Harald F. Stock
Chief Executive Officer
Grünenthal Group

CEO tenure:	CEO since 2009
Headquarters:	Aachen, Germany
Net Revenue 2012:	€973 million (estimated)
Number of Employees:	4,400

Harald F. Stock has been the chief executive officer of the Grünenthal Group, a family-owned, research-oriented pharmaceutical company based in Aachen, Germany, since 2009. Stock received a PhD in inorganic chemistry from the University of Heidelberg in 1997 and has held positions as senior vice president of the global Near Patient Testing business at the Roche Group and as chairman and managing director of the DePuy Group, the Orthopaedics Division of Johnson & Johnson. Stock is a member of the board of immatics biotechnologies GmbH and a board member of the European Federation of Pharmaceutical Industries and Associations.

TCB: Normally what we do is we basically take your five top challenges, which in your case were global expansion, human capital, innovation, sustainability, and operational excellence, and we go through each of those and ask you a few questions. But then we watched your intro video on the website, just as a prep. And we actually picked up five points there. And what I'll be proposing [is] to actually take it from those five points and ask you then to relate them to the challenges as you identified them.

First of all, you being a family-owned company—that's a very important part of the culture that you have. Secondly, being a very patient-centric business. Thirdly, your emphasis on R&D. Fourthly, your focus on global expansion within Europe and in the Americas. And fifthly, what we call maybe a winning culture, a culture around innovation, around operational excellence.

HARALD STOCK: I think the first one, that's about the notion of being a private company. And it's sort of interlinked with the other points that we've raised there. But let me tackle the five points from those five different angles and put together for you how they're interlinked and why certain challenges that I've picked pretty much relate to this.

So, if I go for this family-owned, private notion, first of all, what it does is it gives us the liberty to really take a long-term view, which is very important in pharmaceuticals and with a heavy focus on R&D because we're not necessarily balanced to the capital markets. So, if I, this year, raise my R&D investment to 26 percent of revenues, which is more than 50 per cent more than what the industry average does, this is an easier sell to a group of family shareholders than it would be to analysts, who would hammer me on a quarterly basis until I take the ratio down to 15 percent.

Now, why is it interrelated to the other points? I think, first of all, being family owned, the patient orientation, the patient centricity, provides also the family with a meaning that goes above and beyond the entrepreneurial spirit of building and growing and sustaining a business. So, this special meaning is not only something where we see it as a lighthouse for our innovation efforts, it is also a high motivator for our workforce because for them it's different for our people, for our talent, to work in a company that puts the patient's priority as number one, versus others who would maybe say we want to be the most profitable or we want to be, I don't know—we're a tobacco company or we sell weapons, whatever. I mean, I'm just making these things up. So, I think patient orientation is something that carries a long way also with our family shareholders.

The private ownership, the long-term innovation, patient orientation, also requires sort of, let's say, a diversification. And this is why one of the challenges I have that I've put there is global expansion, and being less exposed to the risk of, let's say, the Euro Zone and the health care systems in the more mature markets. So, to build in sort of a natural hedging in terms of diversifying into emerging markets, which we've already started, so we have an overproportional high percentage of our revenues coming from Latin America. But we're going to continue this and to grow this piece of the business to devote 40 percent. So to double the proportion is one of our strategic objectives.

But that is also tied to the notion of being a private company because it gives the stability that is, on the other hand, needed to have the long-term view and not run into a risk that the bet on R&D is an issue.

TCB: People say a privately owned company makes it possible to actually do these expansions on a more long-term basis. But it's risky, right? And sometimes the family can say, "Well, we really have to be careful with the heritage of our forefathers. And we can't take those kinds of risks to go in these tricky countries." So, is this a difficult thing to balance? Or are you saying no, you don't really see that kind of reaction with a family- or privately owned company?

HARALD STOCK: I wouldn't generalize on this. I think we're in a special situation, as the company started to internationalize 45 years ago, in 1968. So, it's really part of the family's heritage to internationalize. And, funny enough, the second affiliate of Grunenthal outside of Germany was in Peru, and after the first one had been started in 1956 in Switzerland, not anywhere else. So, 1968, it was Peru, and then 1970, it was Ecuador. So, already at that time there was a strong focus on emerging markets. So, I don't think this is a big issue.

And that was one of the risks we took in the last couple of years. The family had been hesitant to go into larger markets, larger countries. So, for instance, Brazil, though being in our strategic focus, we only entered a couple of years ago, with an acquisition. So, in 2012, we completed that acquisition. We're starting to build our own operation based on that acquisition. But that was in the process of handing over to external management. And I've now been with the company for four years; I think the level of professionalization that we were able to bring on board helped them gain trust that even a heavier investment into larger markets is something that the company can survive.

If I may briefly explain how we got into the position we're in today—We really have undergone two-thirds of really a transformation in the company. Because I'd say, four years ago, I would have [said] we're completely disadvantaged in going into emerging markets and then heavy lifting on the R&D side. But what we've done is we've really improved the cost position extremely in the company. We've really restructured our P&L so that we're able to reinvest more into R&D.

So, that's one thing that you can do as a family-owned company; you don't have to have the savings fall into bottom line, into profits. But you can take it back to R&D. And that was something the shareholders were completely happy with. I think the capital market would have said, "Well, you know, you're below peer-level profitability. Why don't you cut R&D? That's the risk you're undertaking anyway." But the family shareholders said, "No, that's completely fine. We're happy with the dividend that we're getting and we're not becoming greedy on this."

And so, that was the first step. The second step was that we had really focused the company on where we are now in terms of geographies and also in terms of the therapeutic areas, i.e., pain. We had a basket of other franchises that we all divested.

Luckily, our innovative portfolio in pain allowed us to further grow, so we have never declined in revenues. But these divestments have enabled us to be completely debt-free while we have significant liquidity. So, right now, our ability to acquire is not smaller by any means, as it is for a public company that could access the capital markets in a different way. So, we're completely unleveraged. We have an equity ratio of, like, 70 percent. So, you can imagine that we can do some heavy lifting on this.

TCB: A few of the strategies that you identified [are] acquiring companies in target geographic areas, investing [in] greenfield operations internationally, granting distribution rights—so strategic business partners in new markets. Can you talk a little bit about the challenges? What makes you decide to go for acquiring companies versus greenfield operations? What are the issues that you have around granting distribution rights? Because you picked them up as being such an important part of your global expansion strategy.

HARALD STOCK: Let me start with acquiring companies. What is the challenge? The challenge is that, in the pharma industry, as you know, the patent cliff is still there for the big pharmas. And so they're heavy in M&A mode. So, we're never alone when we start looking at companies that we could acquire. The aggressiveness and the ability to move fast and to be able to buy at a price that makes sense for us, that is the challenge behind this. But we've pulled off several deals, so I think we can do it. But this is one of the major challenges because my estimate would be that, in 2013, there will even be a more heated M&A market in these geographies.

In addition, in some areas, though, it is investing in the greenfield operations. What we've seen, though, is that, in light of health care systems putting a lot of pressure on health care companies in total, and also the intensified competition, it takes longer until a greenfield operation really breaks even. And so, the challenge for us behind this is: how can we get to a quicker break-even, even though the market environment is tougher? Lower prices, higher hurdles for reimbursement, difficulties to get the right people—I mean, this all sort of ties together.

And then the licensing and IP to strategic business partners, and the distribution rate—there it is a question of really picking the right partner from two angles. One is the pain business is a very special one. There are not many specialized players in this field. And the geographies that we currently do not cover, and we are not planning to cover with our own operations, are mainly in Asia and in Africa. And so, you need to find somebody who understands pain and, in parallel, is of the right size to have, let's say, the muscle to sell our products but to not be too big that maybe a niche product in the pain space is not meaningful enough. So, partners election is really the issue there.

So, that would be on global expansion.

TCB: Very early in the conversation, you said we are extending ourselves into the Americas partly because we want to move away from mature economies and those kinds of things. One thing that did not come up in your five, but that did come up, for example, in the European top three, was political and economic risk.

Is some of the expansion towards mature economies also related to the fact that you're just not comfortable about the sustainability of the growth model in mature economies? Or is it just that you're saying, look, the demographics are just such that the markets are going to be slow, whatever is going to happen? So, is it just that, or is it also a concern that you have about the future of these economies, the volatility of these economies, and that you don't want to be so dependent on them?

HARALD STOCK: No, it's not this. It's a little bit different. I mean, at first glance, emerging markets might look challenging to pharma companies, as IP protection doesn't necessarily happen on the same standard, on the same level, as it does in mature markets. In mature markets, though, you have these 10 years that you are on the market, give another two or so, where you generate revenues and you're able to compete in your segment, and then the business becomes unsustainable for you and you have to come to the next innovation.

So, the innovation cycles have to really come every three to five years. You have to have a new product, which links to the innovation challenge. How can we sustainably continue to innovate and not have certain waves that are too many years apart?

This is very different in the emerging markets, as the patent cliff, the subsidization by generics, doesn't happen that fast. And grants have a longer staying power. I mean, you're not getting the high price, and you're slower in building a market, but once you're there, brands have staying power. And then the demographics and the growth of these markets themselves provide you with a very different cyclical nature of an emerging markets business versus a European business. Whereas Europe, I would say, or the U.S., is cyclical—you have these 10-year cycles for your product—you don't have that in Latin America or in Asia. That's why this is a nice hedging. You have two different cyclical natures.

TCB: You say [you] create a culture of innovation by promoting and rewarding entrepreneurship. And I actually want to tie it to the challenge before, human capital. And you talk about winning culture on your video. Can you tell us a little bit more about that in that context?

HARALD STOCK: There are several balances to strike, I would say. First of all, the success rate in pharma R&D seems to be very strictly correlated to an ability to select the few golden nuggets within about halfway into your innovation cycle, in the so-called Phase II clinical trial cycle. So, this is like a "kill early" many of the projects, and then hang onto the golden nugget and be able to run a very expensive Phase III program with a high success rate.

And the balance you have to strike is, on the other hand—and we've seen that in the past—that maybe, early on, you might have signals where you believe there could something in this molecule, but the trials don't really come out the way you want it, and you need a lot of resilience and belief in the compound until you get to that proof of concept. So, how can I balance resilience without becoming, well, too parenting to my baby?

So, be critical enough, but not shoot from the hip. That's one balance. The other one is: how can I take systematic decisions without overpropertizing the portfolio management? The amount of committees that an R&D project has to pass to get to the next milestone and to get funding for the next year, it's probably five to six committees. And for every one of these committees, there has to be certain stakeholder management prior, you have to develop your deck, you have to work the hierarchy—and all of the above.

Well, this is overkill. On the other hand, what you can't do is just let a group of researchers run and say, "Well, I'll see you in 15 years, and good luck with your product." So, how can I balance the freedom and creativity on one hand versus some sort of discipline and systematics without becoming too bureaucratic? So, that's the second one.

The third one would be: how can I balance an environment where scientific, clinical talents find their way, get fulfillment out of an environment where they can be entrepreneurial, and don't feel the urge to rather go to a start-up biotech with a vibrant environment, where they might be able to become rich in a short period of time or be in a very scientific environment, versus how do they fit into a midsize company and how can I avoid that these guys become scientific nerds and mavericks who would not get any information in the organization, who are not able to relate to other functions—how do they play their interfaces? So, this is another one.

And that's why I think the whole cultural element, focusing on a patient, really rewarding innovation, rewarding risk taking, but also rewarding resilience, rewarding people to speak up, encouraging open discussions, flattening hierarchies, those things are utterly important to sustain such a climate.

TCB: What is it that gives you the edge to keep the talented people with you and not be tempted to go to these other places where they perhaps could make more money or be more specialized?

HARALD STOCK: It's, in the end, human interaction, I think. It might oversimplify it, but it's people join companies, but they are leaving their bosses. That's something I've felt looks a little bit simplified but seems to be the truth all the time. Really work with management, with leadership, that everyone, and especially midmanagers, understands what is needed to really sustain such a climate.

And I think there big pharmas have tougher difficulties because the way from the top—and you set the tone at the top—to the bottom of the pyramid is so long. I don't think that somebody like, I don't know—I'll just pick somebody who I know, and I know he takes a punch pretty well—a guy like [CEO] Chris Viehbacher at Sanofi, I don't think that he spends more than 1 percent of his time talking to bench-top chemists, or that he has ever seen every [one] of his labs or his salespeople or whatever because it's just too tough for him in a company that employs 200,000 people.

In a company that employs 4,000 people, the distance from the CEO to the bench-top scientist or to the salesperson is not as big.

TCB: You also said earlier you have been going through certain restructuring and that has led [to] all kinds of good benefits; you narrowed your product portfolio. I mean, that tends to leave scars on an organization. And, at the other side, you officially want to create this innovative, entrepreneurial kind of a culture. How did you manage to do both things at the same time, under the same roof, so to say?

HARALD STOCK: I think that's a great question. And I may throw in even a third aspect to it. How can you create awareness of what operational excellence is without the pressure of the capital market? Because if you sacrifice profits to reinvest into innovation, that could also be interpreted in a company that this is a lack of results orientation and sense of urgency.

So, how are we trying to balance this? I think the first one is the company, four years ago, was about 14 percent smaller in terms of revenue. But we had 25 percent more employees. So, about one-fifth of the workforce has left the company. Out of these over 1,200, I can safely say it's less than 10 people who have not found a job because we've taken care of it. And I think that's just something that we can also better do as a private company. You don't need to lay off and find the cheapest way. You can talk to the people and find them jobs and just give such a restructuring maybe another 12 months.

But, for instance, we closed one plant here in Germany; those were about 300 jobs that were made redundant. The status at the beginning of December was that we were looking for jobs for two people. The rest we found jobs for either in other companies here or internally because in other areas, there were vacancies. But we really took care of these people.

And if you treat people fairly and if you explain to them why you are doing these things—and then that goes back to patient centricity. If you explain to them that you need the money to reinvest it into R&D; that you create other jobs; that it is about staying alive as a midsize, private company; and that innovation is core and that innovation is oriented to improve patients' lives; and that you also then walk the talk and take care of those people whose jobs were made redundant, I think that gives you a lot of credibility. And we're even measuring this. You might know this Great Place to Work survey, this instrument.

We're measuring this on a global scale, in every affiliate. In the first year, in 2009, when we first did the survey, globally we were around 60 percent of the people who felt that they were working in a great place to work. End of 2012, this came up to 80 percent. So, this is also something where you can really see a lot of progress culturally, even though there has been tremendous change in the company.

TCB: In the European top five, and also in the global top five, one thing that we saw this year is that customer relationships came up as a key challenge. In slow-growing economy, companies are very, very focused on improving their own performance and growing market share.

And so, we're not so surprised that customer relationships come up higher on the list. Would you have any views? You didn't put it as one of the five, maybe because there were just five that were more important, or maybe you say, you know, I've got customer relationships pretty well under control. Would you want to make a comment on that?

HARALD STOCK: I was actually tempted to put it on my top five, so it's a close number six, I would say. I think our customer has changed, especially in mature markets. So, there's no single one customer. We have the patient who benefits. We have the doctor who prescribes. We have the pharmacy that dispenses. We have the wholesaler or distributor that delivers to the pharmacy.

And we have the payer, in most cases, take care of it. And we have regulators who influence which drugs come to the market. And, in addition to the rising complexity—and this is also happening in the emerging markets—there are more limitations versus traditional ways to market on how to manage those relationships. So, what in the past was, well, the wining and dining of doctors in strange locations, or in exotic locations, to have them prescribe your drug, that has now become very scientific. I mean, if you don't have a scientific story, a brief and concise scientific story to tell to many of those guys, be it the payers, be it the doctors, or even the informed patients, you really have no customer relationship at all.

So, the quality and the nature—I mean, the way you interact, the complexity, and what your front-line people—but not only those, but many levels in the organization—have to learn is really tremendous. And so, this is one of my top six challenges.