

Determining When to Outsource: Indicators for Pharmaceutical Companies

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In nearly every industry – and pharmaceuticals are no exception – companies are turning to outsourcing for some aspect of their business. Good arguments can be made for an outsourcing strategy, from a reduction in costs to the opportunity to focus without distraction on the core business of developing, manufacturing, and marketing drugs. But how does a company know when the time is right to outsource?

If only there was a business counterpart to the “check engine” light on your car, something to announce that there is a problem under the hood of your business and it is now time to consider outsourcing. But in the absence of such a clear indicator, a company’s executives must gauge how well the company is running and determine the right moves when things bog down.

There is no better indicator of a company’s health than its financial results. All companies are driven by their return to shareholders or owners. If the results are not as strong as they should be, it is time to thoroughly examine the cost structure. This is more than a financial analysis; it is a strategic and organizational exercise as well.

One of the areas where outsourcing can improve the cost structure is in Information Technology (IT). Does a pharmaceutical company really need to operate its own data center, maintain a sizable IT staff, and develop its own applications? In most cases, the answer is no. By outsourcing the function to a service provider, a company can take advantage of that provider’s economies of scale and ability to spread the costs of its technology infrastructure among several clients. As long as the pharmaceutical company’s most important “product” – its proprietary development data – is adequately protected, it probably doesn’t matter who owns the hardware.

Many major pharmaceutical companies have outsourced part or all of their IT function for several years. In all but a few cases, that outsourcing has been highly successful for them. For instance, one large pharmaceutical company we worked with began by outsourcing processes such as managed network services, as well as accounts payable, payroll, and human resources operations. Its experience has been positive, and it is now looking for additional functions to outsource, with a goal toward reducing its overall expenses. Other companies have had similar experiences.

The M&A Trigger

A merger or acquisition is a common outsourcing trigger for either the divested or newly formed organizations. When two companies become one, there is always extensive redundancy of infrastructure and staff. This duplication typically includes departments, equipment, machinery, and people. Facing the challenge of eliminating this duplication and its ensuing upheaval, a company may choose to look at to an outsourcing provider as an

alternative to taking on this task themselves.

For instance, rather than blend two Human Resources Departments or Payroll processes, or deal with possibly incompatible information systems and excess equipment partnering with an outsourcing service provider can be an attractive alternative.

Service providers have extensive experience in managing this level of complexity, divergent software applications, and infrastructure, and with the help of a third party outsourcing advisor, a company can evaluate the various service providers and choose the one that best suits its needs. An advisor can also help the company determine how it performs relative to its peers and what it would take to be considered best in class, or to be implementing best practices across its operations. A thorough analysis reveals what competitors might be doing better, and why, and may also go beyond the pharmaceutical industry, to find out the keys to success for similar companies in other industries.

Another driver for outsourcing is a company's desire to make some type of technological leap or organizational change that it just can't make on its own, either due to the resistance of certain employee groups or because of a corporate culture issue. Outsourcing offers the opportunity to "refresh" the organization and allows the service provider to facilitate the changes that will improve the company's performance.

When a company changes leadership, with a new chief executive or a change in management team, the door is often opened to outsourcing. New people tend to be more willing to ask the tough questions, such as "Why are we doing things this way?" and "What is this costing us?" The answers often drive a company to further consider a new business model or outsourcing strategy.

It doesn't even take an entirely new executive team to precipitate this kind of self-examination. It could be driven by a board of directors who compare how the company is doing relative to its competitors and push for greater efficiency, process improvement, and cost-cutting in response.

What Business Are You In?

The question comes down to a basic one for a given company: What business do we want to be in? If our business is developing drugs, or manufacturing drugs, do we need to operate all of our HR department? Manage our own payroll? Administer our own benefits? Increasingly, the answer is no as pharmaceutical companies call in outside help for those functions. That frees them to single-mindedly pursue strategic business process issues and focus on their core pharmaceutical competency.

The bottom line analysis comes down to some very straightforward, although admittedly complicated, answers to this question: Can an outside provider perform the process or function more efficiently, resulting in lower costs or greater innovation and improved service levels?

Outsourcing is not always about moving a business function out of a company. Sometimes it provides access to expertise that may be needed in either the short term or the long term – expertise that a company might have a hard time finding and retaining.

For instance, if a company wanted to install an Enterprise Resource Planning (ERP) system, it could hire employees to lead the implementation and transition. However, they are not easy to find, and what would the company do with all of them once the project is complete?

Alternatively, it could hire a specialist organization to implement the ERP system and handle all the user training. Outsourcing a business function takes that same approach and applies it

over the long term.

Similarly, if there is a sudden need for specific drug development expertise, a company may outsource to, or partner with, boutique biopharmaceutical companies, in order to complete a specific project or even engage in a long-term development partnership.

A pharmaceutical company is always going to be driven by the strength of its drug pipeline and its ability to overcome developmental and regulatory hurdles to get to market as quickly as possible. For some companies, eliminating their distractions, in the form of non-core administrative processes, is the solution.

Globally, the pharmaceutical industry is doing an estimated \$66 billion worth of outsourcing this year. That includes ongoing contracts, with pharmaceutical manufacturing accounting for about half of that. Research and development outsourcing is valued at about 20 percent of the total, with all other outsourcing – IT, HR, financial, logistics, contact centers and other processes – reflecting about 30 percent of that amount.

By 2010, we expect to see large increases in the share of pharmaceutical research and development being outsourced, as companies strive to maintain that all-important drug pipeline. Drivers here for the pharmaceutical companies are cost reduction and speed to market. Service providers will face pressure to deliver the high level of skills at a cost that justifies outsourcing this important function. If the providers can do that, companies will increasingly turn to them for rapid access to research and development resources and to bring much greater efficiency to their operations.

Making Outsourcing a Success

Once a company has made its commitment to outsourcing, there are a number of factors that influence the success of its relationship with its service providers over the course of their engagement. Because outsourcing is in itself a major cultural shift for a company and a department, it is a strategy that requires the support of all the key players, from the CEO and board of directors down to the managers who will be working on a daily basis with and alongside the service provider's people.

Getting expert advice is helpful, typically from outside parties, since few companies have people on staff who understand the nature of the outsourcing market, the strengths and weaknesses of service providers, and all the myriad elements involved in an outsourcing deal.

Creating a business case to validate the decision to outsource is a priority, since it lays the foundation for pricing and other negotiation with service providers and helps drive the establishment of a service model. The model lays out precisely what the company will outsource and what it will retain, and reflects the company's objectives and expectations, measured against current service levels.

The corporate sourcing strategy needs to be aligned with the company's functional goals, such as cost reduction or process improvement. This alignment makes clear whether the goals would be better met by outsourcing all functions to a single service provider, or possibly dividing some functions between service providers.

Finally, and perhaps most important for the sake of ongoing success, the governance of the relationship must be thoughtfully constructed. This is one particular area where an expert advisor can add value, by helping to build the management architecture of this highly complex relationship.

Not only does governance involve managing the service provider and its service levels, but it

involves monitoring how executives and employees perceive the service they are getting from the provider. It is an enabler for innovation. It integrates and balances the interests of all key stakeholders and assures that the relationship is providing a level of satisfaction, measured both quantitatively and qualitatively.

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