OLIVER WYMAN

THE PROCUREMENT VALUE IN LIFE SCIENCE

AND THE KEY CHALLENGES TO EFFICIENT EXECUTION

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EXECUTIVE SUMMARY

The days of rapid growth and high margin levels are no more for the pharmaceutical industry. In order to continue delivering high and attractive profitability ratios, the industry is now faced with the same pressure to achieve excellence in cost optimization facing other industries.

Pharmaceutical companies need to gain improved control over their overall cost base and a greater ability to variabilize fixed costs.

Across pharmaceuticals, external spend is largely untapped and significant in size.

However, reaching maximum benefits will require going beyond the traditional negotiations, obvious panel consolidations and basic suppliers' relationship models. Successful companies will need to explore the full set of purchasing and value sourcing levers and build truly optimized outsourcing strategies and enhanced capabilities to manage these complex partnerships.

Oliver Wyman has developed a truly unique value proposition to support our clients in the pharmaceutical industry, built on the combination of state-of-the-art capabilities, a well-tested transformational approach, and deep industry knowledge.

When successfully executed, pharmaceuticals can gain up to 500+ basis points in EBITDA. Optimized procurement also results in additional benefits, such as improved risk management and new growth opportunities through enhanced supplier relationships.

1. PROCUREMENT: UNTAPPED VALUE FOR PHARMACEUTICAL COMPANIES

The pharmaceutical industry has long enjoyed rapid growth, high margin levels with a focus on innovation. As a result, the industry hasn't yet faced the same pressure to achieve excellence in cost optimization as other industries.

However, the industry is now seeing more pressure on revenues and margins due to:

- Drop in R&D productivity
- Patent cliff
- Heavy pressure on payer budgets (multiple health reforms)

Companies are also facing a growing need for funds to finance strategic investments:

- Diversification into related activities (e.g. OTC, generics, animal healthcare)
- Investment in emerging markets that offer significant growth and profitability perspectives (e.g. Brazil, Russia, India, China, Turkey, Korea)
- Increasing R&D costs
- Increased licensing and acquisition of novel technologies

Despite this "scissors effect", pharmaceutical companies are still expected to provide very high and attractive profitability ratios to investors.

Pharmaceutical companies need to gain improved control over their overall cost base and a greater ability to variabilize fixed costs – including enhanced outsourcing strategies.

External spend represents a significant share of sales in the pharmaceutical industry at 47% on average.

Apart from a few exceptions this area has never seemed to be a top priority for the pharmaceutical industry, contrary to most other industries.

More specifically, it appears that Procurement functions in pharmaceutical companies have mainly focused on direct spend (i.e.: Cost Of Goods Sold, COGS) and to some extent on Capital Expenditures (Capex), leaving nearly 50% of overall spend virtually untapped.

In the context of health systems reform and shrinking margins, the pharmaceutical industry will benefit from pursuing the untapped opportunities in Procurement:

- **Control the cost base**
  Extend the scope of Procurement to areas not currently covered, implement more sophisticated levers, increase the level of challenge on prescribers. In short, tailor best-in-class processes already tested in more mature industries to the specific needs of the pharmaceutical industry
- **Increase the variable share of costs**
  Identify the relevant partners to optimize outsourcing efforts, define the appropriate partnership models to maintain strategic control over outsourced key activities, and build the right set of KPIs to ensure an effective management of outsourced resources

Based on our experience in performance optimization for many in the pharmaceutical industry, we believe that it is possible to achieve substantial savings of 3 to 5% per year, measured by Finance – increasing EBITDA by up to 500 basis points – while improving risk management and finding growth opportunities through better supplier relationships.

2. THREE MAIN CHALLENGES IN UNLOCKING THE VALUE

Typically, the purchasing portfolio of a pharmaceutical company covers six major spend areas. Given the current average maturity level in the industry, pharmaceuticals are faced with **3 specific challenges**:

EXHIBIT 1: THE DIFFERENT CHALLENGES TO OPTIMIZE SPEND IN THE PHARMACEUTICAL INDUSTRY

	A. INCREASE COVERAGE AND COLLABORATIVE APPROACHES	B. IMPORT BEST PRACTICES FROM MORE MATURE INDUSTRIES	C. EXTEND OUTSOURCING CAPABILITIES
COGS		+ + +	+ + (Manufacturing subcontracting)
CAPEX	+ +	+ + +	
Corporate services	+ + +	+	
Marketing	+ + +	+	
Sales	+		+ + + (Sales force, call centers)
R&D	+ + (Lab equipment)		+ + + (CRO)

Level of challenge: from medium (+) to very high (+++)

A. INCREASE COVERAGE & COLLABORATIVE APPROACHES

One the key challenges for pharmaceutical companies will be to overcome siloes. The objective is to increase the Procurement function's coverage and increase collaboration between users, prescribers, and buyers. This challenge mainly concerns Corporate Services, IT and Marketing.

- **Corporate Services** (e.g. travel, intellectual services, energy, facility management) **and IT**. Generally speaking, these categories are not fully covered by the purchasing function:
  - Either because they are perceived to be "protected areas" in the hands of topic experts (e.g. IT)
  - Or because the stakes are considered to be too low (e.g. office supplies)

The nature of scattered spend makes it difficult to rationalize requirement and execute global strategy in complex and siloed environments such as pharmaceutical firms.

- **Marketing** (e.g. communication, media, seminars, market access studies). These costs are directly linked to business growth and are generally perceived as highly sensitive by the top management. The key challenge is to increase the return on marketing investments – not necessarily reduce spending. In other words, it is critical to get all stakeholders to work together toward "getting more for less."

B. IMPORT BEST PRACTICES FROM MORE MATURE INDUSTRIES

The second challenge is mostly about implementing advanced and sophisticated levers by leveraging best practices from other more mature industries and adapting them to the specific needs of the pharmaceutical industry (e.g. quality, development leadtimes, regulatory constraints). This challenge mainly affects COGS and Capex – already generally well covered by Procurement:

- **COGS** (e.g. active pharmaceutical ingredients, excipients, devices, industrial subcontracting). These purchases, which represent an important part of the industrial costs, are often already covered by purchasing organizations and usually present a good level of maturity. However, most companies remain very exposed to inflationary risks on commodities markets driving significant increases in costs.
- **Scientific and Industrial investments and maintenance** (e.g. industrial equipment, spare parts). The challenge here is to get a "license to address globally" since the purchases are usually decentralized and delegated to the industrial side of the business with heterogeneous specifications and purchasing practices. Also, those investments are often related to larger projects and therefore require a different set of capabilities from those needed to manage a spend category.

C. EXTEND OUTSOURCING CAPABILITIES

Finally, the third challenge, for scientific and clinical expenses, as well as sales expenses (e.g. sales force, sales force analytics, call centers), relates to finding an efficient balance between Make vs. Buy decisions while expanding the areas in scope for outsourcing, successfuly driving complex outsourcing projects, and managing strategic partnerships on key activities very close to the core business.

- **Scientific and clinical expenses** (e.g. clinical data management, research chemistry). This spend, essentially driven by the R&D function, is very close to core activities. Although many pharmaceutical companies have already engaged in outsourcing parts of these processes, companies need to better manage the existing partnerships, measure the actual return on investment, and optimize usage of the outsourced resources.
- **Sales** (e.g. pharma sales rep, sales analytics, call centers). The key issue is the growing complexity related to:
  - The multiplication of providers required to efficiently cover existing geographical footprints
  - The spectrum of outsourcing services, ranging from very specialized, niche-oriented to fully integrated providers
  - The necessity to shift focus away from lower value-added activities while maintaining a tight strategic control on key data and information

3. HOW TO MAKE IT HAPPEN: EXECUTION IS THE KEY

Our experience in conducting successful purchasing optimization projects in the industry has shown that significant value is left on the table when companies rely solely on traditional approaches.

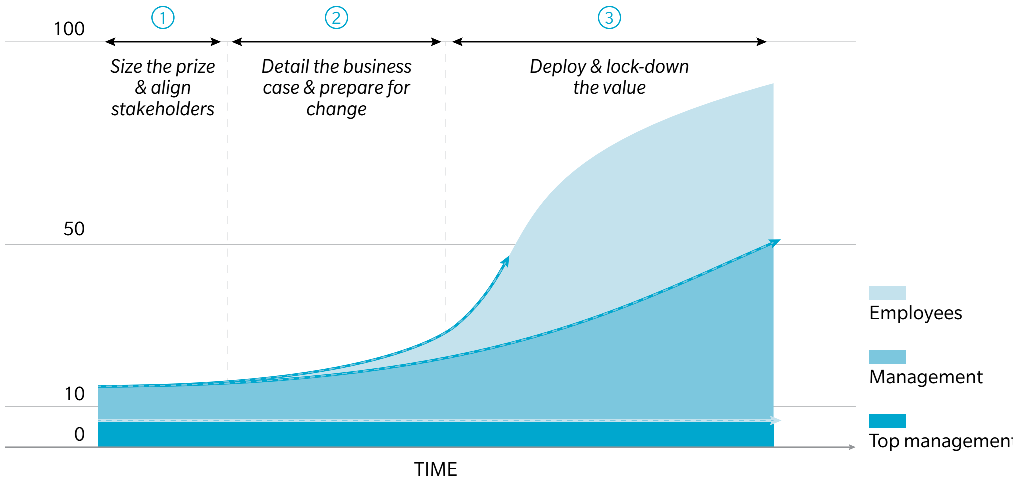
Reaching maximum benefits requires not only leveraging traditional levers (e.g. negotiation and supplier consolidation), but also exploring the full set of purchasing and value sourcing levers:

- **Traditional levers typically deliver 30% to 40% of the potential at stake**:
  - **"Buy cheaper"**: challenge price & payment terms conditions through leveraging scale, consolidating suppliers, and finding market opportunities (e.g. pool volumes, optimize supplier panel, investigate alternative sourcing, negotiate master agreements)
- **The remaining 50% to 60% requires sophisticated levers**:
  - **"Buy better"**: optimize prescription to tailor products/services bought to the real internal needs (e.g. standardized catalogues creation, total cost of ownership trade-offs, specification improvements, Make or Buy decisions)
  - **"Buy less"**: monitor consumption level to avoid performance spoilage (e.g. Best practices sharing, consumption dashboard monitoring, internal benchmarks, budgets constriction)

Many companies feel they already know this. But the fact is fewer than 1 out of 6 companies can do this in practice: **execution is critical** to overcome siloes and maximize and sustain the performance. Putting theory to practice requires engaging in a real Transformation Journey.

First, strive to obtain the unconditional support from top management and involvement of key stakeholders to kick-start the transformation. Second, build tangible and analytically supported improvement plans to progressively increase buy-in, ownership, and accountability of the entire organization. Finally, ensure an effective deployment of adequate organizational changes, dedicated tools and processes to lock-down the benefits.

EXHIBIT 2: PROGRESSIVELY ENGAGE THE ORGANIZATION TO MAXIMIZE BUY-IN



When appropriately conducted, this journey delivers significant and sustainable benefits that are both financial and transformational and has proven effective in many industries and contexts.

- **Step 1 – Size the prize and align key stakeholders**
  The potential must be analytically demonstrated and agreed upon to avoid reluctance and align the top management – who will then set the global objective – and the main business stakeholders – who will take their fair share of the target and enlist relevant resources. A first short step may therefore be required to assess the potential value within a given scope. Opportunities are identified and detailed for each category through global analyses. The main hurdles to successful implementation also need to be identified as soon as possible.

- **Step 2 – Build tangible financial improvement plans and increase buy-in and ownership**
  This step is critical as it is the actual change management phase, designed to get the organization completely involved and committed to the success of this transformation. Based on the findings of step 1 and for each category, cross-functional teams of buyers, prescribers and users develop shared strategies. They also define detailed action plans with related business cases, which then go-through a thorough validation process by management and finance. In this phase, teams may start adjusting their ways of working to overcome the hurdles identified in the previous step and progressively formalize the terms of a sustainable collaboration.

- **Step 3 – Deploy and lock-down the value through the operating system**
  During this step, you should equip the organization with best-in-class processes and tools to accurately steer and measure the value delivered on external spend. It should also build an efficient operating model around processes, governance and capabilities that consistently deliver the expected value, maximize the efficiency of the organization, and make it sustainable.

This Journey can be applied by itself or as part of a more comprehensive operational efficiency project: it generates value that can be reinvested in other cash-demanding initiatives and encourages stronger transverse collaboration as well as increases overall business acumen across the organization.

It upgrades capabilities and skills over the long-term, increasing the actual readiness for change without risking any major organization upheaval.

CASE STUDY
OPTIMIZATION OF CLINICAL STUDIES SPEND

The following example on clinical expenses is taken from a real case in the pharmaceutical industry. It highlights the areas of improvement described above and demonstrates the potential impact of improved procurement capabilities.

INITIAL SITUATION

This leading pharmaceutical company had inherited very heterogeneous regarding its clinical studies staff situations, from multiple external growth operations.

It supplemented its existing staff with external resources from Contract Research Organizations (CRO) for Clinical Project Administrators (CPA), Clinical Research Associates (CRA), and Clinical Project Leaders (CPL) for an annual spend of over one hundred million a year.

The decisions to conduct studies in-house or to outsource part of them were taken locally, resulting in significant heterogeneity between geographical regions and countries in terms of strategies:

- Outsourcing intensity: external resources represented from 0% to 74% of the total need in different countries
- Suppliers panel: the number of approved suppliers by country varied from 1 (creating potential significant risks) to 20 (limiting potential leverage) with a very limited number of suppliers serving more than one country or supplying more than 1 FTE

THE CASE FOR CHANGE

In order to limit risks and create efficiencies, our client was willing to design a global strategy and build common guidelines on how to manage clinical studies staff. In addition, our research indicated trends that advocated global providers:

- Increasing study complexity
- Need of greater geographical coverage
- Flexible resource model to adapt to changing portfolio needs (innovation, regulatory request, unmet medical need, and efficacy & safety results)

THE SOLUTION

Our study found our client should target a position where it could benefit from the upsides global players have to offer while leveraging their global reach, additional services & competitive pricing (in certain areas). While doing so, it would also be critical to define the optimum level of internal resources meeting study demands without resource surplus. In addition to a global provider, and in order to compensate for uneven coverage, local suppliers should be retained where relevant to ensure adequate access to resources. Finding the optimum balance would yield significant savings while increasing the quality and speed of the studies.

This approach to optimize the clinical study spend generated 6% to 11% net savings across the 27 countries addressed.

ABOUT OLIVER WYMAN

With offices in 50+ cities across 25 countries, Oliver Wyman is a leading global management consulting firm that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation. The firm's 3,000 professionals help clients optimize their businesses, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities.

OLIVER WYMAN'S SOURCING CAPABILITIES

Oliver Wyman's global Sourcing practice is one of our key capabilities in Operational Efficiency.

In addition to our dedicated team, we have created a Sourcing Center of Expertise. Leveraging a wide internal and external network of experts, this Center of Expertise supports our teams on all key Sourcing topics, from category expertise to organizational focus.

Our approaches are built to deliver sustainability and avoid the black-box effect:

- Knowledge transfer: it is embedded in our way of working. Through formalized methodologies, supporting tools and processes and continuous coaching and training, we make sure each organization takes full ownership of our recommendations and is equipped to sustain them over time.
- Proprietary tools: Our approach is not a theoretical construct but rather a toolbox we have built a number of proprietary tools – from diagnostic (GSM Oliver Wyman tool ©) to consolidation (APD © and Levers periodic table ©) and performance measurement (SATT ©). This enables us to be immediately operational.

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