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Going for Growth

Balancing Price and Cost to Drive High Performance
in a Recovering Global Economy

A Pharmaceutical Industry Perspective

• Consulting • Technology • Outsourcing

Introduction

As the effects of the recent economic downturn recede, companies once again are turning their attention toward growth. At the same time, many organizations remain concerned about their cost structures. Indeed, recent Accenture experience and research confirms that companies must consider both price and cost levers when seeking profitable growth.

With a deep understanding of how different customers perceive the value of its offers, and with the ability to use that insight to increase the variability of its cost structure so costs can remain in synch with revenue and value, a company is better positioned to grow profitably in what is likely to remain a volatile economy. When such alignment is absent, cost decisions not only can impede profitable growth, but also can wreak havoc with service quality and the overall customer experience. Navigating this dual price and cost imperative is especially critical for the pharmaceutical industry, in which many companies face both a major patent cliff and a transforming health care landscape that is redefining customers' needs and values.

To provide some guidance on this important topic, Accenture embarked on a comprehensive global research effort in which we surveyed 1,000 executives in companies representing 12 countries and eight industries, including pharmaceuticals (Figures 1-3). Our data was collected from November 2010 through January 2011, a period during which economic prospects

were beginning to brighten for most markets and industries, although many companies still were hesitant to believe a full-scale recovery was under way.

At a high level, Accenture found that 50 percent of pharmaceutical executives expect growth of 5 percent or less over the next 18 months, and 80 percent say their growth will remain below 10 percent. With such modest expectations, price and cost will remain essential elements of maintaining healthy profits. In fact, half of pharmaceutical executives said that the value proposition and price points they deliver are the primary factors in their competitive advantage.

To offer strong value and lower prices, which individual and group payers of pharmaceuticals are demanding, pharmaceutical companies must aggressively manage their costs. Our survey shows that while nearly all pharmaceutical respondents reported that they have been either somewhat or very successful in their efforts to create sustained cost reduction, just 9 percent believe they have finished the job. To be sure, in the next six months

pharmaceutical companies will continue cutting costs, with particular attention paid to strategic sourcing, inventory reduction, application outsourcing, product rationalization, and technology infrastructure outsourcing. As they pursue these savings, however, many will be constrained by relatively immature pricing capabilities. They report challenges with many aspects of pricing, including pricing strategy, processes, analytics, and governance, as well as sales execution. In fact, the vast majority do not describe their pricing processes as "sophisticated."

In the following pages, we explore in more detail the responses to our survey from the 126 participating pharmaceutical executives. We begin by discussing how pharmaceutical companies are positioned to use pricing to capitalize on emerging growth opportunities, then review how these companies have used—and plan to use—cost reductions to maintain and improve profitability. These findings can provide a helpful context for other pharmaceutical companies seeking guidance on how to plan for 2012 and beyond.

Figure 1: Participating companies' annual revenue

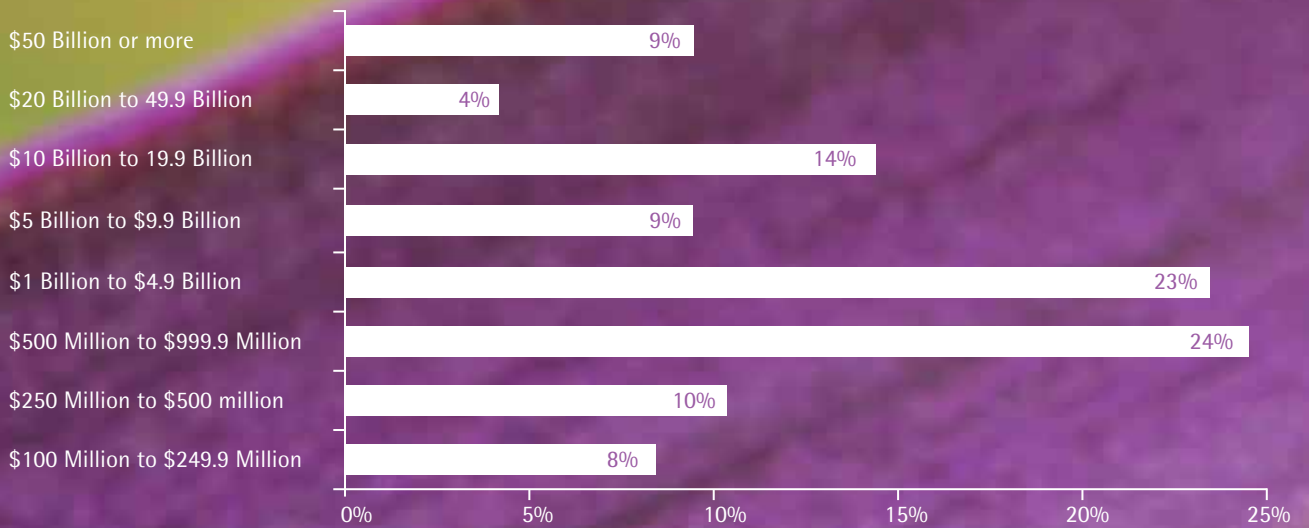


Figure 2: Participating companies' location

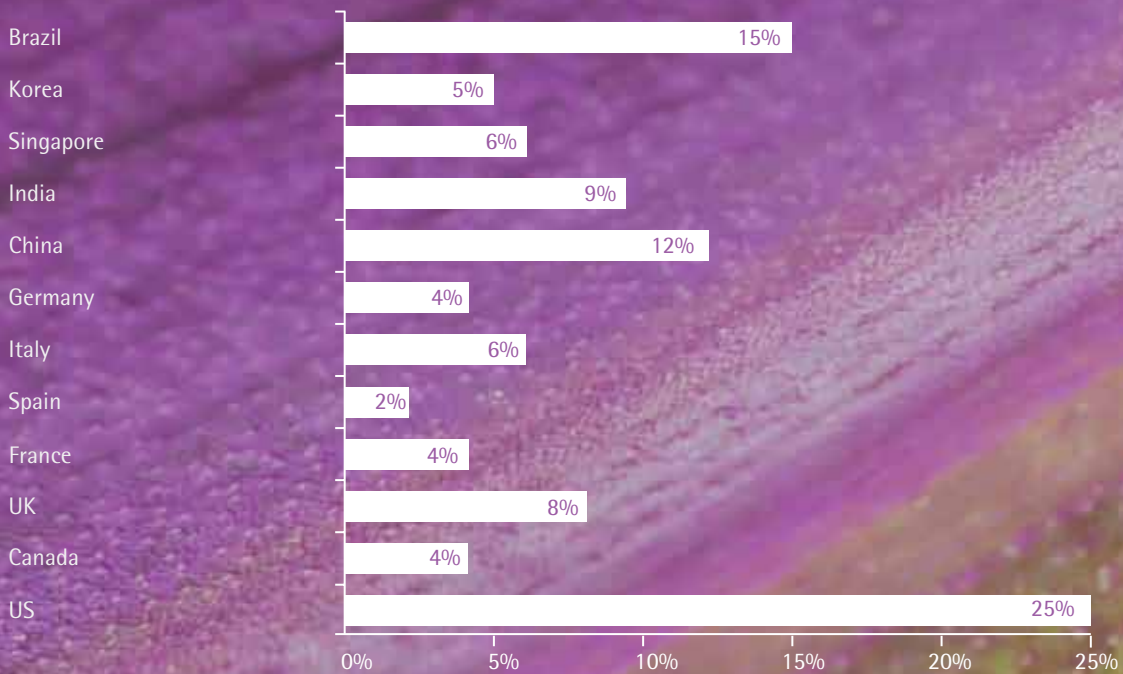
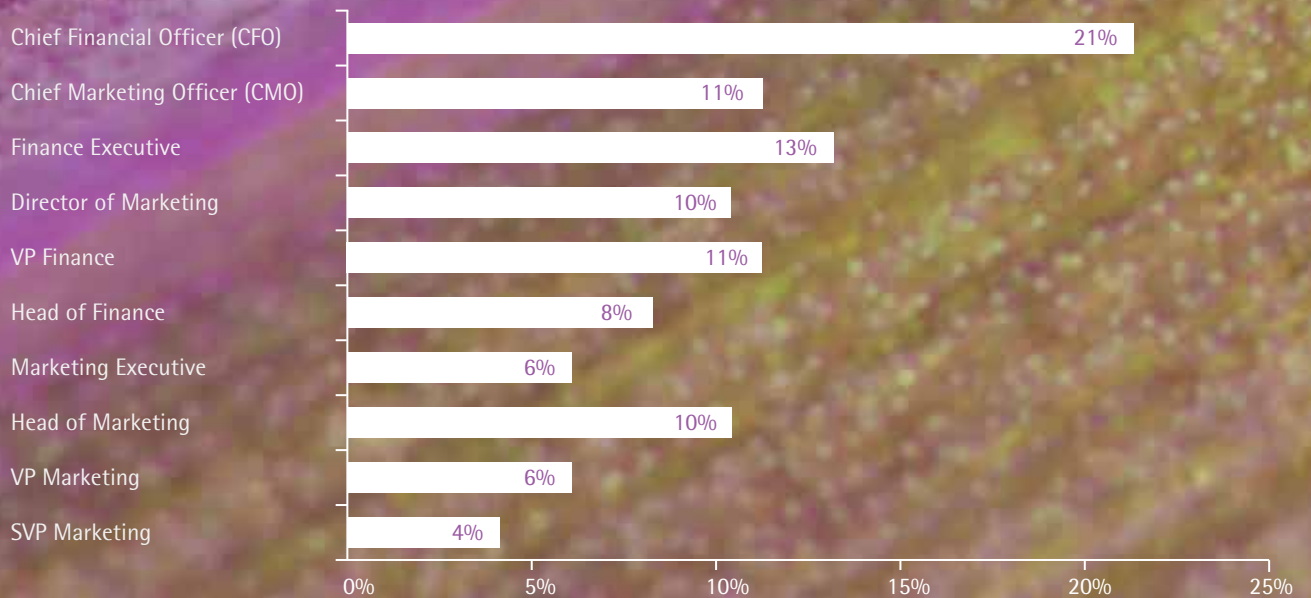
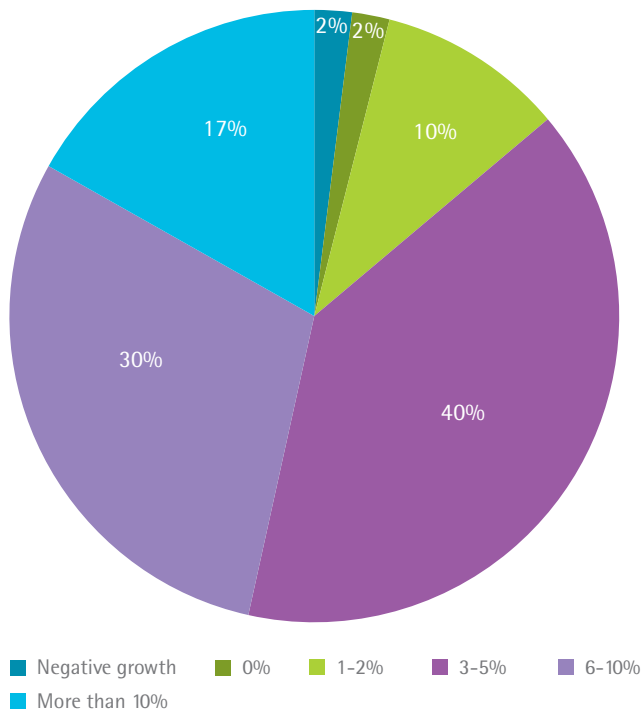


Figure 3: Respondents' title



A Renewed Focus on Growth

Figure 4: Companies' growth expectations in the next 18 months



Although recovery from the recession has been slower to take hold in some regions of the world than others, most pharmaceutical companies participating in our survey still are anticipating revenue growth in the next 18 months—although their expectations are modest. Exactly half of pharmaceutical executives think their revenue will grow only by 5 percent or less in the next year and a half. Thirty percent anticipate growth to reach between 6 percent and 10 percent, and 17 percent expect growth to top 10 percent (Figure 4). Pharmaceutical companies with less than \$5 billion in revenue were almost twice as likely as larger companies to expect more than 10 percent growth.



Driving Growth via the Revenue or Demand Lever



Pricing is a critical tool for creating differentiation from competitors and making offers attractive to customers. And for many companies, optimizing the way they make and execute pricing decisions is among their key strategic priorities. However, enterprises also face a number of challenges that prevent them from optimizing pricing and, for the most part, do not believe their pricing capabilities are mature. Add the complexities of pharmaceutical reimbursement to the mix and it becomes even more evident that opportunities exist for pharmaceutical companies to strengthen their use of pricing to help drive growth.

Innovation and marketing/brand are the most common levers for driving competitive advantage

When seeking to drive competitive advantage and boost revenue, companies have many options at their disposal. According to pharmaceutical companies in our survey, two of

the most popular levers for driving competitive advantage are innovation that drives product differentiation and marketing/brand promotion (Figure 5), which were cited as the primary or strongest factor by 62 percent and 55 percent of respondents, respectively. Also popular were value proposition (52 percent), price position/point (50 percent) and service (48 percent). With innovation in relatively short supply, other levers such as price become more important.

A market-based approach is by far the most popular means for setting prices

When it comes to pricing, our study found that pharmaceutical companies tend to most frequently use a market-based approach (i.e., striking a balance between supply and demand) to setting prices, which was cited by 72 percent of executives. About 60 percent of executives said they use a value-based approach (63 percent), while 57 percent indicated they used competitive-based factors (i.e., price matching). Forty

percent said they take a cost-plus approach, and 23 percent reported they use a risk-based approach (Figure 6).

Several different areas of the business are heavily involved in making pricing decisions

The marketing function, business units, product managers, and executives or executive committees tend to be the most influential groups in determining pricing in pharmaceutical companies. In 78 percent of pharmaceutical companies, the marketing function is always involved in making pricing decisions, followed by business units (68 percent), product managers (68 percent), and executives or executive committees (65 percent). Finance is always involved in more than half of pharmaceutical companies (55 percent), while the legal function is always involved in 40 percent.

Several challenges impede pricing optimization

We found pharmaceutical companies face a wide range of challenges that make it difficult for them to optimize pricing (Figure 7). The factors causing extensive or moderate negative impact on a large percentage of respondents include challenges in sales execution (75 percent), inadequate pricing analytics (69 percent), the wrong strategy (67 percent), unclear pricing strategy (65 percent), inadequate decision support/analytics (63 percent) and governance and accountability incentives (60 percent).

With few exceptions, pharmaceutical companies were more likely than all other surveyed industries to say these challenges were extensively impeding their ability to be more successful in pricing and/or promotion optimization. For instance, while 40 percent of pharmaceutical respondents said the wrong strategy was having such an effect, the same state of affairs was reported by just nine percent of insurers, 15 percent of utility companies, 20 percent of banking and retail respondents, 21 percent of energy executives and 28 percent of those in the communications industry. Similar differences were evident in terms of challenges in sales execution, unclear pricing strategy, inadequate pricing analytics, governance and accountability incentives, and inadequate decision support/analytics.

Pharmaceutical companies with more than \$5 billion in revenue were more likely than smaller companies to report an extensive effect from four out of these six challenges: unclear pricing strategy (44 percent versus 27 percent), inadequate pricing analytics (38 percent versus 30 percent), the wrong strategy (50 percent versus 36 percent), and inadequate decision support/analytics (38 percent versus 25 percent).

Figure 5: Strength of factors in driving companies' competitive advantage

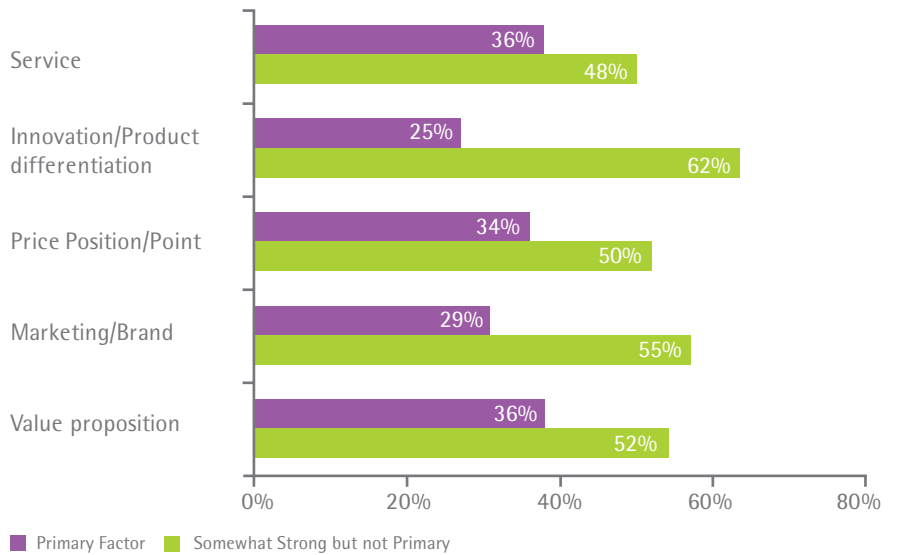


Figure 6: Companies' pricing strategies

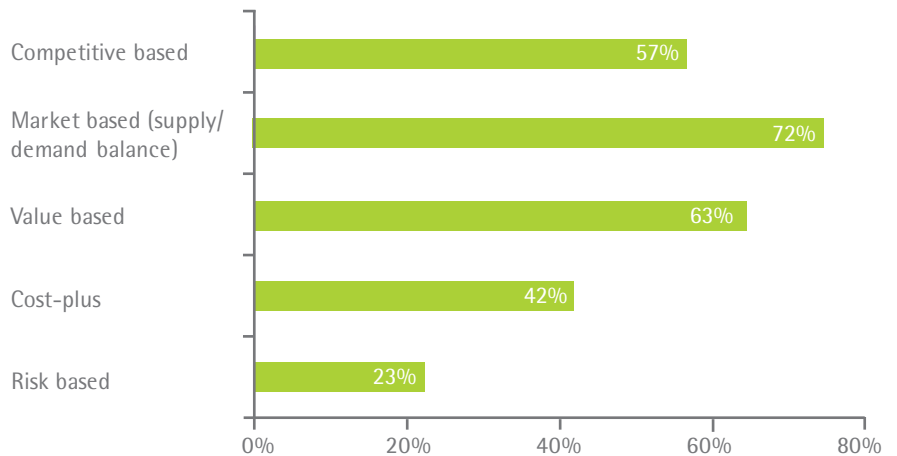


Figure 7: Extent to which various challenges impede companies' ability to be more successful in pricing

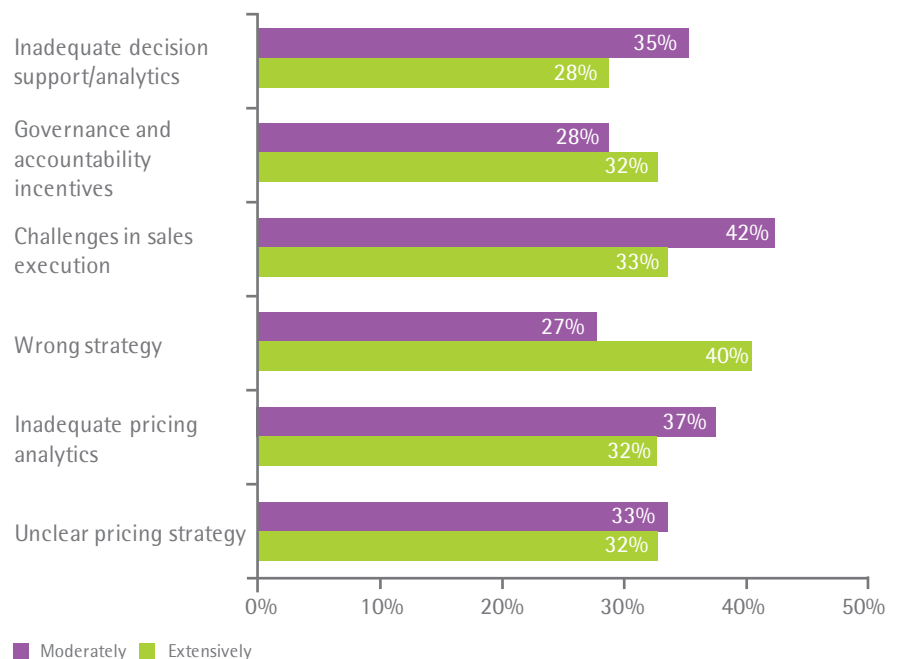
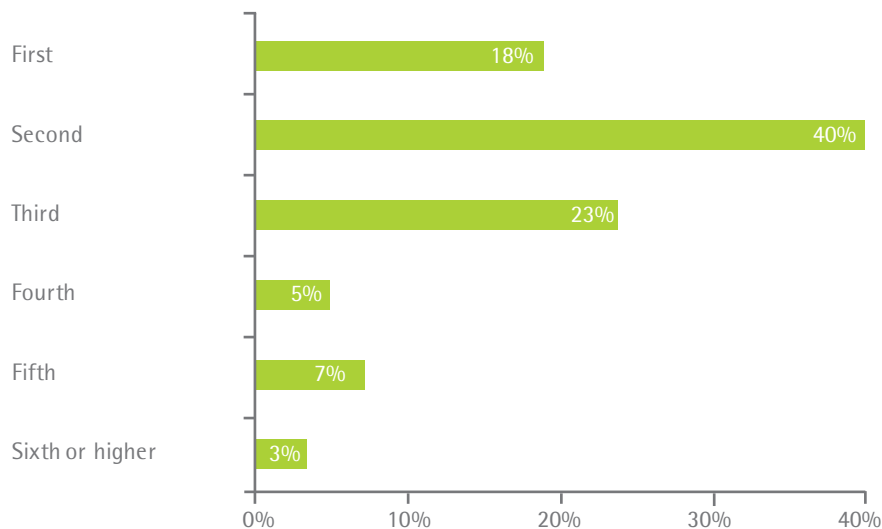


Figure 8: Rank of price optimization among companies' strategic priorities



Price optimization is a priority

Given the importance of pricing to many companies' competitive positioning, and the major challenges they face in optimizing pricing—including increasing public and private pressure on prices—it is not surprising that price optimization was a high priority among a large percentage of pharmaceutical companies. In fact, eighty percent of executives said pricing optimization was one of the three most important strategic priorities for their companies (Figure 8). This is not surprising given that a one percent increase in price can raise operating profits some 7-15 percent.

Pricing capabilities lack sophistication

Pharmaceutical companies appear to have shortcomings in their pricing capabilities, as generally only about one-third of executives or fewer described their pricing capabilities as "sophisticated" (Figure 9). One area that seems to present a particularly

strong challenge for pharmaceutical companies is pricing processes. Eighty percent of pharmaceutical companies do not have sophisticated pricing processes—meaning, their pricing processes are not rigorous, end-to-end, repeatable and technology-enabled. In fact, nearly 30 percent said their pricing processes tend to be ad hoc and lack rigor. Such rudimentary pricing capabilities typically only allow a basic pricing model to be used, rather than a value-based approach, ultimately preventing companies from crafting pricing strategies that support substantial and sustainable performance improvements.

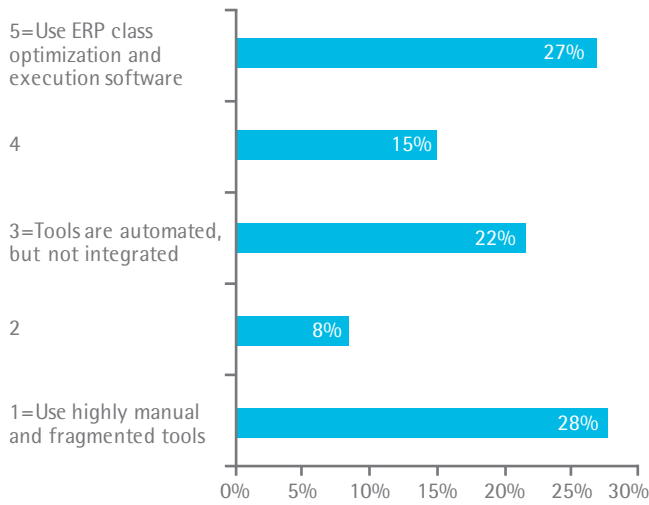
Pricing technology also appears to be a challenge for pharmaceutical companies: Nearly three-fourths of respondents said they do not use sophisticated ERP-class optimization and execution software. Pharmaceutical companies lag several industries in this respect. In fact, while 28 percent of pharmaceutical respondents said they use highly manual and fragmented tools, the same was reported by just 11 percent

of utilities executives, 19 percent of insurance respondents, 20 percent of those from communications, and 25 percent of retailers and consumer packaged goods participants. A similar lack of sophistication also was reported by pharmaceutical companies in pricing governance, organization, strategy and analytics.

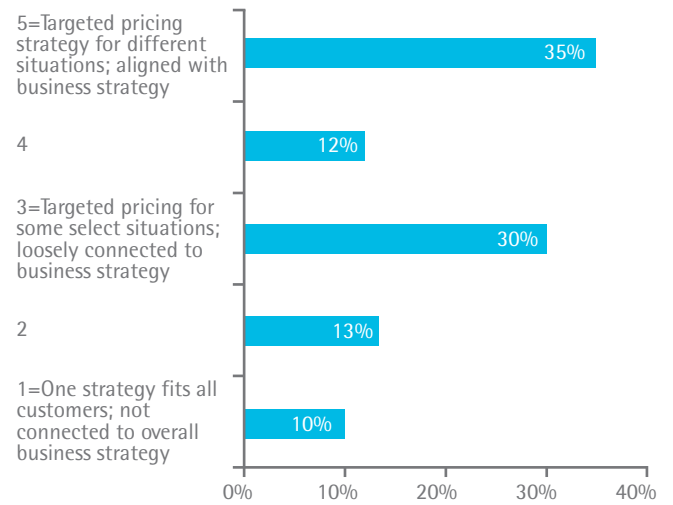
As might be expected, pharmaceutical companies with less than \$5 billion in revenue were even further behind. They were less likely to use ERP-class software than larger companies (23 percent versus 38 percent), have a targeted pricing strategy that is tightly aligned with business strategy (32 percent versus 44 percent), use predictive analytics tied to operations and strategy (25 percent versus 38 percent), or report sophisticated pricing organization capabilities (27 percent versus 44 percent). This gap exists despite the fact, as noted earlier, that such smaller companies are less likely to report being challenged by inadequate analytics, strategy, and decision support.

Figure 9: Maturity of key pricing capabilities

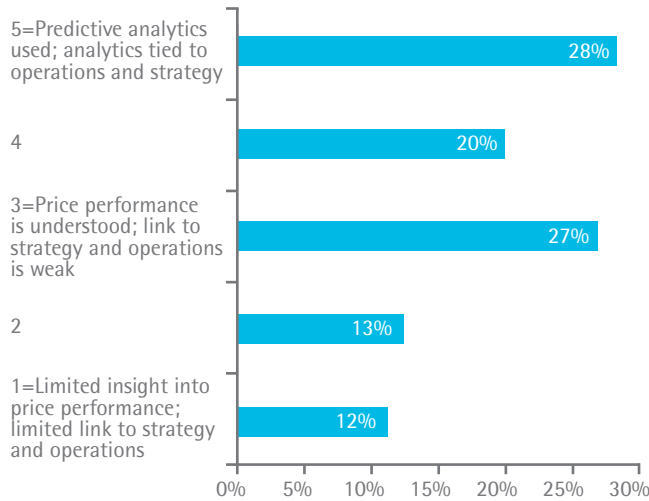
Pricing Technology



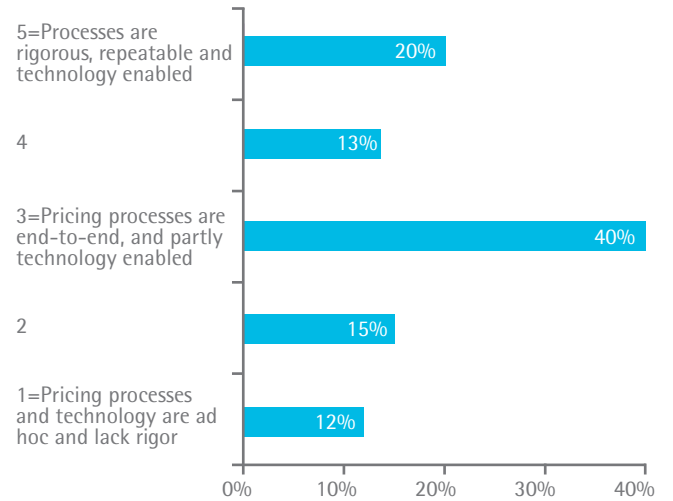
Pricing Strategy



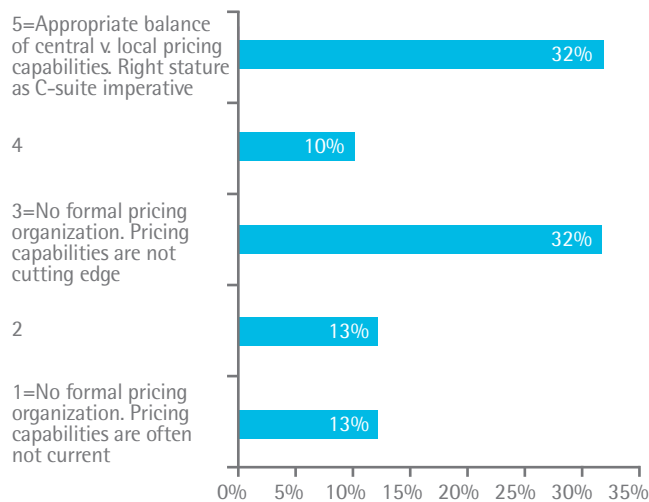
Pricing Analytics



Pricing Processes



Pricing Organization



Pricing Governance

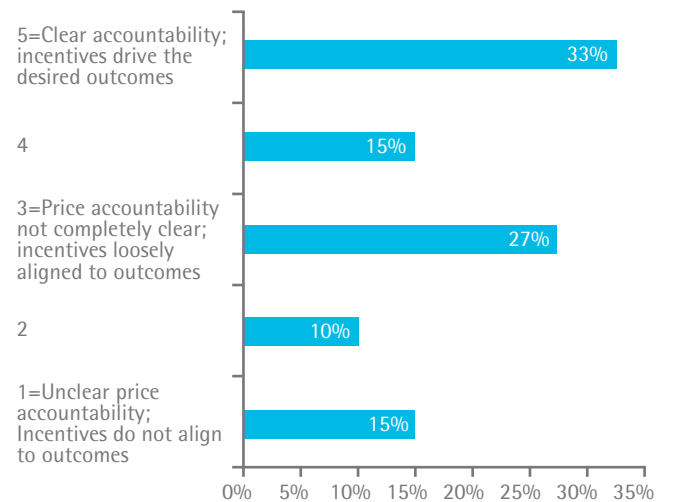
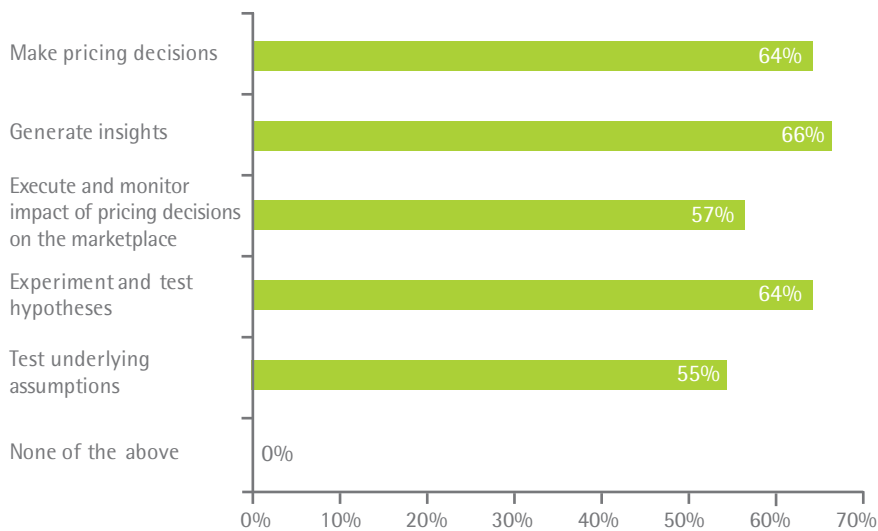


Figure 10: How companies use analytics



Overall, the fact that approximately two-thirds of pharmaceutical companies do not have sophisticated pricing capabilities suggests most enterprises have considerable room for improvement in all aspects of pricing. In particular, implementing pricing technology is becoming more popular, which is not surprising given the positive effects superior pricing capabilities can have on margins. However, to achieve these benefits companies must do much more than simply implement new software: They must also ready the organization for a major change in the way it handles pricing, from strategy, to processes, organizational structures, metrics, and incentives.

Analytics are important, but not core

For the vast majority of pharmaceutical companies, analytics plays some role in their ability to optimize pricing, although it is not core to price optimization initiatives in a majority of companies. Forty percent of pharmaceutical executives said analytics are core to their price optimization programs or initiatives, while 52 percent said analytics are one of several inputs.

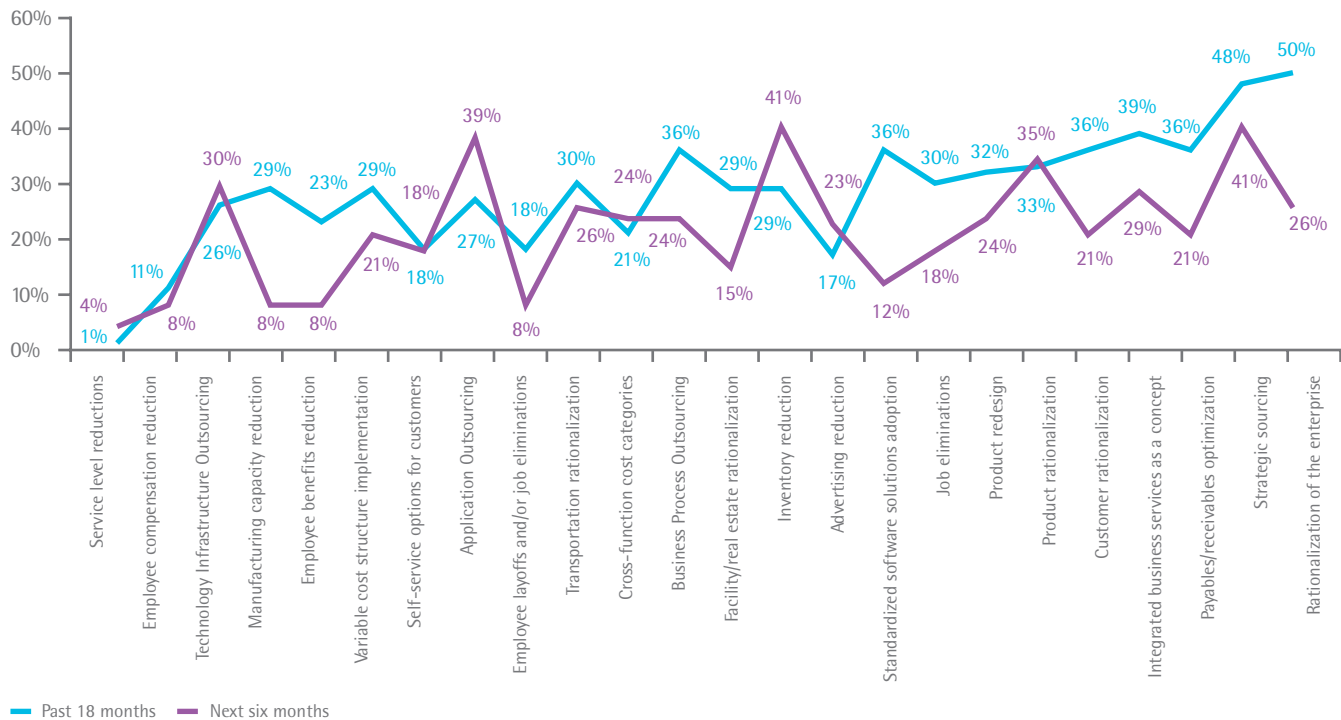
In general, participating pharmaceutical companies use analytics for a wide range of activities, the most popular of which are generating insights (cited by 66 percent of respondents), making pricing decisions and experimenting and testing hypotheses (named by 64 percent each), executing and

monitoring the impact of pricing decisions on the marketplace (57 percent), and testing underlying assumptions (reported by 55 percent) (Figure 10). At the same time, even though pharmaceutical respondents do use analytics to make pricing decisions, they were less likely to do so than those from retail or consumer packaged goods companies.



Driving Growth via the Cost or Supply Lever

Figure 11. Cost management actions companies have implemented in the past 18 months and those they plan to implement in the next six months



While companies appear to be struggling with building and leveraging pricing capabilities to strengthen growth and profitability, their track record in using the cost lever to stabilize their operations looks considerably better. Nearly all pharmaceutical companies have reduced costs in the recent past, with many describing those efforts as successful in creating sustained cost reduction. However, many pharmaceutical companies also believe they have additional opportunities to capture and, thus, are planning cost-reduction efforts in the near future.

Companies have undertaken significant cost reductions

Given the uncertain nature of the economic recovery in various markets, a large majority of pharmaceutical companies in the survey have been focused on reducing costs. Indeed, in the past 18 months, 79 percent of global pharmaceutical executives said their company has undertaken a significant effort to reduce costs.

These cost-reduction efforts took many forms (Figure 11): Half of pharmaceutical executives said their company has rationalized some aspect of their enterprise in the past 18 months, which could include such actions as redesigning processes or consolidating back-office activities through global business services, shared services, or outsourcing. Just under half (48 percent) also said they implemented strategic sourcing as a way to rein in costs. Other popular initiatives include implementing integrated shared services as a

concept, optimizing payables or receivables, rationalizing the customer base or product offerings, redesigning products, and adopting standardized software solutions.

For most pharmaceutical organizations, competitive pricing pressures have had some influence on the level of strategic cost reduction measures they have taken. Thirty-two percent of pharmaceutical executives said the impact has been extensive, while 57 percent described it as moderate.

Cost-reduction efforts have generated positive results

In nearly all pharmaceutical companies, cost-reduction efforts are viewed as having been a qualified success (Figure 12). Sixty-four percent of pharmaceutical executives said their efforts have been somewhat successful and 35 percent said they have been very successful in creating sustained cost reduction—i.e., a permanent shift

Figure 12: Success of cost reduction efforts in creating sustained cost reduction

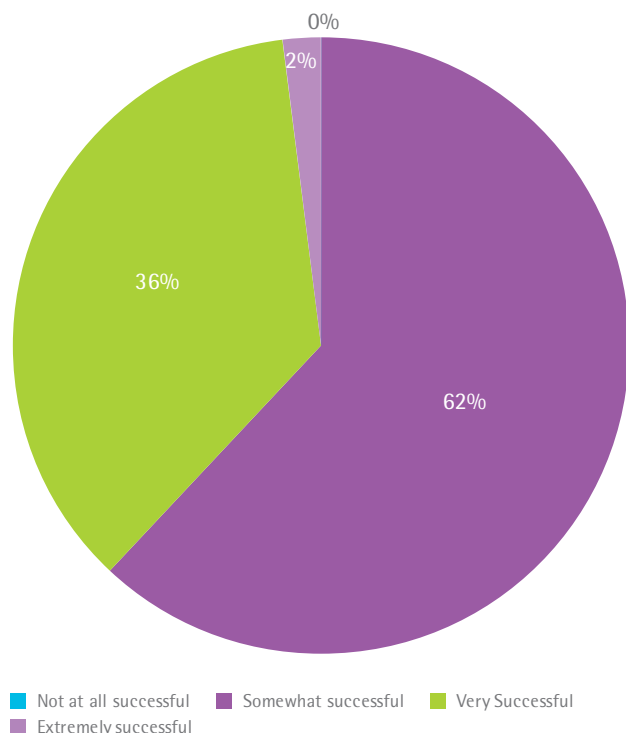
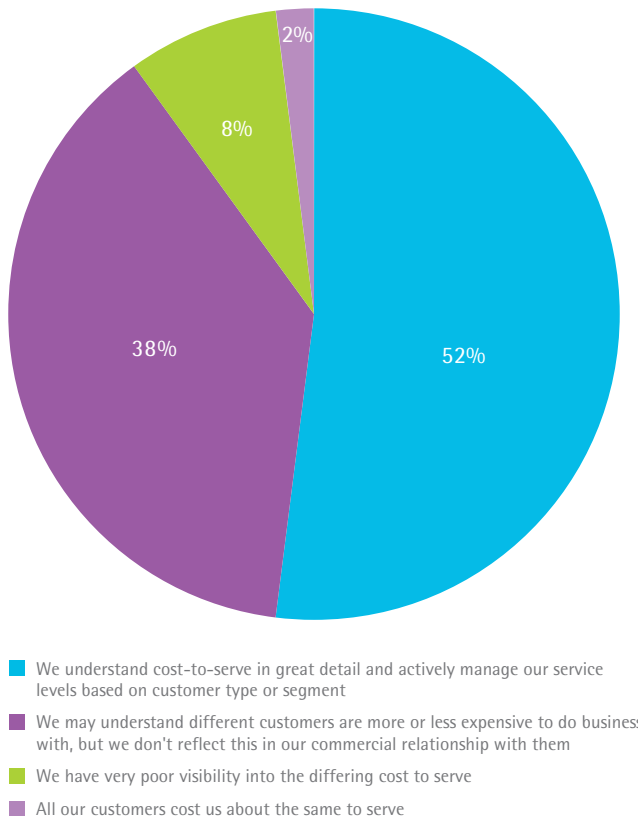


Figure 13: Extent to which companies understand cost to serve customers



in their cost base and mindset about costs instead of a temporary change that will revert to former levels at some point in the future. Pharmaceutical companies with more than \$5 billion in revenue report having had more success than smaller firms: While only 19 percent of smaller pharmaceutical companies said their efforts to create sustained cost reduction had been very or extremely successful, 56 percent of larger companies reported such success rates.

However, that doesn't mean pharmaceutical companies are finished. Indeed, only 9 percent of pharmaceutical executives believe they have captured virtually all cost reduction opportunities available to them. Forty-four percent said they have captured the majority of cost reduction opportunities, while 45 percent believe that although they have captured many cost reductions, more opportunities remain.

Companies fall short in understanding their true cost to serve

While many pharmaceutical companies participating in our survey actively try to match service levels with a customer's cost to serve, a large percentage are missing potential opportunities to improve margins by reflecting cost to serve in how customers are treated and managed.

Only half (52 percent) of participating pharmaceutical executives said their companies understand cost to serve in great detail and actively manage their service levels based on customer type or segment—fewer than those in retail, consumer goods, and communications industries (Figure 13). Thirty-eight percent of executives said their companies do not reflect the cost to do business with different customers in their commercial relationship with these customers—despite understanding different customers are more or less expensive

to do business with. Eight percent said they have very poor visibility into the cost to serve different customers—a greater percentage than that found in communications, consumer goods, energy, retail, and utilities.

Cost reductions are expected to continue

Despite the success of pharmaceutical companies in reducing costs, the focus on cost likely will continue in the foreseeable future. The next six months will see more cost cutting, with strategic sourcing and inventory reduction being the most popular cost management actions among pharmaceutical companies—each cited by 41 percent of respondents. Other prevalent cost-cutting actions in the near future likely will include application outsourcing (39 percent), product rationalization (35 percent), and technology infrastructure outsourcing (30 percent) (Figure 11).

Conclusion

During the most recent recession, pharmaceutical companies generally responded by slashing costs to align with a dramatic slowdown in demand. For many organizations, given their competitive positioning and the conditions of their operations, varying degrees of cost reduction were, indeed, necessary.

Today, as the economy in most areas of the world has recovered (but remains volatile), globally focused pharmaceutical companies once again are concerned about growth—although cost reduction has not left the executive suite's agenda given the uneven progress of the recovery and many companies' patent exposure and innovation challenges. Thus, the question becomes: How can pharmaceutical companies reignite growth in a time of strengthening demand while continuing to make intelligent, and appropriate, reductions in cost?

In our experience, the answer is using insights from the demand side to drive appropriate cost-reduction efforts on the supply side. Even if a company shores up its pricing capabilities and is successful in wringing more efficiencies from its operations, it can only improve cost and revenue (or demand) levers independently of one another so much until growth stalls. Thus, achieving robust, sustainable profitable growth requires using both levers simultaneously.

In other words, during the recession, many companies across industries cut costs with an axe, and growth suffered as a result. Now, they need to fine-tune costs with a scalpel by gathering and acting on insight from the demand side to pursue profitable growth. For example, they should use segmentation to understand which pricing strategy is most beneficial for which parts of the business, identify the true cost to serve each customer segment and make appropriate changes to service to reduce costs and enhance value, and create a more variable cost structure based on company performance to help avoid the typical cycle of hiring and laying off in concert with economic swings.

Pharmaceutical companies that can strike this delicate balance will be the ones setting the agenda for competitive differentiation, profitable growth and, ultimately, high performance in a volatile world.







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