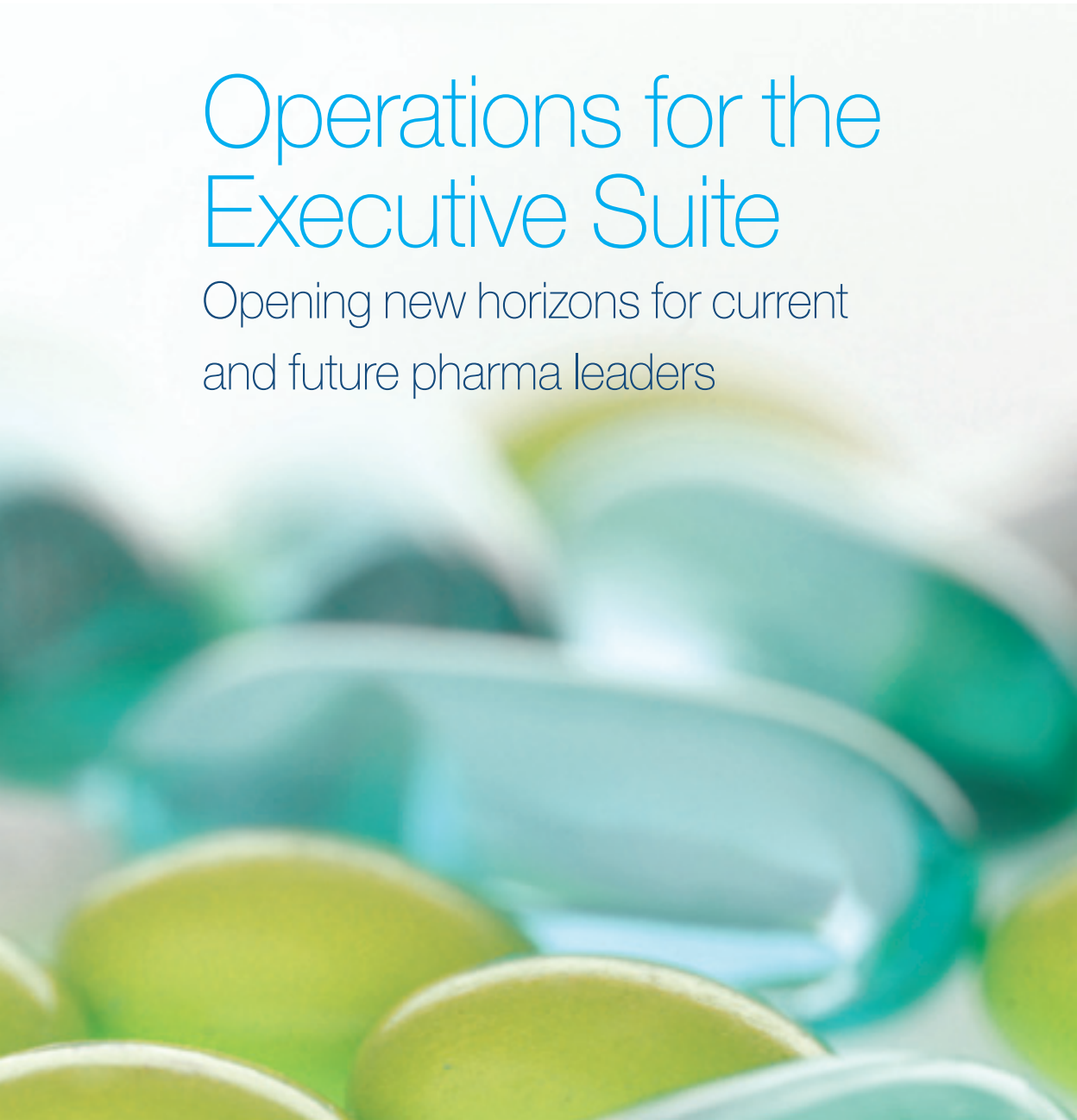


Operations for the Executive Suite

Opening new horizons for current
and future pharma leaders



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Operations for the executive suite

David Keeling, Ulf Schrader

Traditionally, Operations topics have not always been prioritized or well understood by pharma CEOs and their senior leadership teams because, frankly, other topics were more important to growth and profits. But the past should not be a blueprint for the future.

It's common knowledge that the pharma industry is in the midst of significant changes. For the first time in half a century, growth has reached a plateau. Pharma revenues for 2010 were essentially flat—just 0.4 percent growth over 2009¹. Emerging markets, with their lower margins, are projected to grow at 10 to 20 percent annually over the next decade. And the decline in big pharma innovation is diverting value to the generic players.²

Operations have been a pivotal success factor in sectors that have experienced similar phases of maturation, declines in innovation, and commoditization. For example, consider the exceptional supply chain efficiencies of Walmart and Dell, how Apple and Unilever have developed new talent, and the success of Procter & Gamble in breaking down silos within Operations and other functions in order to capture value.

1 S&P Capital IQ Unit; McKinsey analysis—based on the revenues of more than 210 pharma companies.

2 For more details, see "Trends shaping up the pharma industry" on page 181.

Many pharma CEOs and executive teams have already started to spend a lot more time on operations. But all too often, their attention has been in reaction to serious regulatory issues. We believe that it is time for pharma CEOs to proactively examine how their organizations can capture even more value from operations—indeed, how they might be able to harness operations to create competitive advantage. Other industries have proved that it is possible to leverage operations to spur innovation, help open new market opportunities, and shift cost and risk paradigms.

We have identified a number of specific Operations topics, grouped into five themes, that could create billions of dollars in value upside for pharmacos. By leveraging lessons from other industries that have been down similar paths, we provide context to shed light on the black box of operations and its potential for this value creation. We also emphasize the role of the executive suite and offer questions that CEOs can use as starting points for discussion on each topic.

All these opportunities require sustained executive suite involvement and repeated challenges to the organization. Looking to other industries, such continuous change has meant the difference between average and superior performance. Here are the key themes in this book:

New aspirations and operations models

Leaders in other maturing industries have found new sources of growth by setting aggressive aspirations for their operations. Apple operates at two days of finished-goods inventory. Nucor can build a mill at 10 percent of the cost of a traditional integrated mill. Walmart's focus on operational cost-efficiency has driven 17 percent annual sales growth and 20 percent EBIT annual growth over the last decade. The pharma executive suite must challenge Operations to more aggressively question the company's operations model and develop a transformational strategy—delivering breakaway performance rather than incremental improvements.

- Could we launch products in half the current time, at best-in-class costs right from the start? Could we deliver small-scale personalized drugs immediately—and on demand? Could we track patient behavior in real time to improve efficacy and patient compliance? Could we make innovation a strategic priority and develop our own version of “Plantopia”?
- Could a fundamental challenge to the manufacturing ownership-and-control model gain us billions of dollars in market capitalization and newly freed working capital? Apple and Intel provide examples of the spectrum of this discussion.

- Structural industry changes are pushing manufacturing questions to the center of biopharma companies' agendas. What's the right technology to invest in? Should we manufacture internally or externally? How could we push back against the low-cost players? Placing the right bets in biopharma will make the difference between failure and success in the swiftly changing biopharma landscape.

Developing talent

The former head of Operations at Apple is the company's new CEO—and that is an organization where few of us think that operations is the core. Pharma executive suites can help Operations organizations to develop their talent and shift their mindsets in step with their evolving responsibilities. That applies both to Operations' global leadership team and to shop floor personnel.

- Operations leaders of the future should be able to turn operations into a competitive advantage for their companies. For this they would need new skills and competencies—boldness in vision, ambition, creativity, and commitment; a mindset and skills that extend beyond operations; and the ability to lead fundamental transformation at scale. Do our operations leaders have those characteristics? If not, what can we do about it?
- How could we develop our front-line transformation leaders and ensure strong and sustained support for driving change? With the right levels of ambition and support, transformational change initiatives can capture 20 to 30 percent in productivity gains within a year, as well as improve quality, flexibility, and employee morale.

Moving from cost to growth

Operations has the potential to open up new opportunities just as a new treatment or a blockbuster drug would do. Volkswagen's platforming and modularization strategy has allowed the company to serve niche markets at 25 to 40 percent lower cost and with significantly faster time-to-market. Nestlé and Unilever have reached large and underserved emerging markets populations through novel distribution models. GE, Coca-Cola, and Deere, among others, have leveraged low-cost designs for emerging markets to win new customers back in their developed markets. But to achieve this type of success, the pharma executive teams have to coach and challenge the companies' Operations groups and shape their roles toward delivering growth.

- Could we leverage our operations capabilities to boost revenues? Other industries did that a long time ago—using products and platforms from

emerging markets for global strategic advantage; making niche products profitable; or reacting nimbly to shifts in demand.

- Technology has already transformed many industries, and healthcare is ripe for a similar change. Could hundreds of billions in healthcare costs and sales losses be avoided through improvements in patient compliance and with more effective management of chronic diseases? Could our company develop the technological skills to succeed against the new competitors in this field?
- The biggest unexplored opportunities in developing markets lie in the fast-growing, emerging middle-class population. What will it take to unlock these opportunities? Do we have the operations capabilities to reach and serve a lower-income population in economically viable ways?

Managing risk

Risk exposure and value at stake are higher than ever before in the healthcare industry. Supply chain risk events are the second-largest contributors of large monthly declines in share price, resulting in drops of 10 percent or more when compared to the S&P 500 over the same time period. Pharmacology leadership teams must have a deeper understanding of this and work to embed agile mindsets in their organizations, while helping them to manage risk systematically, proactively, and cost-effectively. Taking a lesson from other industries, Hewlett-Packard's supply chain risk-management program delivered incremental value in excess of \$500 million during its first six years.

- Could we substantially reduce or eliminate our supply chain risk exposure? A systematic and structured risk-management approach will cost-effectively mitigate risk and proactively reduce the likelihood and negative consequences of disruptive events. By taking advantage of upside opportunities, this approach could potentially deliver millions of dollars in reduced supply chain costs and higher supply assurance.
- The industry's current dynamics and volatility require lean initiatives to be supplemented with agility as a central focus for operations. How could we set up a system of structural agility that goes beyond issue resolution and firefighting, improves operating margins significantly without major investments, and drives profitable growth thanks to faster product launches and fewer stock-outs?
- Is our organization prepared for the evolving regulatory environment? Regulators worldwide are transforming themselves—developing smarter and leaner ways of working, and becoming more collaborative and increasingly sophisticated in their use of standards, best practices, and

proven methods. Pharma executives must be vigilant about regulators' new mindset and new strategies in order to sustain financial performance, brand image, and long-term competitiveness.

- Do we still rely on “compliance by inspection” in an increasingly complex and competitive medical devices sector? Could we achieve a 10 to 15 percent increase in earnings by adopting modern quality approaches and tools? Through cross-industry best practices in quality assurance, the medical products sector could improve patient outcomes, capture \$5 to \$6 billion in incremental EBITA, and reduce risk.

Breaking down the silos

Operations needs sufficient cross-functional support to step into its new role and deliver to its full potential. The CEO and the executive team are the only ones who can break down the organizational silos and align Operations, R&D, and Commercial leaders behind common goals and strategy.

- What happens when the product and customer value that are driven by pure science innovation start to slow down? Could we combine customer insight, engineering innovation, and manufacturing best practices to create products with distinctive value for customers? Design-to-value is finally finding its way into healthcare to drive growth and profits. Getting it right could mean 15 to 25 percent higher margins and increased sales, plus improvements in speed-to-market.
- Consumer goods supply chain champions achieve 4 percent or higher operating margins, better service levels, and greater capital effectiveness than their peers. Could we follow the same path within the pharma industry to transform our supply chains?

While this book does not have all the answers or off-the-shelf solutions, it can help to raise awareness of new possibilities. Indeed, we would encourage an in-depth discussion of these and other similar questions at the next meeting of the executive team.