

# Opportunities in adversity

## Life sciences survey snapshot

### Overview

While major life sciences companies have weathered the financial crisis better than most, they are realigning their organizations to address a number of longer term structural changes to the industry's traditional business model. The era of blockbuster drugs is nearing an end, with many patents set to expire in the next one to three years and few prospects in the pipeline to replace them. The current economic realities are exacerbating this dearth of innovation by putting further pressure on spending. Faced by these constraints, life sciences executives are increasingly managing for the bottom line as much as the top.

With the Economist Intelligence Unit, we interviewed senior executives from major life sciences companies (most with more than \$1 billion in annual revenue) from around the world in order to identify which areas are garnering the most management attention and to help spot competitive opportunities. The respondents from these firms reported focusing on improving cash flows, increasing speed to market, catering more to top customers and driving efficiencies throughout the supply chain. The executives' responses also reflected their openness to strategic pairings – whether by outright acquisition or through alliances.

With the awareness that the financial crisis has affected life sciences companies differently across the development spectrum, we highlight how leading life sciences firms are revising their strategy to secure their present and position themselves to seize future opportunities.

### About this survey

For this study, the Economist Intelligence Unit surveyed 569 C-suite and board-level executives.

Respondents were drawn from across the world and across a wide variety of industry sectors, including life sciences. Over half the executives polled worked for companies with annual global revenue in excess of US\$1 billion.

The research was carried out in June 2009. Responses are rounded to the nearest percentage.

### Market challenges: added pressure

Even before the recession, the life sciences industry was facing some major, and escalating, headwinds. Revenue growth was on a downward trend due to a combination of increased competition from generic drugs, declining research and development (R&D) productivity, the ongoing fallout from product safety concerns and narrowing patent exclusivity periods. When they looked to the future, pharmaceutical executives had little cause for celebration – seeing the looming “patent cliff,” from which many key blockbuster drugs and other revenue-generating products are scheduled to fall (lose their exclusivity) between 2010 and 2012.



Although the life sciences industry has weathered the downturn better than most, investors remain wary of the potential of drug stocks due to concerns about these pressing challenges. As investors become more selective, smaller companies are often unable to raise capital to fund their operations, and many are focusing their R&D initiatives on the most high-potential drug candidates – increasing the risk of failure as portfolio diversification declines. In addition, in the US, government and private-sector payors are finding their budgets squeezed, putting downward pressure on drug prices. In Japan and Europe, long-term public funding sources are also under pressure due to aging populations and escalating healthcare costs.

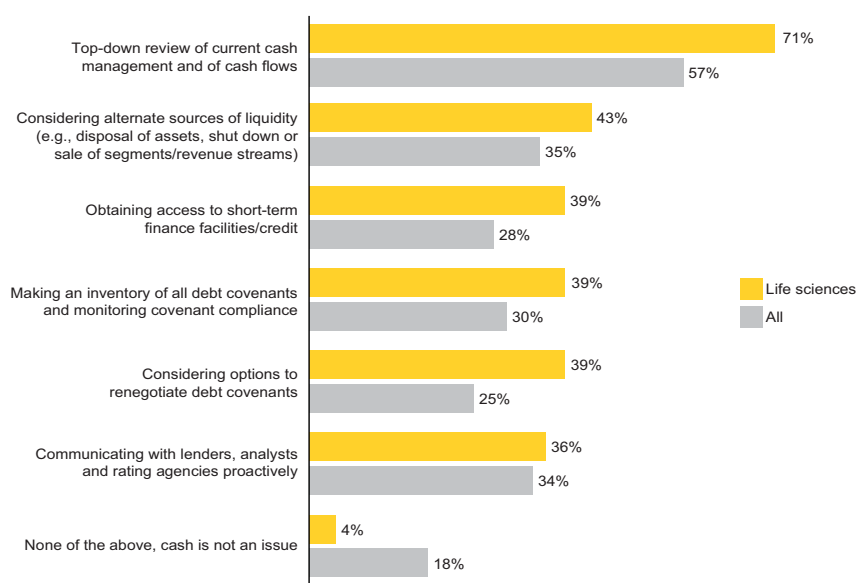
While big life sciences companies are flush with cash, the fact that the US pharmaceutical market is expected to contract in 2009 for the first time in more than 50 years is forcing companies to look abroad to connect with new customers in emerging markets where growth remains strong.

## A survey of the life sciences industry

Life sciences respondents were generally more optimistic than overall respondents with the majority predicting growth returning to the sector by the second half of 2009 or sooner. Respondents were generally resilient to the effect of the crisis with over 70% indicating that their business has actually improved over the last year. But bottom-line growth and working capital concerns were evident throughout the industry survey.

When asked about steps their organizations are undertaking to maintain liquidity, life sciences respondents indicated that they are addressing liquidity concerns with greater rigor than overall respondents. Over 70% of life sciences respondents indicated that they are undergoing top-down reviews of cash management, compared to just 57% of overall respondents. In virtually every category, life sciences respondents were more inclined than overall respondents to indicate that active steps are under way for cash management.

**Q: Which of the following steps is your company currently taking to maintain liquidity in the light of current market conditions?**



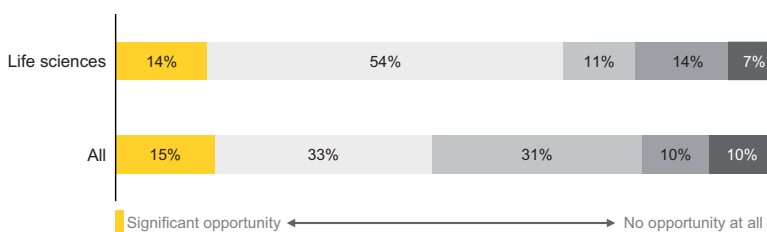
*Shown: percentage of life sciences respondents compared with overall respondents*

Active management of working capital is a key concern for executives in the life sciences sector.



The supply chain was consistently listed as a top target of management for cost-efficiency efforts. Life sciences respondents were more likely than their counterparts in other industries to report that supply chain reengineering programs accelerated over the past 12 months, but they also expressed their belief that there is ample room for additional cost savings from such initiatives. In fact, the supply chain garnered the most votes among life sciences respondents as the likeliest vehicle for exacting cost savings over the next 12 months: 68% saw an opportunity or a significant opportunity, which was 20 percentage points higher than in the general survey.

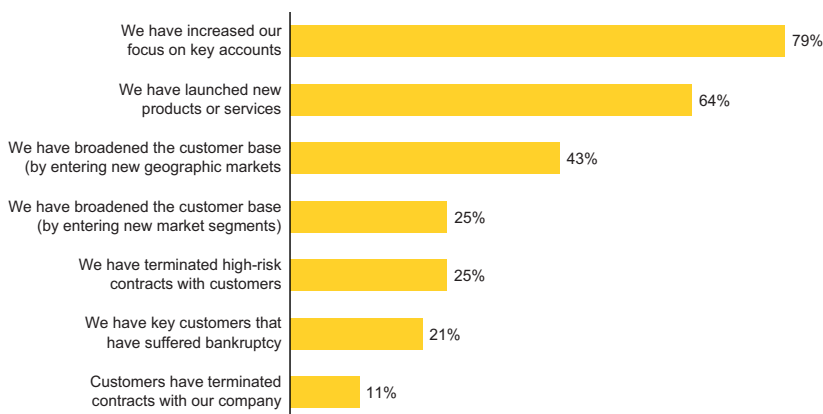
**Q: On a scale of 1 to 5, where 1 = Significant opportunity and 5 = No opportunity at all, how would you rate the additional opportunities for cost reductions over the next 12 months for supply chain?**



Shown: percentage of life sciences respondents compared with overall. Totals may not add to 100% due to rounding.

“Customer-centricity” was another common thread running through the life sciences executives’ answers to several questions. When asked how responsive they were to changes in customer management, 82% of life sciences respondents indicated that they were either responsive or very responsive – a telling indicator related to management priorities for the coming year. While profitability and meeting sales goals were listed as the top two concerns to management in the next year, the third highest response for the sector was improving customer loyalty. When asked about how the economic crisis has affected their organizations’ approach to its customers, it is no surprise that broadening the customer base by entering new geographic markets and launching new products were top picks for the sector, but the number one pick was increasing the focus on key accounts.

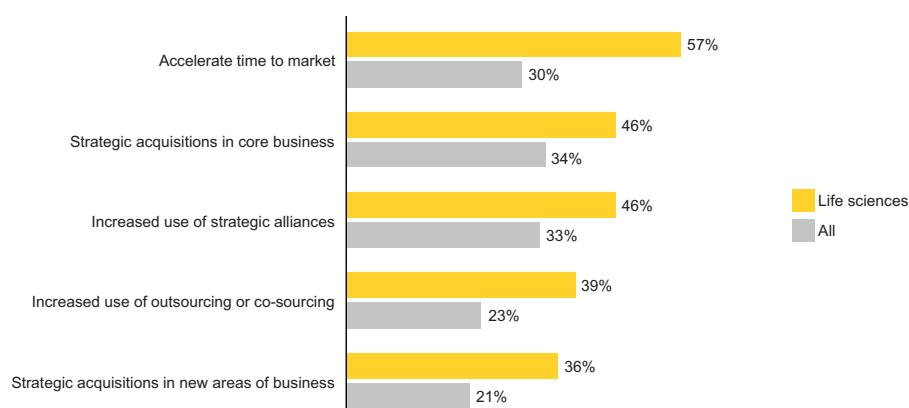
**Q: In which of the following ways has the global economic crisis affected your organization’s approach to its customers over the past six months?**



Shown: percentage of life sciences respondents

On top of accelerating time to market, life sciences industry respondents said that they were considering a number of strategic steps to align their business to take advantage of post-recovery opportunities. They were more inclined than respondents in the general survey to say that they planned to engage in strategic acquisitions in core businesses, employ strategic alliances and turn more to outsourcing or cosourcing arrangements.

**Q: In the next 12 months, what actions do you plan to take to position your business to emerge stronger from the crisis than your competitors?**



*Shown: percentage of life sciences respondents compared with overall respondents*

## Market responses

To meet this combination of structural and short-term challenges, executives at leading life sciences companies are adopting a range of strategic responses to improve the efficiency of their operations, boost the productivity of their R&D initiatives and reorient their business models to capture new and emerging market opportunities. Our work with industry leaders has identified five actionable areas of advice to help life sciences companies achieve a profitable balance between navigating near-term pressures and positioning the organization to compete more effectively when economic conditions improve.

- ▶ **Securing your present.** Leading life sciences companies are bringing a heightened focus to actively managing working capital and cash flows. Leading performers are actively seeking out and exploiting opportunities for improvement by examining the practices of other industries. Executives report conducting regular stress testing to identify and remedy potential areas of weakness – a process that involves evaluating and enhancing liquidity contingency plans on both a global and domestic basis, as well as making management more accountable for working capital considerations. Companies are also increasing their emphasis on efficient capital allocation and are more actively managing their balance sheets. While cost reduction programs have been a prevalent feature of life sciences companies over the past several years, the economic downturn has prompted executives to rationalize asset portfolios and push efficiency campaigns into every corner of their organizations. Cost-reduction targets are increasingly well defined and communicated to create a lasting cost advantage.
- ▶ **Protecting your assets.** The industry is fighting harder than ever to protect its intellectual property, as patents are essential for raising capital and performing the R&D necessary to bring a potential product to market. The recent emergence of biosimilars – as the first biologic patents expire – is hastening the need for life sciences companies to consider defensive strategies that protect their intellectual property in a dynamic marketplace. The life sciences supply chain is becoming increasingly complex and is governed by a growing array of regulations. To stay on top of the evolving regulatory landscape and make sure that product safety remains a primary focus, companies are adopting regular processes to check risk management practices and related key performance indicators against a balanced scorecard.

- ▶ **Improving your performance.** Because life sciences companies rely on a close-knit network of suppliers for key inputs in their major products, supplier viability has emerged as a primary concern. Decreased demand, along with deteriorating funding and credit conditions, have put the squeeze on the industry's supply base, forcing manufacturers to closely monitor suppliers for potential disruptions and changes to procurement and sourcing costs. Supplier and dealer vulnerabilities are weighing more significantly in the management of the supply chain – an emerging area for sustainable efficiency gains. Optimizing the supply chain may also offer significant operational savings by helping to reduce inventory levels and freeing up working capital.
- ▶ **Reshaping your business.** The economic downturn is prompting companies to consider outsourcing more noncore functions that are currently being performed in-house. This strategy is freeing up companies to focus on emerging disease segments and more diligently address true market needs for high-value products. Companies that are already outsourcing report using the current economic environment to exact better terms on existing contracts through renegotiation. Centralization of enabling functions is reducing costs and increasing accountability for delivering efficiencies and operating effectiveness. Mounting cost pressures, in light of the economic environment, have made the geographic relocation of some activities and/or subsidiaries more attractive – particularly to China and India, which are quickly evolving as international hubs for research and manufacturing. Meanwhile, the economic downturn is stifling the flow of workers across borders and elevating the value of skilled labor pools in emerging markets.
- ▶ **Sustaining your future.** The economic downturn has highlighted the need for life sciences companies to be able to absorb shocks and adjust quickly to changes in supply, demand and distribution frameworks. Executives are seeking to create flexible and scalable business models by streamlining functional processes and increasing integration between business units. Large pharmaceutical companies are beginning to emulate biotechnology companies by breaking R&D into smaller, more innovative teams and giving them greater autonomy. On the acquisition front, a growing number of distressed assets are being brought to market at attractive prices, creating openings for stronger companies to exploit, particularly in high-growth emerging markets. Large pharmaceutical companies are using their strong cash position to augment their drug pipelines by acquiring pharmaceutical rivals and biotech firms. There is also an increased focus on optimizing partnership alliances, usually centered around a single product or therapeutic area.

## Conclusion

The global economic downturn has instilled global, mature life sciences companies with a new sense of urgency in the hunt for operational efficiencies and cost-saving partnerships. While slack demand has created fresh profit pressures, it has also created strategic openings – bringing down the prices of acquisition targets, offering greater leverage in supplier contracts and bringing new awareness to the need to better manage working capital.

A dearth of innovation in product pipelines is being filled by innovation in cost and supplier management, defensive strategies to protect expiring patents and the reorganization of R&D teams. The systemic challenges facing the industry will likely survive the economic downturn, but forward-looking companies are seizing this opportunity to reassess their business models and reposition their sizable assets to successfully manage those challenges no matter the economic climate.

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