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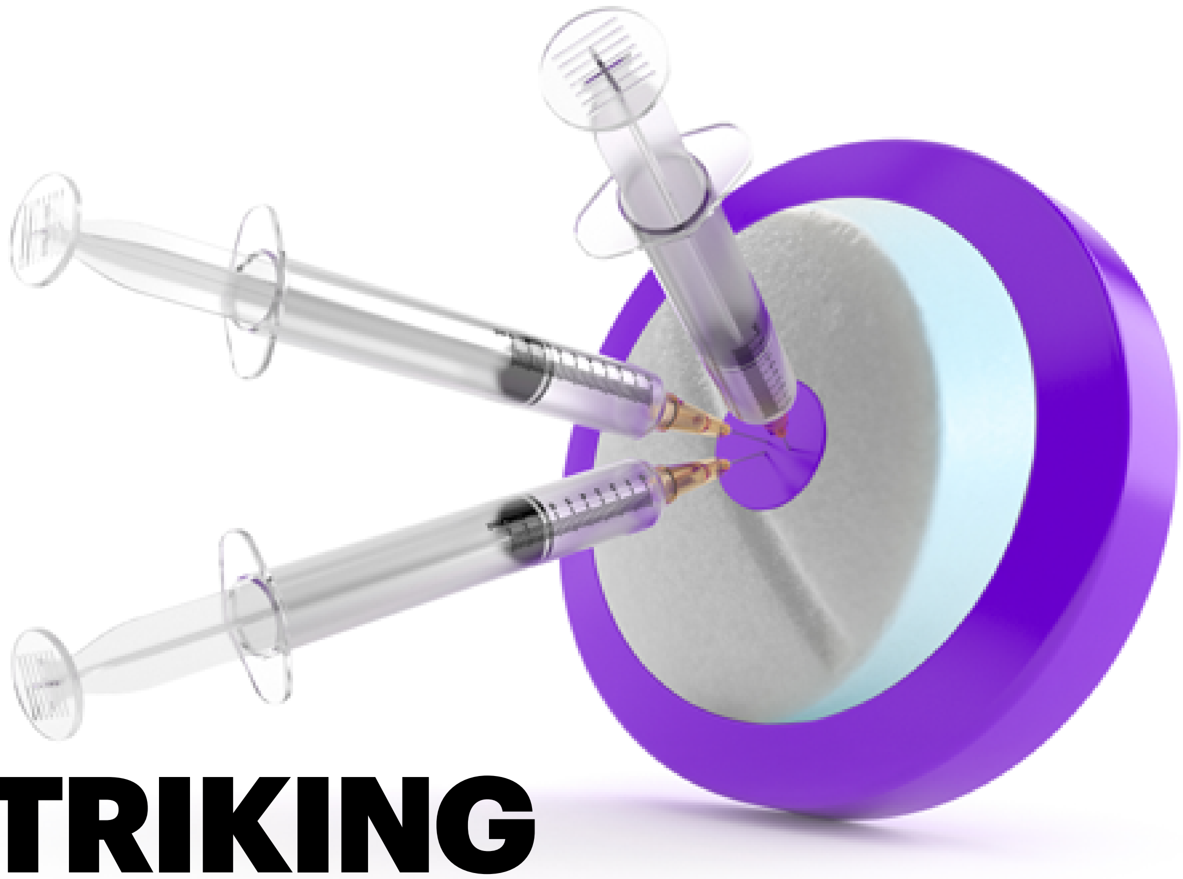
THE NEW GROWTH TONIC FOR INDIAN PHARMA

A zero-based approach to identify cost savings, and reinvest for growth and profitability



STRIKING THE GOLD MINE OF PHARMA

The world has been the playground for the Indian pharma industry since the economic liberalization of 1991. Today, India is one of the world's biggest suppliers of generic drugs and complex formulations—accounting for 20 percent of global generics exports volume. India also ranks among the top five fastest-growing pharma markets.

Why India is the pharmacy of the world

Manufacturing hub
India has the maximum US Food and Drug Administration (US FDA) approved manufacturing plants outside the US.

High growth rate
India has achieved 20–25 percent growth in the last two decades to become a US$40 billion pharma giant.

Skilled workforce
Compared with other emerging economies, the Indian workforce is technically more advanced.

Exports express
India exported pharmaceuticals worth US$16.4 billion in 2016–2017, contributing more than 50 percent to revenues of the Indian pharma industry.

WINDS OF CHANGE:
FROM GOLD TO GLOOMY

Despite its dream run, the Indian pharma industry has hit a roadblock over the past two years. The sector has been incumbered by heightened US FDA scrutiny, pricing pressures, and rise in manufacturing, employee and compliance costs, among other factors.

Our recent analysis* shows that the pharma industry faces a double whammy of declining topline growth and decreasing profitability.

The Indian pharma industry has had a dream run. However, in the past two years, the sector has faced a downturn, with declining topline growth and profits.

Declining topline growth
Average year-on-year revenue growth has dropped from 19% in FY13–14 to 6% in FY16–17[1]

Dwindling profits
Average earnings before interest, taxes, depreciation and amortization (EBITDA) percentage has shrunk from 23% in FY13 to 18% in FY17[1]

Stocks in Red
NIFTY Pharma Indices operate at a three-year low.[3]

*Based on the analysis of top pharma companies in India

1 Accenture Research basis company financials and annual reports
3 http://www.moneycontrol.com/indian-indices/cnx-pharma-41.html

Pricing pressures and soaring costs in the domestic as well as the world stage are stalling the Indian pharma's profit engines—as indicated by the declining profitability.

Declining topline growth

- Enhanced bargaining power of buyers across large markets such as the US due to demand-side consolidation.
  - The top four players now account for 80 percent of generic drugs sourcing compared with the seven players that accounted for 85 percent in 2013.[2]
  - Revenue growth from the US has decreased at a CAGR of more than 33 percent in the last 10 years to 14.4 percent in FY16, and 4 percent year-on-year in FY17.[2] The fourth quarter of FY17 registered negative growth despite consolidation and currency benefits.[2]

- Increased competitive intensity with faster regulatory approvals on the back of Generic Drug User Fee Amendments (GDUFA) act—Abbreviated New Drug Application (ANDA) approvals have catapulted from approximately 32 to 79 per month from FY16 onwards.[2]

- Absence of blockbuster drugs going off patent and limited near-term first-to-file generic opportunities.

- Increased government regulations on pricing and push toward price restrictions and anti-profiteering measures.

Dwindling Profits

- Employee costs have seen the biggest increase in the last five years—from 14 percent to 18 percent of revenue—while selling, general and administrative (SG&A) has been the next highest contributor.[1]

- Manufacturing costs have remained stable, testifying traditional focus toward improving efficiency and costs across organizations.[1]

- Research and development spend is being used to build a pipeline of specialty drugs, niche molecules and complex therapies to stay competitive in the market.[1]

- Compliance costs have increased due to significant regulatory scrutiny on improving product and process quality, data management and operational effectiveness. The number of US FDA inspections at Indian facilities have also soared by 2.5 times between 2010 and 2015.[2]

1 Accenture Research basis company financials and annual reports
2 Edelweiss Research Report – "Pharmaceutical Realigning to ground realities"

STOCKS IN RED

Due to the decline in profitability and topline growth, India's pharma stocks have also taken a beating in the past few years. The NIFTY Pharma Index hit a three-year low in August 2017.[3] Since then, the index has continued to trend at the same level.

Clearly, the Indian pharma industry is at a critical inflection point. The downturn of the sector has presented an unprecedented opportunity for pharma players to tighten their grip in a way they have never done before.

SO HERE'S A NEW DOSE OF PROFITABILITY TO FUEL THE PHARMA INDUSTRY'S GROWTH.

Historically, revenue growth has been the driving force for Indian pharma companies. But as pricing pressures deepen, companies need to shift their focus to a NEW comprehensive cost management mindset to augment profitability and fuel future growth.

3 http://www.moneycontrol.com/indian-indices/cnx-pharma-41.html

ZERO-BASED MINDSET (ZBx)

A NEW PRESCRIPTION FOR PROFITABILITY

When it comes to cost reduction, pharma companies stand accused of "looking in the rear-view mirror"—projecting costs based on past demands and applying incremental cutbacks on previous budgets. It is this rear-view mirror approach that is slowing the growth engines of businesses and leading to cost overruns. To address the challenges of today's digital disruption, businesses need a new, forward-looking approach to establish which costs "should be". An approach that looks at every line item and sets it to a zero base across the organization—from the front office to the supply chain and everywhere in between.

Accenture calls this Zero-Based Mindset (ZBx) the future of competitiveness.

A zero-based approach focuses on four essential areas to help businesses become—and stay—agile in today's volatile business environment.

GENERAL & ADMINISTRATIVE (G&A) EXPENSES

Zero-Based Spend

ZBS

SALES & MARKETING

Zero-Based Front Office

ZBFO

DIRECT & INDIRECT LABOUR

Zero-Based Organization

ZBO

COST OF GOODS SOLD

Zero-Based Supply Chain

ZBSC

ZBS

Identify discretionary consumption of non-labor overhead costs that free up cash to improve growth, capability investments and EBITDA while driving cultural change.

ZBS IN ACTION

25–30% drop in travel costs

Accenture worked closely with an Indian pharma company to cut its high travel costs. We initiated a comprehensive cost management program that involved commercial, policy and consumption interventions such as better rates, low fees, online meeting tools and revised travel guidelines. We leveraged our real-time visibility tools and governance mechanisms to enable stringent spend monitoring, which led to reduced costs.

ZBFO

Improve marketing, sales, customer service and pricing to lower customer acquisition costs while optimizing customer spending.

ZBFO IN ACTION

10–15% marketing spends redistributed to fuel growth

Accenture collaborated with a pharma company to revisit its marketing costs. Traditionally, marketing expenses are treated as investments to drive sales growth, and they remain largely untouched during any cost optimization activity. As part of a ZBFO engagement, we teamed with the client to put together a comprehensive analytics program that identified inefficiencies in marketing spends and optimization opportunities. The right variables such as brand vintage, size and therapy were defined to determine the marketing spend. The 10–15 percent spend identified for rationalization was redistributed to other areas for greater return and growth.

ZBO

Create new business value and drive profitable growth through a clean sheet organizational design that shifts talent and resources to distinctive capabilities.

ZBO IN ACTION

20–25% blue-collar workforce optimization

Accenture led a blue-collar productivity improvement program for a leading generics pharma manufacturer. The Maynard Operation Sequence Technique (MOST), which involves industrial engineering principles and lean best practices, was deployed to scientifically arrive at blue-collar manpower estimation. Reusable standards were created across active pharma ingredient (API) and formulation plants for manufacturing and support functions such as warehousing, engineering and quality to achieve 20-25 percent workforce optimization.

ZBSC

Optimize supply chain to drive cost of goods sold (COGS) reduction by identifying “should costs” and enabling continuous renewal that constantly resets the cost baseline. A closed loop process ensures results hold over time.

ZBSC IN ACTION

20% cost reduction as product remains king

A large Indian pharma company was ready to discontinue one of its unprofitable product after every potential cost reduction effort failed to meet targets. We worked closely with the client and helped them apply the ZBSC mindset by exploring consumption levers based on value engineering analysis. Material consumption was critically analyzed and tablet size was reduced—resulting in 20 percent cost reduction. The variation filing was approved by US FDA and the product was reinvigorated with enhanced profitability.

CLOSED LOOP SPEND MANAGEMENT—AT THE HEART OF ZBx

A successful ZBx journey comprises:

6 blocks

1 proprietary closed loop spend management methodology for all spend types

1 structured way to achieve significant cost savings

Visibility:
Provide transparency on “who-spends-how-much-on-what” through transactional data analysis.

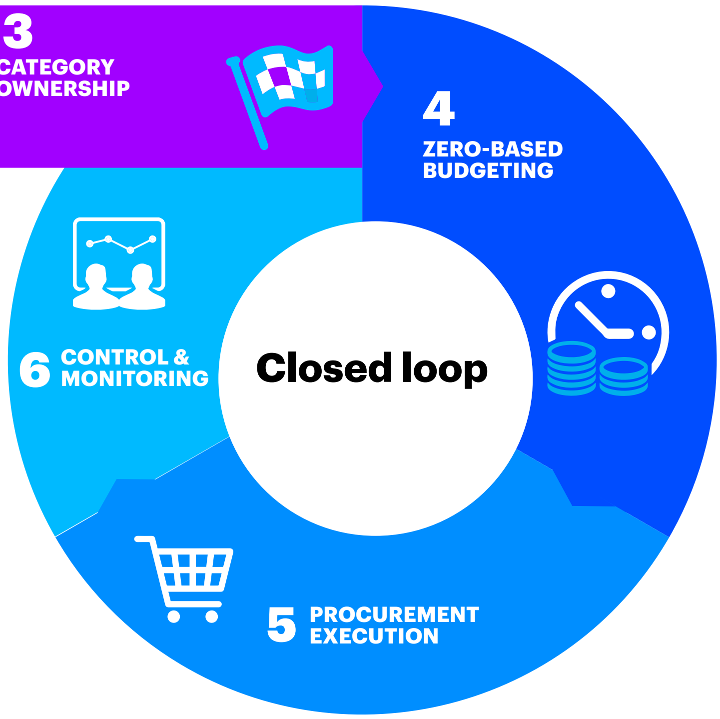
Value Targeting:
Define policies and procurement initiatives to reduce both consumption and price.

Category Ownership:
Create an accountability matrix to guide dual-ownership of every expense.

Zero-Based Budgeting:
Budget from zero annually to expose and remove unproductive expenses.

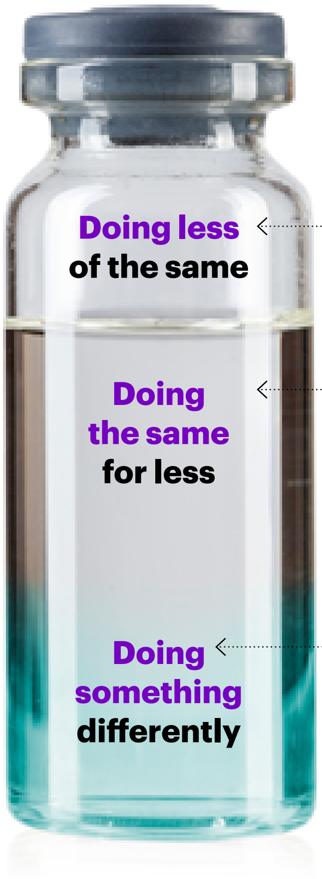
Procurement Execution:
Execute strategic sourcing events and buying operations to realize price reductions with suppliers.

Control, Monitoring & Sustainability:
Monthly review to identify budget variances, owners responsibility and action plans to resolve them.



COMPREHENSIVE VALUE LEVERS

Success of any ZBx initiative lies in complementing the traditional price levers with the consumption and specification levers. Our experience indicates that the latter two can contribute 60–70 percent of overall cost reduction.



Consumption

- Reduce absolute demand for a service/good
- Archived through policies or budget savings targets
- Typically a source of quick win initiatives

Changed mindset of business behavior

Price

- Reduce the price paid per service/good
- Use procurement to renegotiate existing contracts
- Consolidate spend with vendors to capture volume discounts
- Not typically a source of quick win initiatives

Close collaboration between business units and procurement

Specification

- Clearly defined requirements for a given service/good
- Achieved through standardization of service levels
- Can be a source of quick win initiatives

Rethink the way to operate

QUARTILE ZERO IS INTEGRATED IN CLOSED LOOP

TRADITIONAL BENCHMARKING

Price and consumption value levers to bring you to 1st quartile

1. Identify where you stand today compared with best-in-class companies.
2. Analyze cost by category and identify the gap to Q1.
3. Identify initiatives (price, consumption, specification) to close the gap to Q1.

THE NEW

Should cost models to go beyond...

1. Evaluate what is really needed to drive the business
2. Review and evaluate solutions available with the market
3. Assess applicability and overall impact, define to be cost
4. Redesign operations

Quartile Zero is the "should be" cost for selected categories, after making traditional improvements and applying game-changing digital solutions for further enhancements.

ENABLING ZBx
FOR INDIAN PHARMA

To achieve the cost optimization needed for growth, Indian pharma companies need to prioritize three areas:

Grow leadership commitment:
CEOs and leaders are responsible for driving and operationalizing ZBx into their business each day. They should manage and communicate the change correctly as ZBx won't work if employees don't understand the need and what is in it for them.

Intensify focus:
Examine your company costs carefully—from plant maintenance and customer marketing to sales. This will require forensic visibility, opening the cost gaps relative to the "should be" costs as well as closing the gaps in an engaging way with all the stakeholders involved. Reset the budget to a zero base, and change your company governance and culture.

Build an owner's mindset:
Provide a structure for "category ownership" to ensure there are checks and double checks to keep the players honest. This requires adopting a new operating model—one that reduces complexity, clarifies responsibility and helps enable a sustainable corporate lifestyle. This will ensure that a sustainable cost management philosophy is part of the company's DNA and employees constantly question the need for spending.

TIME TO ZERO BASE YOUR PHARMA BUSINESS

While India pharma companies have several paths to growth in front of them, ZBx is by far the one that affords individual businesses the most control over their own future. Given the competitive situation, pharma companies need to move beyond the cost reduction efforts they have historically used. Rather than choosing an arbitrary percentage of costs to reduce, they need to start with a blank slate, calculating costs from a zero base. And if they take zero-based budgeting a step further—to ZBx, then ZBx can help them fuel the growth necessary to be on top of the game again and compete with global pharma players.

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