



A&M INSIGHTS

Pragmatic Zero-Based Budgeting in Health & Life Sciences: a Private Equity Perspective

The whole healthcare sector, from care delivery to pharmaceuticals, is facing significant financial, technological and operational issues. It is likely that COVID-19 will accelerate change in a range of areas, such as speeding up the digitisation of hospitals and revolutionising pharmaceutical sales models. Likewise, supply chains need to be put to the test and be revisited from scratch.

Given the potential for rapid change in healthcare models, how can businesses ensure that spend is going in the right direction and costs are being controlled effectively, particularly in the subsectors with the highest fixed costs? Mandating top-down cost reductions can be effective but often do not capture all possible savings and can alienate management and staff.

An alternative approach is to employ a zero-based review. These can be company-wide or deliberately targeted at areas impacted by significant technological or operational change. Zero-Based Budgeting (ZBB) is a management framework that can be employed to both release resources for redeployment in other areas of an organisation to create value as well as reducing costs. Ideally, it is set into the context of a review of the existing operating model and the definition of a fit-for-purpose target operating model.

Our view is that for companies weighing up the potential benefits of a change programme, a targeted 'Pragmatic-ZBB' review can deliver tangible benefits for investors and portfolio companies.

Pragmatic-ZBB: funding growth, not just saving money!

2019 saw \$79bn of healthcare PE transactions, fuelled in part by some huge deals like the [multibillion Galderma carve-out](#). We are seeing strong dealflow through 2020 so far, despite (or perhaps because of) COVID-19.





The majority of these healthcare deals are growth-orientated and in each transaction it is key that resources are optimised to support growth.

As well as assessing the feasibility of cost optimisation where possible – trimming the fat without cutting the muscle – health sector players will also look to capitalise on new growth opportunities amid the global COVID-19 response. A Pragmatic-ZBB review can aid investors and their portfolio companies in delivering on both of these objectives.

So when should a healthcare business begin to think about kicking off a zero-based review? A few key trigger events can help guide investors and executives in kicking off Pragmatic-ZBB reviews:

Operating model triggers

- Changing distribution models
- Digitisation of core processes
- Payor pressure on healthcare services
- Reducing organisational complexity

Transaction triggers

- Carve-out events where sellers divest assets that are viable but were a neglected part of the portfolio and are in need of a 'spring-clean'
- Post-merger integrations where organisations need to realise synergies and rationalise back-office or shared services functions
- Buy-and-build scenarios where an organisation seeks to 'roll up' smaller competitors or firms with adjacent specialties

At A&M we have significant practical experience in conducting zero-based reviews. Three examples are outlined below covering three of the major healthcare subsectors (services, 'medtech' and pharma) and covering a variety of functional areas.

- In a recent case we worked with a healthcare services provider merging two entities. Through zero-basing the requirements of the combined entity it was possible to release synergies but also to recognise the enhanced role (and resource requirements) of operations and fund this area whilst reducing overall costs.
- We also worked with a medtech company whose new distributor-based revenue model was not releasing the required costs. A wide-ranging zero-based review identified that there were areas of spend, such as local conferences, that had not been rationalised in the new commercial model. Resources were reallocated to achieve a more targeted focus, and distributor support was also improved (education, product playbooks etc).
- We also addressed resource issues in a pharma carve-out which did not have the infrastructure and people needed to operate the business immediately post-transaction. We worked with the incoming management team to frame the target operating model and zero-base the organisation required to operate the business. This involved understanding the requirements and activities of each functional area while defining an organisation structure and the scale of resource to support the business over the long term.

[Sustainable cost restructuring](#) is a traditional value lever for PE firms, but there are different approaches to executing this kind of plan. In the healthcare space and beyond, Pragmatic-ZBB reviews quickly improve transparency and enable closer links between cost transformation and the broader strategic plan, helping move the organisation towards the end goal of a new target operating model. Those interested in learning more about A&M's Pragmatic-ZBB approach can read our full report [here](#).



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Our professionals have extensive experience supporting sellers and buyers through carve-outs and divestments, helping guide businesses through tough, complex situations. To learn more about our expertise and to understand the full scope of our Private Equity Performance Improvement work, contact our team here.

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