emphasis on Profits and Advertising Than Innovation

One of the biggest controversies swirling around the drug industry goes beyond its high prices and huge revenues to the question of what pharmaceuticals do with all their money. Financial reports show that the companies plow far more into profits, marketing and administration than into research and development. Consider:

- As a whole, Fortune 500 drug companies channeled 17 percent of revenue into profits last year. Yet they spent just 14.1 percent of revenues on R&D. [See Figure 3]
- Specifically, seven of the nine profitable Fortune 500 drug companies devoted more of their revenue to profits than to R&D. [See Figure 4]

The drug industry contends that it needs extraordinary profits, built on high prices, to fund expensive and risky R&D. Ironically, when some analysts contemplate the future of the industry, their greatest concern is large pharmaceutical companies' over-reliance on advertising and marketing of existing drugs – especially their “blockbusters” – and their failure to keep enough innovative drugs in the research pipeline.¹⁵

From 1989 through 2000, the FDA approved 1,035 new drugs. Of those, only 248 (24 percent) were given priority review by the FDA – an indication that the drugs represented a significant improvement in treating or preventing disease. That means that only 24 percent of the drug approvals over the 12-year-period were considered to be significant improvements over existing remedies.¹⁶

When drug companies talk about their R&D investments, they never mention “me-too” drugs. In reality, much of their R&D is devoted to copying the latest blockbuster drug, not to developing breakthrough remedies. “Me-too” drugs already have been invented, so developing modifications to them does not require as much investment as discovering new chemical compounds.¹⁷ As *Money* magazine describes the situation:

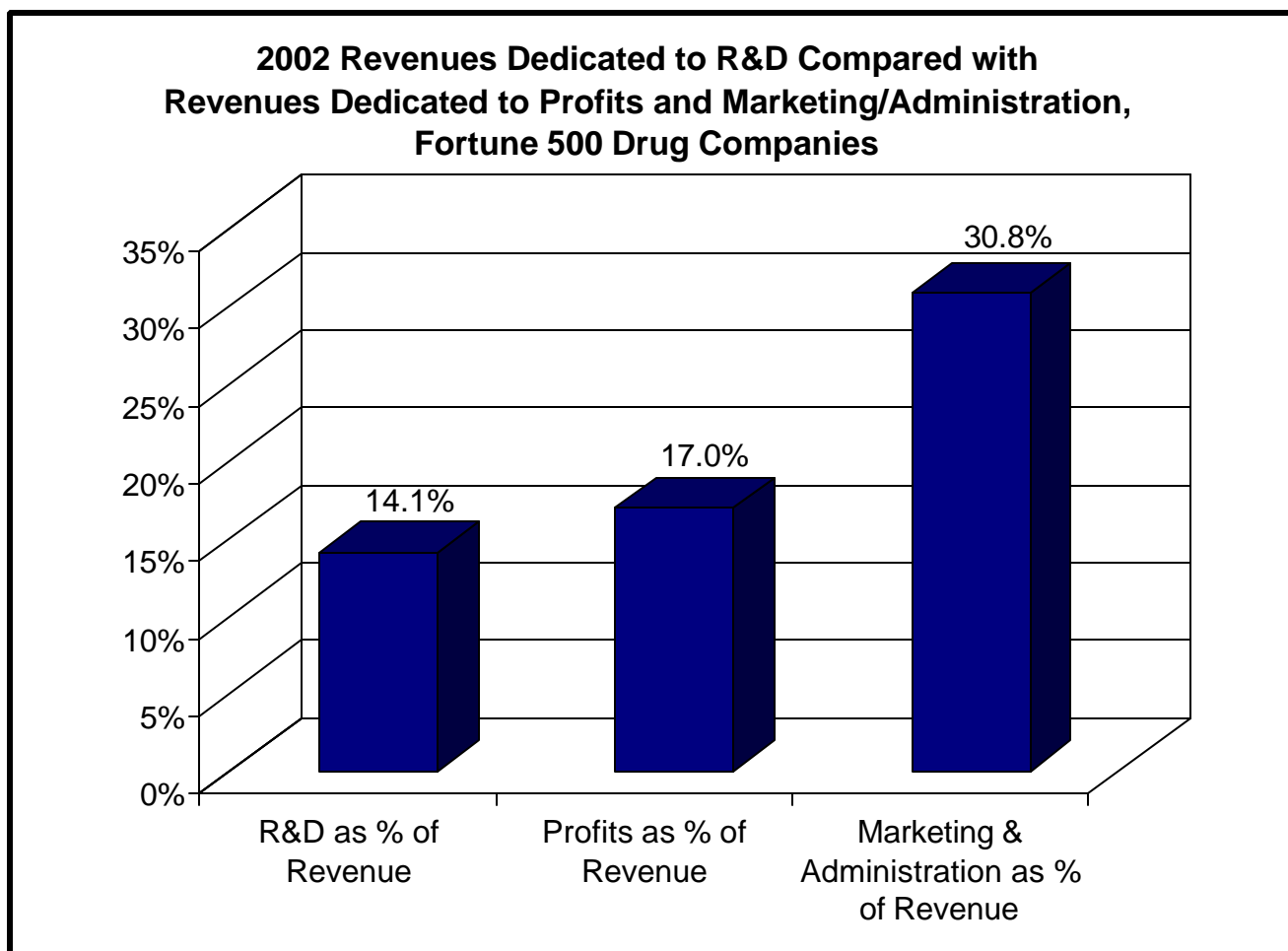
“It was an addictive formula: Offer a simple variation on an existing medicine, turn it over to the marketing machine and watch the money roll in. Indeed, marketing, as much as science, was responsible for creating the blockbuster phenomenon.”¹⁸

In fact, the drug industry in 2002 continued its pattern of emphasizing marketing at levels that rival or exceed R&D. (Drug companies typically don't report advertising and marketing costs as a separate category but lump them with administrative costs.)¹⁹

- Fortune 500 drug companies devoted 30.8 percent of their revenues to marketing and administration, compared with the 14.1 percent of revenues spent on R&D.
- In *Advertising Age* magazine's 2002 rankings, advertising budgets for two of the Fortune 500 drug companies, Pfizer and Johnson & Johnson, were listed among the 10 biggest advertising budgets in the United States.²⁰ These pharmaceutical giants spent more on ads than did Coca-Cola, McDonald's or Toyota.

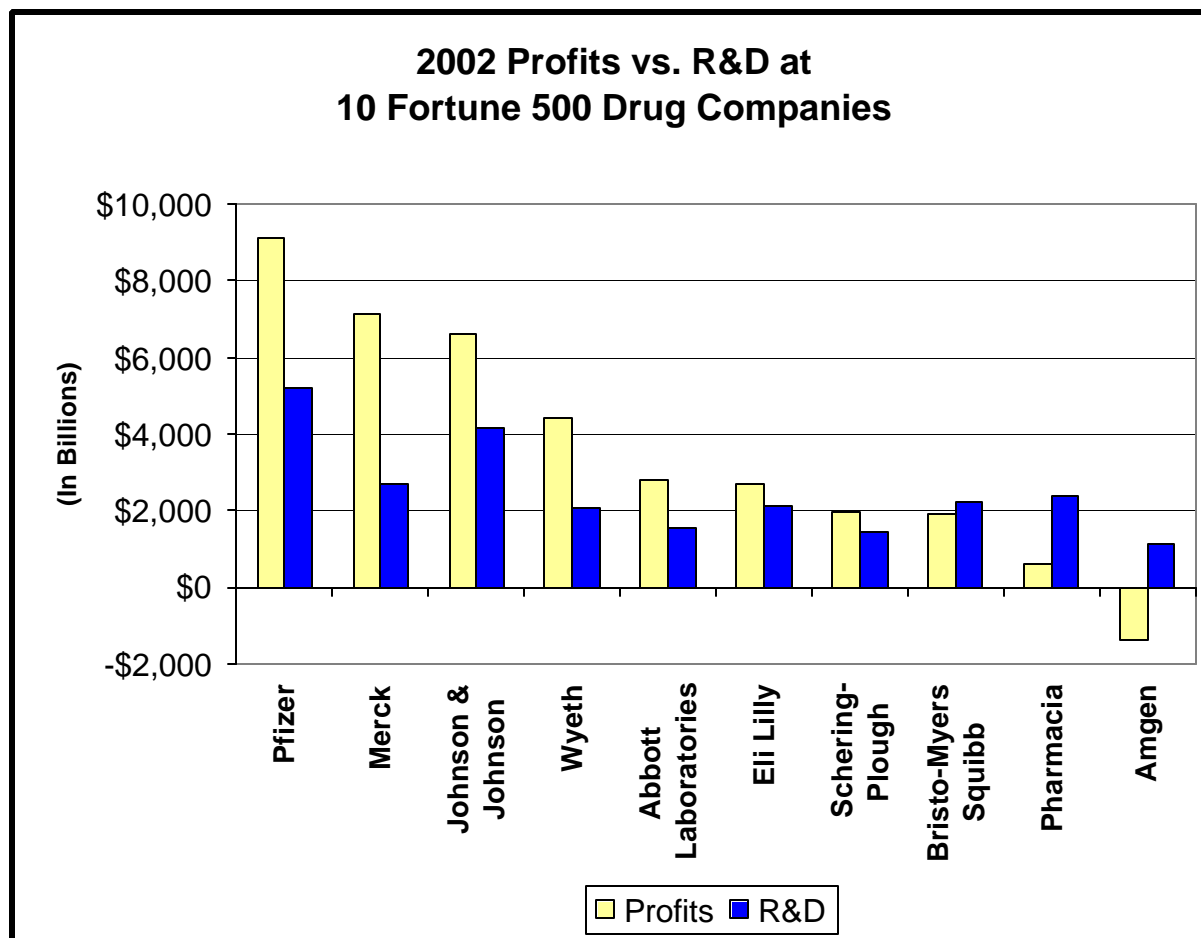
A Harvard-MIT study released in 2003 determined that direct-to-consumer advertising by the drug industry increased from \$800 million in 1996 to \$2.7 billion in 2001.²¹ Measured purely by profits, it is easy to see why pharmaceuticals are sold on advertising: The Harvard-MIT study found that for every dollar spent on direct-to-consumer ads, the companies achieved \$4.20 in sales.²²

Figure 3



Source: Public Citizen analysis of company annual reports; *Fortune* magazine, April 17, 2003.

Figure 4



Source: Public Citizen analysis of company annual reports; *Fortune* magazine, April 17, 2003.
* On March 11, 2002, American Home Products changed its name to Wyeth.

Companies Use Clout to Protect Profits

As in previous years, drug companies and their lobbying arm, the Pharmaceutical Research and Manufacturers of America (PhRMA), made sure that elected officials were aware of their clout – and their wishes – during 2002.

As documented in the new Public Citizen report, *The Other Drug War 2003*, the extent of the drug industry's lobbying blitz is revealed by federal lobbying disclosure records for 2002. Public Citizen's analysis of those documents shows that the industry spent a record \$91.4 million on lobbying activities, an 11.6 percent increase from 2001.²³ And this figure does not include spending on advertising and other public relations, direct mail and telemarketing efforts, or grants to advocacy groups and academics pushing the industry's position.

The drug industry hired 675 different individual lobbyists from 138 firms in 2002. That's nearly seven lobbyists for each U.S. Senator

The pharmaceutical industry's most significant victory came in derailing efforts to include a prescription drug benefit as part of the traditional Medicare program. Instead, the industry has pushed to have Medicare drug coverage provided by private insurers and HMOs – fracturing the bargaining power of the 41 million Medicare beneficiaries in negotiating for lower prices.

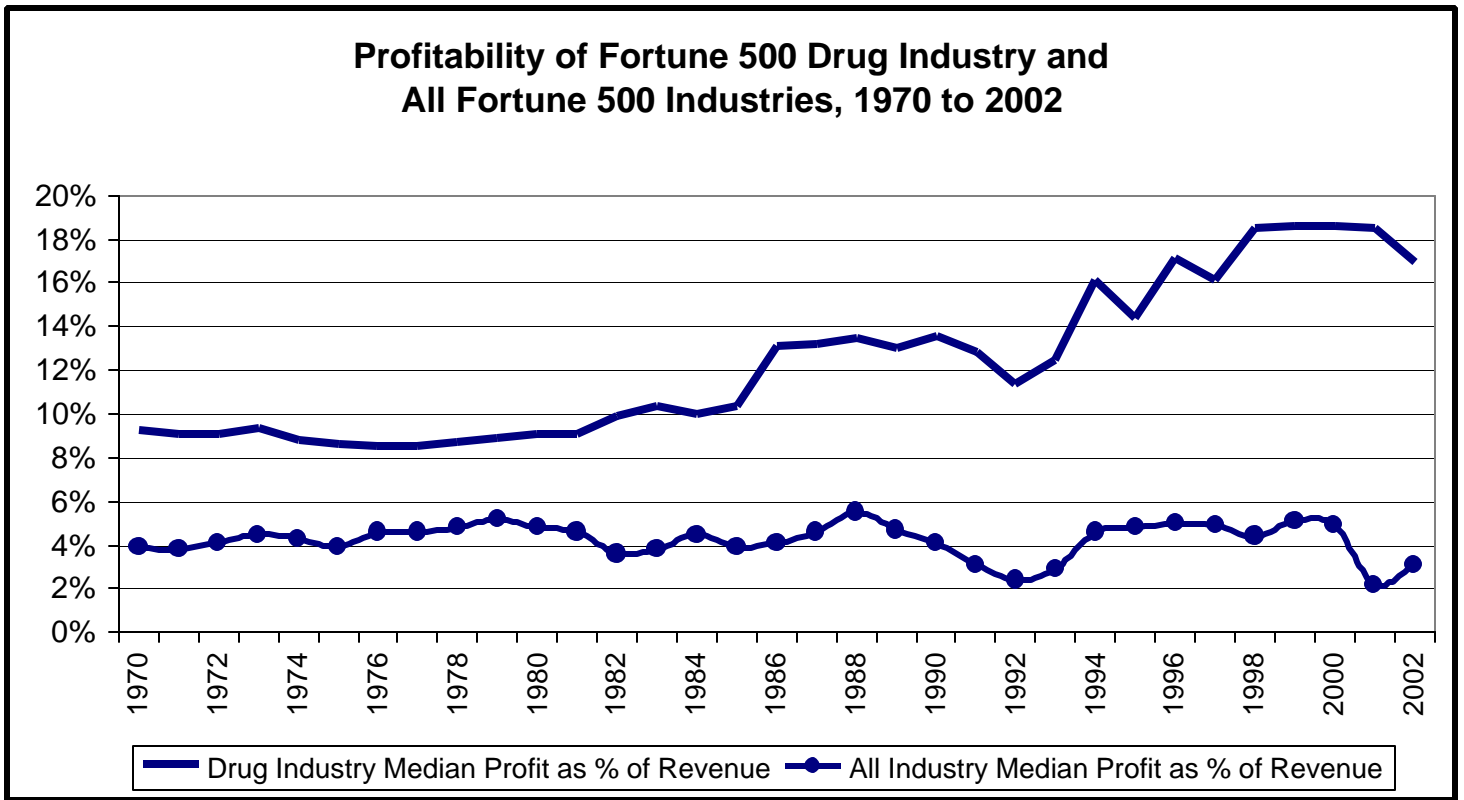
Congress seems likely to approve some restructuring of Medicare in the summer of 2003. Clamoring for a “market-based” solution, drug companies have made it clear they won't tolerate any plan that threatens their bottom line – and a prescription drug benefit under Medicare (the most efficient, pro-consumer option of paying for drugs needed by the elderly and disabled) has failed to survive early votes in the House and Senate.

In addition to its lobbying, the drug industry channeled assets into returning friendly lawmakers to Congress in the 2002 elections. PhRMA supported the election-year activities of the United Seniors Association (USA), a non-profit group that ran purported “issue ads” that were designed to help drug industry allies who faced tough re-election campaigns.²⁴

In the 2002 election cycle, USA spent at least \$17.6 million on advertising and Internet/direct mail outreach in support of GOP prescription drug legislation that was supported by PhRMA. A \$8 million round of ads launched two months before the general election was aimed at supporting two dozen members of Congress – most of them Republicans in competitive races.²⁵

In 2002 alone, USA spent at least \$10.7 million on drug issue ads, which was 18 percent more than USA's total budget had been in 2000 (\$9 million). The *Wall Street Journal* reported that PhRMA acknowledged giving USA at least \$4 million dollars for its election year activities,²⁶ and there is little reason to believe PhRMA did not pay for all of them.

Figure 5



Source: Public Citizen update of Stephen W. Schondelmeyer calculation, *Competition and Pricing Issues in the Pharmaceutical Market*, PRIME Institute, University of Minnesota, based on data found in *Fortune* magazine, 1958 to 1999; *Fortune* magazine, April 17, 2003.

Endnotes

¹ “The Fortune 500: Honey, I Shrunk The Profits,” *Fortune*, Vol. 147, No. 7, April 17, 2003, pp. 199, F-26, F-59.

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³ *Id.*

⁴ Trevor Delaney, “The Inside Dope,” *SmartMoney*, June 1, 2003. And, “Sales Battle by Pfizer, Others Begins to Wane, but Few Dare to Retreat,” *Wall Street Journal Europe*, June 13, 2003.

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¹⁹ Andy Miller, “Drug Profit Debate Builds Claritin’s Over-the-Counter Cost Focuses Attention,” *Atlanta Journal and Constitution*, Dec. 18, 2002.

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²² *Id.*

²³ Public Citizen analysis of lobby disclosure reports filed with the Secretary of the Senate and Clerk of the House pursuant to the Lobby Disclosure Act of 1995.

²⁴ Public Citizen’s report, “United Seniors Association: Hired Guns for PhRMA and Other Corporate Interests,” October 2002. Online at: www.citizen.org/congress/reform/drug_industry/contribution/articles.cfm?ID=8415

²⁵ Tom Hamburger, “Drug Industry Moves to Boost Image Before Vote,” *Wall Street Journal*, Sept. 16, 2002. “USA Prescription Freedom Campaign Expands to 16 States,” United Seniors Association press release, Sept. 12, 2002; and Meg Kinnard, “Senior Group Airs New Ads for Rx Coverage,” *National Journal*, Sept. 11, 2002. See also, Public Citizen’s report, “United Seniors Association: Hired Guns for PhRMA and Other Corporate Interests,” October 2002. Online at:

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²⁶ Tom Hamburger, “Drug Industry Moves to Boost Image Before Vote,” *Wall Street Journal*, Sept. 16, 2002.