

The government's Kodak moment looks badly underexposed

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If you're a venture capitalist betting on a new business, the first thing you look for is management expertise.

If you're investing taxpayer money, that step apparently is optional. President Donald Trump's administration wants to create more domestic manufacturing capacity for pharmaceutical ingredients, but it turned to a failed film company instead of finding an experienced drug-industry team.

The government's preliminary decision to lend Eastman Kodak \$765 million is raising plenty of questions. The Securities and Exchange Commission is investigating the way Kodak broke the news, and members of Congress want to know why executives got stock options the day before the announcement.

Kodak's glory days are far behind it. After filing bankruptcy in 2012, the onetime photography giant became a money-losing maker of printing supplies, movie film and industrial chemicals. In its latest annual report, auditors express “substantial doubt about the company's ability to continue as a going concern.”

With that red flag raised, Kodak probably couldn't attract private financing for a big new venture. News of the potential federal loan sent its shares soaring to as high as \$60 on July 29, up from \$2 and change a couple of days before. They've since fallen back to about \$15, still enough to make executives' stock options highly lucrative.

If the private market wouldn't touch this deal, why should Uncle Sam? “The idea that the government would be lending money to a company whose prospects are not bright doesn't sound like a good idea,” said Glenn MacDonald, professor of economics and strategy at Washington University's Olin Business School.

The loan, if it happens, would be made under the Defense Production Act. The administration's goal is to lessen America's dependence on other countries, especially China, for key drug ingredients.

That may be a smart strategy, but the government just launched a sweeping study of the pharmaceutical supply chain. To send Kodak money now would be picking a solution before we know the extent of the problem.

“Why are we rushing this?” asks Scott Lincicome, a senior fellow at the libertarian Cato Institute. “It is not a small amount of money.”

If the study does find vulnerabilities in the supply chain, it also could identify companies that are best positioned to fill those gaps. Kodak doesn't seem like a leading candidate.

“Kodak has some chemistry experience and capacity but they don't have pharmaceutical experience,” Lincicome said. “There is a big difference. There are hundreds of API (active pharmaceutical ingredient) factories in the U.S. that have exactly the right kind of experience and facilities.”

In fact, subsidizing Kodak may discourage other manufacturers from expanding. They presumably aren't looking forward to having a big, new competitor backed by the government.

With Kodak on such shaky financial ground, it's worth asking how the government will protect itself in the event of another bankruptcy. “It's hard to think of anything that makes this Kodak thing look good,” MacDonald said.

One thing's for sure: This deal needs a lot of scrutiny before Kodak gets the money. “I hope Congress at least lifts the hood on this,” Lincicome said.

In the film company's old ads, a “Kodak moment” happened when the camera perfectly captured a sentimental scene. In the current Kodak moment, sentiment should play no role.

If the Trump administration is determined to transform the drug industry using industrial policy, it needs to make some hardheaded business decisions. For starters, officials need to ask if some other firm is better qualified for the job.