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Pharmaceutical industry summary

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Recent events have clearly demonstrated the extent to which the world is interconnected. The crisis which began in the US banking system has spread through the global economy as a whole – and no region has emerged unscathed. This historic moment provides an unprecedented opportunity for companies, governments and individuals to think more deeply about the sophisticated eco-systems of which we are all a part.

The current crisis has highlighted the need for new institutions, new mechanisms, new strategies and – most critically, perhaps – a different mindset among those leading the world's most important institutions and companies. Every CEO will have to make tough decisions about what actions are required to ensure his or her company's short-term survival. Yet none can afford to ignore the need to build a business that is agile enough to respond to new situations as they emerge, durable enough to grow over the long term and responsive to the requirements of all its stakeholders.

Redefining success, the PricewaterhouseCoopers 12th Annual Global CEO Survey, explores how CEOs are reconsidering the fundamentals of business in response to extreme operating conditions and assuming responsibility for issues that were once considered outside the scope of industry. We interviewed 1,124 CEOs around the world between September 10 and December 2, 2008. Our findings show that they are collaborating more extensively to balance the interests of increasingly influential stakeholders. They are also seeking new kinds of information to help them anticipate changes in critical business drivers.

Here, we look specifically at what the 47 CEOs in the pharmaceutical industry think, and how they are dealing with a combination of challenges such as mankind has never seen before.

The business environment

Historically, external economic forces have affected the pharmaceutical sector less than they have other manufacturing areas – which may well explain why pharmaceutical CEOs are notably more confident about the prospects for growth than their peers in other industries. Thirty-two percent are very confident that they can increase their companies' revenues over the next 12 months, compared with just 21% of the total survey population.

Pharmaceutical CEOs are also less concerned about the disruption of the capital markets, less likely to state that recent problems in the global banking system will delay their investment plans and less likely to collaborate with the providers of capital than the overall survey sample. Conversely, they are more likely to use internally generated cash flows as a means of financing growth. So the credit crunch may provide new opportunities for many large pharmaceutical companies, particularly those with low debt ratios and strong cash positions.

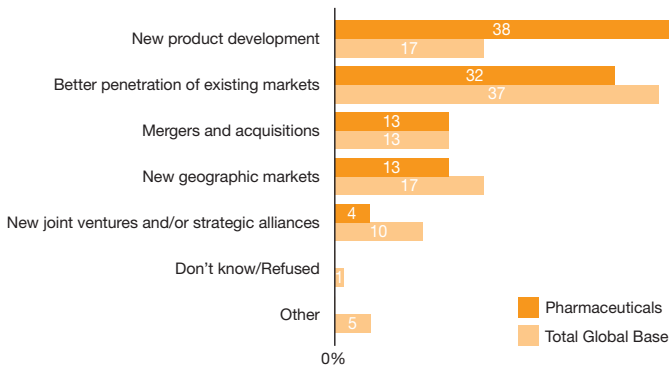
Some firms have already seized the chance to snap up a few bargains, but more deal-making may be on the horizon. Pharmaceutical CEOs are more likely than CEOs in other sectors to be planning a cross-border merger or acquisition in the next 12 months. And analysts at Datamonitor predict a flurry of deal-making, as large companies with strong cash flows buy small biotechnology companies whose access to capital has suddenly evaporated.

Acquiring biotechnology firms with promising molecules is one way in which pharmaceutical companies can enhance their R&D pipelines – and new product development is absolutely fundamental to the industry's future, as many pharmaceutical CEOs recognise (see figure 1). With the yen rising against the US dollar and the euro, Japanese companies are particularly well placed to go on a shopping spree.

However, any pharmaceutical CEOs who are interested in scooping up struggling biotechnology firms should start by taking

Figure 1

Pharmaceutical CEOs concentrate on new product development to grow



Q: Which one of these potential opportunities for business growth do you see as the main opportunity to grow your business in the next 12 months?
Base: Pharmaceutical: 47; Global: 1,124

Source: PricewaterhouseCoopers 12th Annual Global CEO Survey 2009

Note: Data for 2009 are based on interviews conducted in the last quarter of 2008

a careful look at their portfolios and doing their homework to ensure that the clinical and operational cultures of the companies in which they are interested offer a good match. They should also focus on people as a vital part of the integration process.

Fred Hassan, Chairman and CEO of Schering-Plough Corporation, explains how his own company tackled the challenge when it acquired Organon Biosciences. It involved staff from Organon in reviews of the combined portfolio and made the firm's former head of R&D a senior member of the Schering-Plough R&D team. That helped Schering-Plough realise its financial targets, but, as Hassan notes, there were other benefits, too.

'...this is a long game, and the key is to build the R&D base and a science base that will keep us strong for the very long term. That's where Organon comes in. They give us expertise in women's health and central nervous system research. Also, we have adopted their information technology system (named

Atlas) and made that our own. By taking these actions, we've developed a much more positive cultural synergy here than a typical large acquisition,' he explains.

Hassan suggests that the economic downturn might provide an extra stimulus to innovate. In his view, 'If we keep thinking short-term, we will not be able to deal with some of the structural challenges that need to be dealt with. In other words, tough times can make one innovate harder and faster.'

He also stresses the role innovation can play in reducing healthcare costs: 'We have to find ways to deliver healthcare in a more cost-effective manner. For example, preventative care is much more cost-effective than emergency care. It's been shown again and again that if you can keep people away from emergency rooms, if you can avoid heart attacks in the first place or avoid asthma attacks in the first place, you can greatly reduce cost in the healthcare system. More focus on prevention, more focus on innovation and more focus on patient literacy can make a big difference.'

Balancing short- and long-term concerns

Addressing global risks

The economic downturn has brought the interconnectedness of global economies into sharp relief. One implication is that CEOs need better processes for gathering and analysing information about risks – both short-term problems and long-term, global threats.

In the pharmaceutical industry, the risk matrix is undergoing a fundamental transformation. A growing number of healthcare payers and providers are assessing the pharmacoeconomic performance of different medicines; in other words, pharmaceutical companies now have to prove that their products really work, provide value for money and are better than alternative forms of intervention.

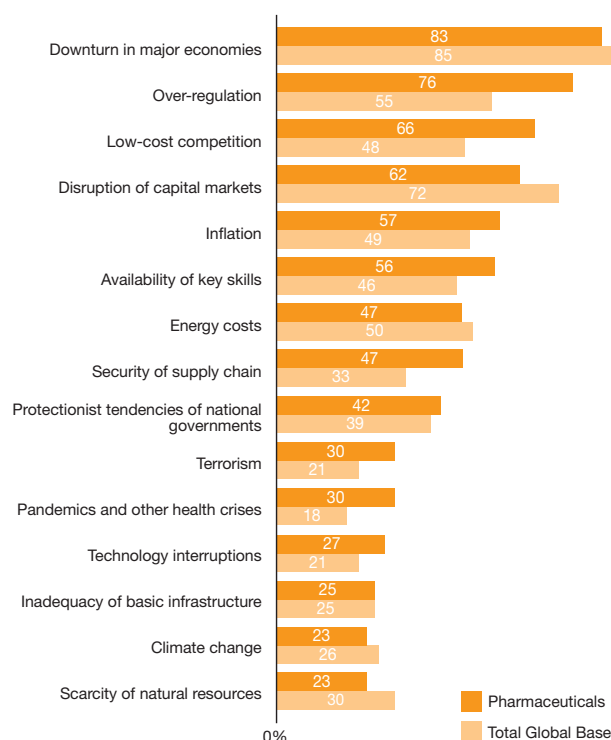
Patients are also playing a much bigger part in the prescribing process, as Hassan points out. 'The unmet medical needs of

patients drive our decision-making because the endgame is with patients. If a product can benefit a patient, then the doctor would become an advocate and a user of the product. If the doctor becomes an advocate and a user of the product, there's a pretty good chance that it would get reimbursed. So now the payer is also on your side, and it's a win-win. So, if you can do the right things for the patients, then you're going to do very well,' he observes.

This change has profound implications for how the industry operates. In order to ensure that its products are effective, it requires access to patient information, both on an individual level and across patient populations. Yet fewer pharmaceutical CEOs report that they have comprehensive information about the needs of their customers than those in other industries – a finding that illustrates the scale of the challenge associated with acquiring a better understanding of patient outcomes. Pharmaceutical companies also have to develop 'better ways to communicate with patients so they are more motivated to comply with preventive medicines and to make lifestyle changes', says Hassan.

However, although the industry is undergoing huge alterations, it could actually benefit from some of the systemic risks that trouble CEOs in general. Pharmaceutical CEOs are particularly concerned about inflation, terrorism, pandemics, low-cost competition, over-regulation, the availability of key skills and the security of their supply chains (see figure 2). But they are more likely to see the spread of infectious diseases (e.g., malaria, tuberculosis and HIV) and demographic shifts (e.g., aging populations), as potential opportunities for growth. This is not surprising, since both trends will stimulate demand for medicines, while the rising incidence of chronic diseases (e.g., diabetes and obesity) will provide new ways of generating revenues by moving into health management.

Figure 2
Pharmaceutical CEOs see economic downturn and regulation as top threats



Q: How concerned are you about the following threats in relation to your business growth prospects?

Base: Pharmaceutical: 47; Global: 1,124

Source: PricewaterhouseCoopers 12th Annual Global CEO Survey 2009

Note: 2009 data are based on interviews conducted in the last quarter of 2008.

Collaborating with government

Most pharmaceutical companies already collaborate with governmental and non-governmental organisations to a greater extent than companies in other sectors, and pharmaceutical CEOs report that such external stakeholders have a stronger influence than they did three years ago. Much of this collaboration centres on the regulatory procedures required to secure approval of new medications. The regulation of the industry is rapidly evolving, with several proposals for major changes under consideration. One such instance is the incremental development of new medicines, with 'live licences' contingent on further testing outside a clinical setting to substantiate the safety and efficacy of new products in larger populations, different populations or the treatment of other conditions.

Hassan sees regulatory evolution as 'critical in our business because the products that we bring out from our innovation have to be approved by regulatory authorities, primarily the FDA [US Food and Drug Administration] but also now, increasingly, the EMEA [European Medicines Evaluation Agency] and the authorities in other large countries, such as Japan. It is very important that there be the same unwavering commitment to good science, to staying current with the latest information on evolving scientific facts, and in getting the support of society,' he comments.

Transforming the regulatory environment also has an important impact on innovation, he adds: 'If people don't know what the endgame is going to be with all their work in terms of regulatory approval – if they don't know what the last mile will look like – you can imagine what a chilling effect that would have on innovation.'

More collaboration with payers during the regulatory process is likely, too. Public expenditure still accounts for the bulk of healthcare spending in every G7 country except the US. But with a Democratic president now in power in Washington, many

people expect that the US government will spend considerably more on healthcare. Whether or not this happens, though, healthcare payers everywhere will probably place more emphasis on prevention in a bid to curb soaring costs. Preventing disease is more economical than treating it – and, as we have already noted, offers the industry new opportunities for growth by entering the wellness space.

Pharmaceutical CEOs are also looking for governments to do their part in facilitating a better working relationship with businesses. They are more likely than CEOs in other industries to believe that there should be a better balance between the incentives and constraints imposed through regulation and tax, in order to help them adapt their business to the issues raised by climate change. And 91% think that a clear, consistent policy framework is also essential to achieving this goal.

However, many pharmaceutical CEOs are cautiously optimistic about the long term. Eighty-one percent believe that the world's economic axis is shifting, and that a new set of countries will emerge to challenge the economic, political and cultural power of the G8. Some respondents think that this will ultimately be positive; 36% believe, for example, that the gap between rich and poor people will decrease. Even so, fewer patients in emerging markets are likely to be able to afford expensive medications or vaccines, so multi-tiered pricing models will probably become the norm.

Cultivating key skills

The pharmaceutical industry is heavily dependent on innovation, so recruiting and retaining skilled scientists is a key priority. This probably explains why pharmaceutical CEOs are less likely than their peers in other industries to be planning headcount reductions over the next 12 months. It also explains why they are more worried about declining enrolment in university courses in the sciences and technologies, the limited supply of candidates with the right skills and the difficulties in retaining female employees.

In fact, most pharmaceutical CEOs are actively trying to cultivate the talent they need to succeed in the long term. They are more likely to redeploy pivotal employees, collaborate with networks of external specialists, provide a more flexible working environment, outsource business functions and hire from a more diverse pool of sources (e.g., retirees and former staff) than CEOs in other sectors. But many pharmaceutical companies could also do more to tap the potential of emerging countries like China, India, Korea and Taiwan. Other research conducted by PricewaterhouseCoopers shows that the number of highly qualified scientists in Asia is increasing – although the wage gap between the developed and developing countries is shrinking, as a growing number of Asian companies compete for ‘high-end skills’ in the international labour market.

Hassan believes that ‘internal culture is extremely important when you’re trying to attract people from the outside. We have six explicit ‘leader behaviours’ in our culture – which are part of our performance management system – and job performance is, in part, based on the behaviours people exhibit. Two examples of our six leader behaviours are working collaboratively across units and geographies and coaching and developing others. By strengthening our internal culture, we become a more attractive company to many people on the outside.’ he explains.

Looking forward

The pharmaceutical industry’s business model is changing in several key respects. Demand for specialist therapies is increasing, but developing such therapies will require deep-seated alterations in R&D and sales and marketing. Many companies will also have to adopt a more holistic approach to the treatment of disease, either individually or in collaboration with other firms, rather than concentrating exclusively on the production and distribution of medicines. And they will have to take the lead in helping patients manage their health more proactively.

However, healthcare professionals and patients will not trust the industry to provide such services unless they are sure that it has their best interests at heart. So it will have to work hard to rebuild its reputation, as many CEOs appreciate. They place more

emphasis on meeting the broader needs of society than their peers in other sectors. They are also more likely to think that greater engagement with the public and a management structure that rewards decisions made for long-term business success are critical or important than the total survey population.

Hassan sums up the situation when he says: ‘There’s a concerted effort to show we are on the side of the patients, on the side of information and transparency, on the side of coverage and reimbursement. If you compare the industry’s standing with the American public five years ago versus now, we’ve made a lot of progress. But there’s a lot more work to do. We still haven’t separated ourselves as much as we’d like to from some other industries where the social benefits are just not that clear.’

A significant percentage of the pharmaceutical CEOs we surveyed are confident about the industry’s ability to rise to these challenges, though. Fifty-five percent believe that structural changes in the industry’s business model will have a positive impact over the long term.

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Full findings of the PricewaterhouseCoopers 12th Annual Global CEO Survey are available at www.pwc.com/ceosurvey

For additional information regarding PricewaterhouseCoopers’ pharmaceutical sector practice, please visit www.pwc.com/pharmaceutical