

# PERSPECTIVE

## Procurement Outsourcing in the Pharmaceutical Industry Driving cost effectiveness and improving operational efficiency

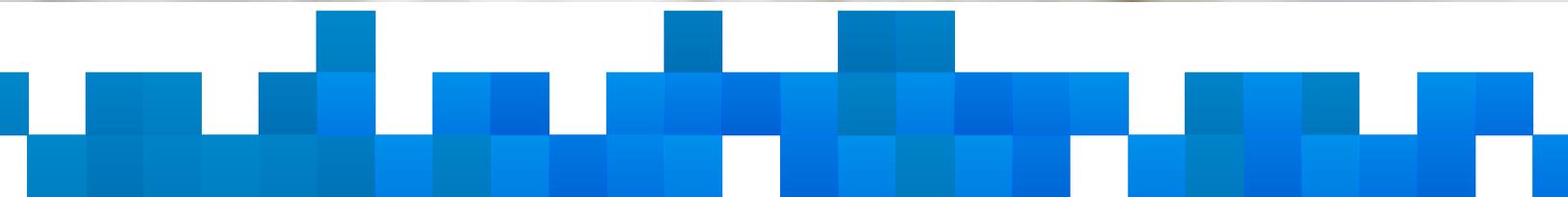


- Michael Kleha

### Abstract

The Pharmaceutical manufacturing industry was at one time the darling of the business world. With staggering profits and highly regarded reputations, Pharma was the envy of the global business community and the model which most others tried to replicate. However, increased regulatory and pricing pressures have forced Pharma to look at their business differently than in the past. With limited growth in the domestic market, Pharma is looking to expand into emerging markets while at the same time, gain efficiencies to reduce their cost structure.

As such, the concept of outsourcing non-core business functions has gained significant momentum within the realm of Pharmaceutical manufacturers. While being more pervasive in other industries for quite some time, Pharma is now exploring numerous options relating to reducing their cost base and to gain efficiency in their overall business operations. In making evaluations related to this trend, outsourced procurement organizations can prove to be very valuable to corporate entities.



## Shifting Market Dynamics

One of the major trends within the Pharmaceutical industry today is related to the shrinking market and price pressures on the domestic US market. As a result, almost all Pharma companies have strategic initiatives to expand globally and to open up (or increase) emerging markets. Specific focus appears to be on China, Asia Pac and South America. In a break with the past, many Pharma companies are appointing global heads for business and manufacturing units as opposed to their former primarily regional structures. This trend is putting an emphasis on cost cutting and trying to gain efficiencies by constructing global strategies (specifically as it relates to outsourcing). As such, several trends are emerging with the Pharmaceutical industry. Companies are looking for;

- Alignment of their operating model for efficiency/ effectiveness
- Optimization of their global footprint
- Redefining the business model for greater integration
- Improved collaboration across teams
- Active mining of data to drive greater insight
- Growth in emerging markets
- Protection of their brand through delivery of a common customer experience

Due to the global breadth of exposure and experience that outsourced procurement groups can bring, companies are finding much value in supplementing their own procurement efforts with external resources.

## Alignment of the Operating Model

Pharmaceutical industry outsourcing, in certain areas, has been prevalent for quite some time (i.e. contract manufacturing) and is considered standard practice. Additional areas, particularly for CROs and CMOs, have grown over the last decade. We are now, however, starting to see entire new outsourcing industry sectors, such as high-throughput screening services, animal toxicology testing, and a rapid increase of outsourcing related to the corporate procurement operations.

The underlying nature of the Pharmaceutical industry has changed as cost reductions and the need to gain efficiencies become essential to success. Outsourcing has become an industry norm, and now includes the full range of corporate activities. Many areas previously immune to cost reduction initiatives such as marketing, legal and consulting are being impacted.

Outsourcing has proven effective at reducing operational and infrastructure costs for Pharma companies. One of the major challenges becomes what

functionality is retained versus what is a candidate to outsource. In some instances (i.e. facilities maintenance, security) the decision is not as involved as when the functionality touches the core product(s), but is not central to them.

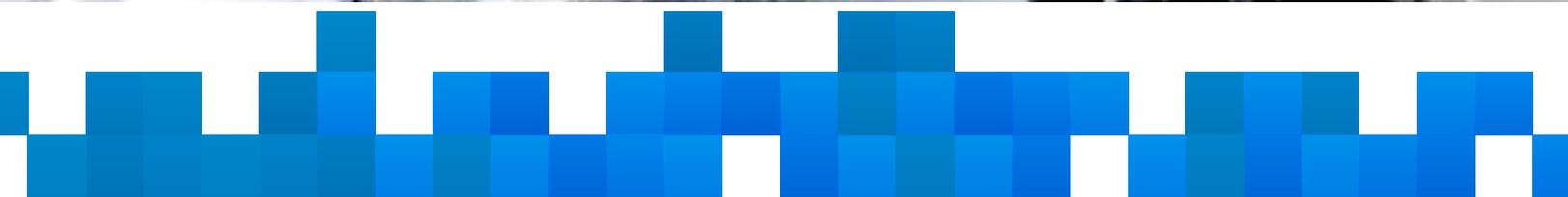
Other areas are deemed mission critical (primary sales, basic manufacturing). Challenges arise when some aspects of complex functions are candidates for outsourcing and others are best of being retained by the company.

- Many components of core functions such as manufacturing, marketing, market research and sales lend themselves to an outsource model

- Many support functions (Human Resources, Finance, and Legal) are being looked at as being “non-core”, therefore candidates for outsourcing
- Central functions (Regulatory, Compliance, Main Product Sales, and Core Manufacturing) are typically retained by the parent company

With procurement playing a larger role, companies are finding that they can gain competitive advantage by supplementing their own internal procurement efforts with additional support. BPO procurement efforts can provide support in areas which companies may lack in-house expertise, or where global knowledge is not readily available.





## Redefining the Business Model - Marketing Example

As stated above, the need to reduce costs is forcing companies to look at areas which have previously been exempt for cost reduction initiatives. One of these areas is marketing. The marketing of a Pharmaceutical product is a long cycle and involves processes that begin long before the product itself is promoted. Up to the point where actual promotion begins, the functions associated with marketing are held very closely by the parent company.

However, in recent past, we are seeing global marketing functions (specifically around production of promotional materials) which have significant outsourcing activity associated with them. The promotional materials are generally created by promotional/advertising agencies who work very closely with the core marketing team. Historically, the strategy, development and production of the collateral materials which would be created, would be completely handled by the creative agency (and typically produced within the geography in which the materials were to be utilized.) Several major players in the industry currently have models in place where all assets (no matter where they are originated or to be deployed) are centrally created by one of a stable of outsourcing partners at offshore locations.

In pilot studies related to comparing costs of identical collateral material produced via the offshore versus traditional model, procurement savings in the vicinity of 30-70% have been achieved. The wide range is a function of the complexity and nature of the asset being produced.

While the savings that can be generated have the potential to be substantial, the road to achieve them is not straight forward and simple.

- Management support at the highest levels of the organization is required as the migration of processes can be of significant disruption to business as usual
- The search for the appropriate partners can be very long and involved and can consume substantial portions of people's time to bring the candidates up to speed on existing operations
- Comprehensive change management initiatives are required as the processes to be utilized will vary significantly from the existing operations. Staff will need to be specifically trained in the new processes

BPO companies can play a significant role by providing resources, along with data and processes, to achieve desired outcomes.

## Improved Collaboration

While the example above illustrates a major global initiative, gaining efficiencies and reducing cost structure is not limited to sweeping initiatives which impact the entire corporate structure. Many opportunities exist for lowering costs through improved collaboration with sourcing partners, and can be enacted at the business unit or geographical regional level. Some models which have been implemented by various organizations are indicated next.

*Local suppliers* – often times due to the temporal requirements of receiving a product or service, partnering with a supplier who is physically close in proximity to the client will yield “total cost” savings, even if the unit cost of the product or service may be higher.

*Regional supply base* – Similarly to above, the business demands of a particular region, unit, or geography may be met by selecting suppliers who have core competency in delivering to a tightly defined geography.

*Preferred (sub) partners* - Even within established supplier relationships, various elements are subcontracted out for completion. Procurement can expand its influence by moving further down the supply chain and negotiating contracts with sub-contractors of their preferred suppliers. Care should be taken such that when work needs to go outside a suppliers shop, it is directed to one of the preferred sub-contractors.

*True partnerships* – Some Pharmaceutical companies have formed relationships which extend way beyond the traditional client/vendor relationship. In partnerships of this level, true enterprise interactions take place to look at the entire breadth of operations and partner to bring mutual benefit to both organizations.



## Moving Ahead

With the projection for the Pharmaceutical landscape to continue to become more and more regulated, restricted and competitive, drug companies will need to continue to look for ways to improve on their bottom lines. While the challenges associated with revenue are beyond the scope of this paper, there are multitudes of ways in which the expense line can be impacted to achieve cost reductions.

The scrutiny (and adaptation) in two key areas will define the BPO trend for Pharma moving forward, Research & Development (R&D) and continued inroads into Sales and Marketing:

### Research & Development

Pharmaceutical companies are seriously reevaluating their R&D efforts. While the migration to contract manufacturing is not new, there is a new found focus on Pharma “manufacturers” getting completely out of the manufacturing & research aspects of drug development. Completely outsourced manufacturing and product licensing models are being adopted with ever increasing frequency as companies are looking for every way possibly to bring products to market faster, and at lower costs.

### Sales and Marketing

Pharmaceutical companies are rethinking how they structure and support their sales and marketing efforts. The increasing threat of traditional Pharma brands by such trends as branded generic and biopharmaceutical, products (especially in emerging markets) is a serious concern to manufacturers. Pharma companies are consistently adopting new strategies to obtain customers. Social media outreach, non traditional brand building, and multi channel distribution will extend beyond its current consumer focus to target health professionals in emerging markets where, unlike the western countries, no structured database currently exists.



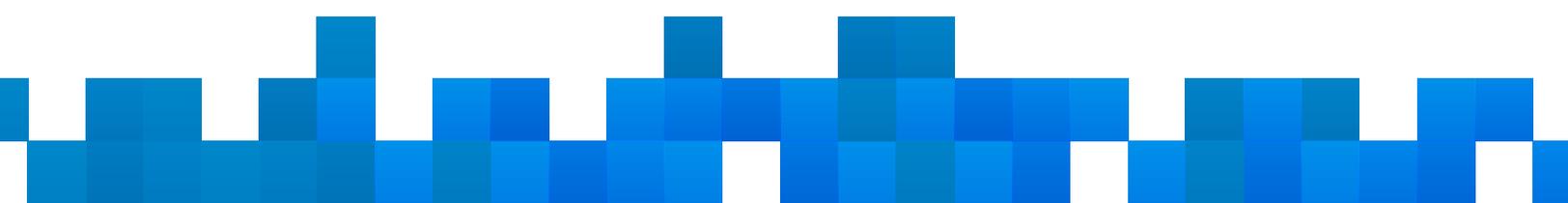
### About the Author

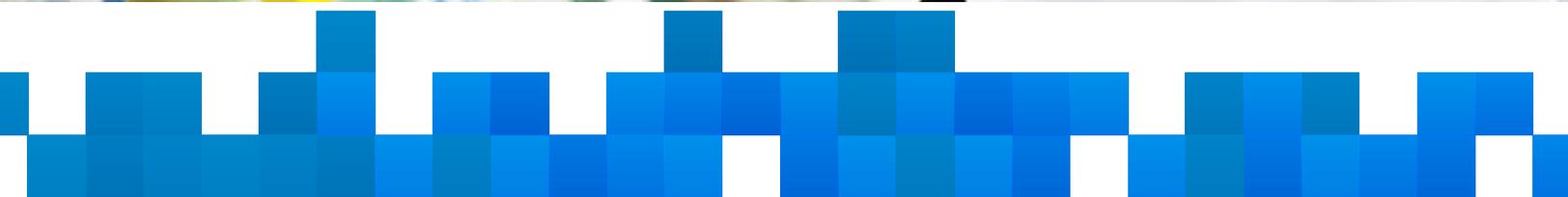
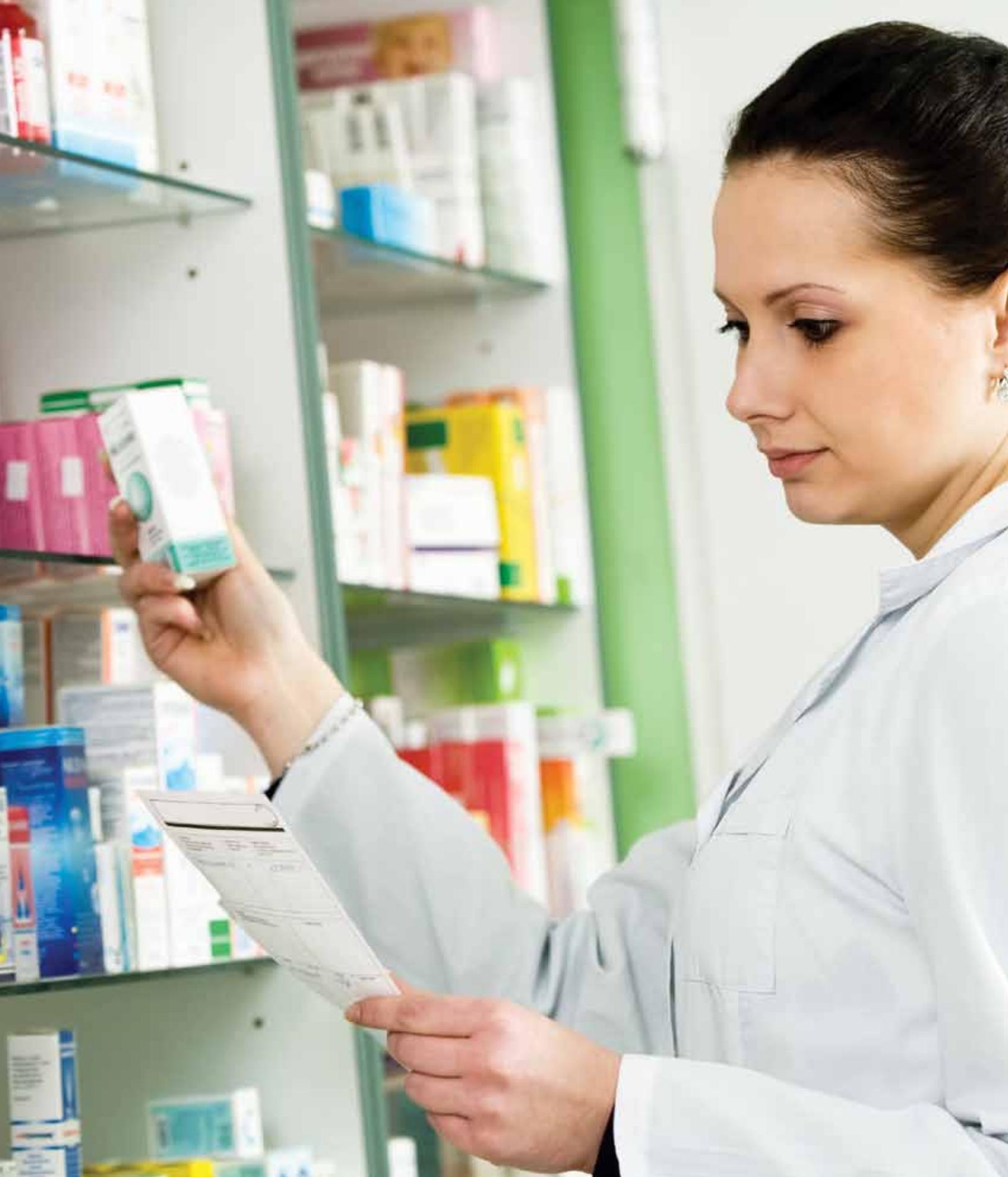
Mike Kleha

Principal Consultant, Sourcing and Procurement Practice, Infosys BPO

Mike has 24 years of experience in the areas of Marketing and Marketing Procurement. As a charter member of the marketing procurement effort at Merck & Co., Inc., he led the areas of Media, Agencies, Print, Paper and Digital Marketing procurement. He also served as Media Director for several years. Mike also led the procurement effort for Global Outsourcing of Marketing Production as Procurement Director for AstraZeneca Pharmaceuticals. Mike resides with his wife and 3 children in Philadelphia, PA

BPO providers can support Pharma companies by leveraging their global footprint to develop innovative solutions to meet future challenges. In emerging markets, BPO partnerships can allow for development of data and information sources which are currently either lacking or non-existent. The expertise in data mining and core analytics will allow Pharma to access critical information to assist in decision making, without the requirement of having to invest their own staff and infrastructure.





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