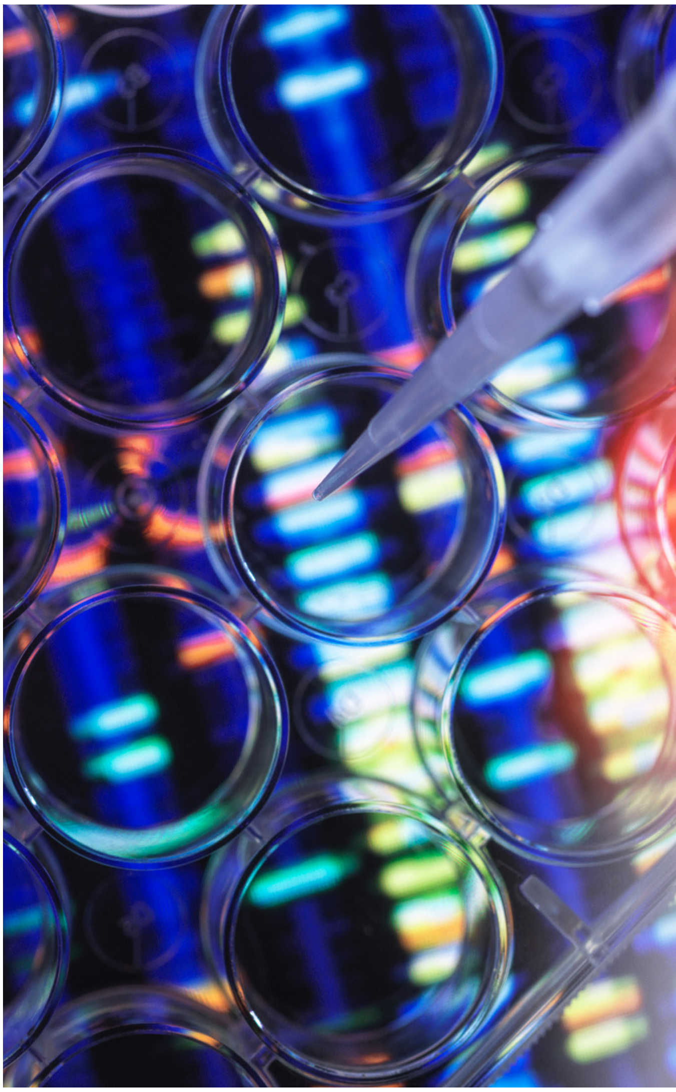
HEALTHCARE & LIFE SCIENCES

Transforming Asset-Light Pharmaceutical Companies

A&M Perspectives: How asset-light pharmaceutical companies can augment value creation in a disrupted market environment

Introduction

Over the past two decades, originator pharmaceutical businesses have increasingly disposed of late-stage drug portfolios to third parties. This has spurred the growth of asset-light pharmaceutical companies with radically different operating models. Operating through networks of Contract Development and Manufacturing Organisations (CDMOs), these businesses avoid major capital expenditure, have greater flexibility, and can therefore focus on critical capabilities such as supply chain excellence, market authorisation and technical transfers.



While there are advantages, asset-light models are complex. Many different partners are involved, comprising of specialised CDMOs, distribution partners and a mix of in-house sales and country distributors. This leads to challenges related to demand planning, inventory control and cost control.

At the same time, asset-light pharma businesses are having to respond to global challenges including rising inflation, supply chain disruptions, Covid-19 outbreaks and growing geopolitical tensions.

Whether these factors drive a recession or not, asset-light business models will remain under increased pressure for the rest of 2022 and beyond. Leaders of these businesses should therefore augment and accelerate value creation plans if they want to respond quickly to critical issues such as:

- How can networks of CDMOs be better organised and managed, to address fragmented supply bases, price increases and poor delivery performance?
- How can Sales and Operational Planning be better executed to improve customer service and avoid stock-outs?
- What can be done to optimise working capital and release cash for strategic investments?
- How can complex, third-party logistics networks be better configured and managed?
- How can digital approaches be applied to improve performance?

This article shares selected perspectives and insights from A&M's work with leading asset-light pharmaceutical businesses. They can be used to strengthen existing value creation plans or build new ones for rapid transformation amid the changing external environment.

Five value levers for asset-light pharmaceutical businesses

Based on our experiences of delivering change for a range of asset-light pharmaceutical companies across Europe, we recommend five levers of value creation.

1. CDMO rationalisation and technical transfer excellence
2. S&OP/ IBP upgrades
3. Inventory and working capital optimisation
4. Logistics simplification
5. Digital tools deployment (commercial focus)

1 CDMO rationalisation and technical transfer excellence

Asset-light pharmaceutical businesses should consider these key actions to excel in CDMO management and tech transfer.

- **Routinely review and rationalise supply base.** Benefits include reduced COGS and improved customer service. For instance, in a recent project, an asset-light pharmaceutical business had a significant number of CDMOs with a low On-Time-In-Full (OTIF) delivery performance. Following a rationalisation and performance improvement exercise, the number of CDMOs was reduced by 20% in one targeted dosage form segment, achieving savings of 11%. Fall-back options for two critical products were also identified as a result of this effort, while overall OTIF increased significantly with corresponding reductions in safety stock holding.
- **Achieve excellence in CDMO technology transfer.** Drive COGS improvement by transferring technology from one CDMO to another or from an originator business to a CDMO. For pharma companies operating asset-light models, market authorisations and technical transfers must be a strategic capability, since the downsides to a long and poorly executed transfer can be significant in terms of bridging stock, missed sales in case of stock-outs, and costs to extend project teams.
- **Employ Best Cost Country (BCC) sourcing strategies.** Leveraging specific expertise and insight to ensure that CDMOs are selected in the right markets, with a view to future developments (e.g. wage inflation, skills development and technology upgrades).
- **Review contracts with CDMOs to understand how price pass-throughs will impact profitability.** Having visibility of the magnitude and timing of potential price increases will help financial planning and target performance improvements. As an example, an A&M review shows a range of situations, including cases where price increases are allowed over 3% while being capped at 20%, price rises that could be passed on at any time, and agreements that only allow increases after 4-5 years of signing.

2 S&OP/ IBP upgrades

Asset-light businesses need to excel at planning and forecasting processes but often they also need to implement or upgrade their ERP systems. Both can be expensive and time consuming.

Because the investment to implement new systems can be difficult to justify, we have seen companies prioritising an ERP over a planning software implementation. Yet business leaders must consider the following when making this decision:

- **For asset-light businesses,** targeted investments in planning software can generate value faster and more effectively than large scale MRP implementations. While we understand the need for an aligned master data base and standardised execution of business enabling functions, we recommend rethinking the general push to large ERP vendors for this type of business.
- **Control towers are also key to improving supply chain visibility.** These tools process transactions from partners across the supply chain to support decision making. For instance, they provide information on quality statuses, import testing, releases, and deviation management, and can support improved management of safety stocks and delivery performance.

An A&M review of CDMO contracts showed a range of price pass-throughs, including cases where price increases are allowed over 3% while being capped at 20%.

3 Inventory and working capital optimisation

Stocks of API, bulk, primary and secondary packaging are spread across asset-light supply chains with limited visibility of actual levels and demand forecasts, leading to overstocking and stock-outs. Since unnecessarily large inventories have an adverse impact on cashflow and can result in the write-off a larger amount of older inventory, it is critical that asset-light businesses focus on:

- **Forecast Days Inventory Outstanding (DIO)** under current conditions, then assess impact of targeted interventions to improve DIO. For an asset-light business, A&M projected DIO using a tool that considered MOQs, Purchase Orders, write-offs and CMO lead-times. Through the cross-functional inventory reduction plan, the business achieved targeted 190 days DIO from around 250 days DIO previously.
- **Use postponement models to significantly reduce inventory holding,** where finished goods stocks held in many markets are replaced with fewer centralised inventories of semi-finished products, that are labelled and packed only when there is demand. As such, postponement models improve OTIF performance metrics, reduce lead-times and optimise working capital.

Leaders must understand the inherent complexity in employing postponement strategies, accounting for multiple factors such as customers, products, manufacturing and product and financial flows. It's also crucial to have a firm grasp on the best ways to build responsiveness and resilience into networks, as well as the financial case for making the change. Our recent paper on the topic provides more details and can be found on our website[1].

4 Logistics simplification

Logistics in an asset-light model is not only limited to regional or global wholesalers delivering products to the final point-of-sales, such as pharmacies or hospitals. Logistics is also required to provide API, supplements, devices and intermediates between the single suppliers and partners. This complexity requires significant management effort and adds cost. Two key considerations are:

- **Centralise logistic streams by implementing a logistic and invoicing hub.** This can reduce the overall logistic costs, improve OTIF, reduce stock levels and optimise logistic costs. Typically freight procurement contracts can also be improved by competitive tendering of freight services and strengthening of the global transport function.
- **Implement direct delivery models e.g., directly to hospitals and pharmacies bypassing wholesalers.** By doing this, business retain ownership of products to the customers, wholesaler mark-ups can be avoided, and unwanted trade-routes negated. Generally, this approach is applicable to high value medicines such as biologics where the cost of distribution is small relative to the cost of the product.

The business achieved targeted 190 days DIO from around 250 days DIO previously.

[1] https://www.alvarezandmarsal.com/insights/pharma-supply-chain-priorities-support-recovery-and-resilience

5 Digital tools deployment

Asset-light pharmaceutical businesses have opportunities to deploy digital tools for improved performance. Key areas of attention include:

- **Reinvent market access with innovative contracting approaches**. The value propositions of assets must be tailored to the needs of patients, HCPs, caregivers and other ecosystem stakeholders. They also need to be well evidenced and supported via innovative contracting approaches that engage both traditional and non-traditional partners.
  Successfully launching a drug largely used to be about doing the right things at the right time; a checklist, playbook, and launch office. However, in today's world that traditional approach is no longer enough; launch teams need to deeply understand the competitive environment, therapeutic nuances, and unique customer needs.
- **Innovate the customer facing activities using virtual tools and platforms.** There is a need to further re-design and evolve the customer facing commercial model, recognising that experience is just as important to customers as science. Amplifying it with the right digital capabilities will create future relevance and impact. Reinvention means more personalised and consistently focused on customer value and outcomes across all channels and marketing activities.
  Life sciences greatest top line impact continues to come from promotional activity delivered via field sales team. But the pandemic has dramatically upended this model, with reps visits to HCPs drastically reduced due to official restrictions. Meanwhile, virtual tools and platforms have flourished. The wealth of customers' data available at health & life sciences companies can be leveraged to deliver a more customised experience for patients, HCPs and other stakeholders in a flexible and productive manner.
- **Simplify operations.** The commercial model of life sciences companies remains underpinned by laborious processes. Complex models and large teams are often used to define field force alignments, perform basic segmentations, determine the right marketing mixes, manage customer data, among other day-to-day tasks. Commercial operations need to be radically transformed. Cross-functional teams in and beyond commercial operations need to strengthen the core capabilities in sales & marketing; but focus of all activities needs to be on partnerships and digital innovations. Being ready to re-wire the front office while sustaining growth and realising value for patients, HCPs and pharma itself.biologics where the cost of distribution is small relative to the cost of the product.

Conclusion

Asset-light pharma businesses, which may already be experiencing the effects of high inflation, be it energy, staffing or material costs, should reassess and enhance value creation plans considering the points covered here. In addition to these selected levers, there are others that we would welcome discussing to help businesses successfully navigate these unprecedented times.

CASE STUDY
LEADING EUROPEAN ASSET-LIGHT PHARMACEUTICAL COMPANY

A&M supported an asset-light pharma company in a rapid performance improvement programme across the supply chain with a focus on inventory & working capital improvement, procurement and integrated business planning.

Background

- The company is a leading European specialty pharmaceutical company in FY 2020 it had ~900 employees, gross sales near to €500m; the company is PE-owned with new ownership in 2020
- The company had been growing fast, which – in combination with Covid-19 impacts – caused challenges to the supply chain affecting inventory levels, delivery deadlines and working capital. Enhancements around MRP functionality were brought on the way, but have not been fully adopted and did not provide all of the expected efficiency gains yet. For that scenario the supply chain including procurement lacked several resources
- The company engaged A&M initially in March 2021 for an 11-week rapid improvement programme aiming at EBITDA improvements within 3-6 months.

A&M Role

- In phase I, A&M ran the rapid improvement programme through 2 weeks diagnostic, 3 weeks design and a 6 week implementation process
- Activities were driven across 5 work streams: Demand Planning, Supplier Planning, KPIs, CMO Sourcing and IBP (Integrated Business Planning)
- At end of phase I, The asset-light pharma company extended the engagement aiming to complete development of a DIO[1] tool (extra 3 weeks), progress CMO sourcing activities and take interim sourcing role as well as drive the IBP tool vendor selection process (both 13 weeks).

Outcome

- A&M delivered a comprehensive training programme with >100 hours of training and playbooks lifted the competence level to make the changes sustainable in demand and supply planning
- Created DIO tool that generates an improved inventory model by giving optimal order quantity and projects DIO (~value) and target safety stock – also considering uncertainties. This allows for substantial improvement in the working capital as well as improvements in demand planning
- Defined a complete set up supply chain related KPIs, agreed and deployed KPIs across the entire organisation
- Procurement created €1.8m of saving potential during phase I (5.5% on targeted €33m spend with CMOs, licensors and API suppliers) and gathered supplier commitment for 25% of that; in addition, created a sourcing playbook incl. implementing and using templates to run RFIs and RFQs[2]
  - Phase II: hardened phase I commitment for 66% of saving potential (= €1.5m); created additional €1m (= 20%) in saving potential on €5m solids spend, picked up urgent sourcing topics in interim role and onboarded new head of CMO sourcing; designed improvement plan for contract management
- The IBP workstream cataloged 100+ functional requirements and created 50+ use cases for tool comparison. These were used to launch and execute an RFQ[2] process with 3 best-of-breed vendors, and in addition to evaluate potential custom development with an established German software firm
- A&M introduced a structured vendor evaluation framework, organised & ran vendor demos, collected and jointly scored vendor proposals; aligned on a preferred solution with timelines and synergies, and presented the recommendation for IBP vendor selection to the SteerCo

[1] Days Inventory Outstanding
[2] Request for Information, Request for Quotation

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A&M has worked with some of the largest European and global organisations to transform operations and accelerate growth through decisive action. A&M's teams across Health and Life Sciences, Private Equity Performance Improvement and Corporate Transformation bring decades of experience and fact-based, action-oriented leadership to create value and drive rapid results for healthcare businesses. To learn more, reach out to our key contacts listed below.

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