Invigorating biopharma
How the three rules can drive superior performance
About the authors

John Matthews

John Matthews is a principal at Deloitte Consulting LLP. He specializes in strategy and works primarily in life sciences and health care. His client work often bridges traditional sector boundaries, and is oriented toward helping clients take advantage of new opportunities created by the rapidly changing health care environment. Prior to joining Deloitte, he was a senior partner at Monitor Group. Matthews has a PhD from Columbia University and lives in Chicago with his wife and two daughters.

Geri C. Gibbons

Geri Gibbons has more than 25 years of experience in sales, marketing, strategy, market research, and eminence with Fortune 500 companies and major professional services firms. Her experience includes senior positions in industries as diverse as life sciences, telecommunications, technology, and financial services in the United Kingdom and the United States.

Emily Miller

Emily Miller is a manager in Deloitte's US Strategy, Brand & Innovation Group, where she leads strategic thought leadership initiatives focused on the life sciences and health care industries. Prior to joining Deloitte in 2003, Miller held market research positions in the oil and gas and manufacturing industries. She holds a Certificate of Business Administration from the Wharton School of Business and a BS in television, radio, and film production from the S. I. Newhouse School of Public Communications at Syracuse University.
Introduction

The biopharmaceutical industry is at a transformative point in its history. For decades, the industry has had an outstanding run of success, finding therapies for some of the most significant health issues of our time and generating strong returns as a result. These successes, both medical and business, were predicated on a strong model of productive R&D generating innovative products that drove growth and delivered considerable value to patients. Now, however, disruption and challenge are found throughout the industry in its thinning pipelines, expanding lists of stakeholders, narrowing distribution channels, and increasing regulatory and value requirements:

- Despite an estimated $135 billion spent on R&D by biopharma companies in 2013, few have discovered new drugs with the market potential to replace revenue from those coming off patent. Additionally, the changing health care landscape has made it harder to extend the lifetime of billion-dollar drugs through slight modifications.
- Changes in the health care landscape are also shifting the balance of power away from individual physicians and toward larger provider organizations and other non-traditional stakeholders, including accountable care organizations (ACOs), employers, and advocacy groups. This presents a challenge to traditional biopharma company marketing models.
- The Patient Protection and Affordable Care Act (PPACA), along with increasing scrutiny from commercial payers, are altering traditional payment models. New drugs that do not provide demonstrated comparative effectiveness or increased value over existing drug therapies will likely not be reimbursed at favorable price levels.

The industry is not at a standstill and is far from losing its profitability, but the pace of growth has slowed (figure 1) and margins have shrunk, causing biopharma leaders to consider how to best position their companies for success. The attractive business environment of...
The industry is not at a standstill and is far from losing its profitability, but the pace of growth has slowed and margins have shrunk...

the 1990s and 2000s is gone and in its place, a more complex, less certain, and likely more volatile operating environment has emerged.

As this situation has unfolded, a common response by many companies has been to continue to adhere to many elements of the old model (e.g., trying to boost R&D productivity, generally with limited success) while cutting costs as a way to stabilize profitability. Though sensible as a near-term response to the new market conditions and economic pressures, this approach will not likely drive superior performance over time. It is tempting to spend disproportionate management time on costs, and even to consider whether cost and price are the new basis for competition in the industry; however, evidence suggests that this will not be a strategy that works in the longer term.

Research conducted across industries, described in The Three Rules: How Exceptional Companies Think, shows that the most successful enterprises are those that continually search for and find ways to create new value—that is, value that is not price-driven—and in the process pursue growth. Examining the study’s most consistently successful businesses, the researchers have distilled three clear rules that can drive long-term superior performance (see the sidebar “About The Three Rules”).

These rules imply that, notwithstanding the need to think differently about cost structure and the places where they spend money, the most successful biopharma companies will need to rapidly find new ways to deliver differential value to patients and other stakeholders.

This will likely not be simple, and companies will need to find new growth and value...
ABOUT THE THREE RULES

More than five years ago, Deloitte launched the Exceptional Company research project to determine what enabled companies to deliver exceptional performance over the long term. Adopting a uniquely rigorous combination of statistical and case-based research, this project has led to over a dozen publications in academic and management journals, including the Strategic Management Journal, Harvard Business Review, and Deloitte Review. The fullest expression of this work to date is in The Three Rules: How Exceptional Companies Think (www.thethreerules.com).

The project studied the full population of all publicly traded companies based in the United States at any time between 1966 and 2010, encompassing more than 25,000 individual companies and more than 300,000 company-years of data. Performance was measured using return on assets (ROA) in order to isolate the impact of managerial choices: Measures such as shareholder returns often confound company-level behaviors with changes in investor expectations.

Using a simulation model, the researchers estimated how well each company “should” have done given its industry, size, life span, and a variety of other characteristics. They then compared this theoretical performance with how well each company actually did. A company qualified as “exceptional” if it surpassed its expected performance by more than population-level variability would predict.

Not all exceptional companies are equally exceptional, however. The researchers identified “Miracle Workers,” or the best of the best, and “Long Runners,” companies that did slightly less well but still better than anyone had a right to expect. In the entire database, there were 174 Miracle Workers and 170 Long Runners.

To uncover what enabled these companies to turn in this standout performance over their lifetimes, the researchers compared the behaviors of Miracle Workers and Long Runners with each other and with “Average Joes,” companies with average lifespan, performance level, and performance volatility.

First, to understand the financial structure of exceptional companies’ performance advantages, the researchers pulled apart their income statements and balance sheets. This provided invaluable clues: Miracle Workers systematically rely on gross margin advantages, and very often tolerate cost and asset turnover disadvantages. In contrast, Long Runners tended to rely on cost advantages and lean on gross margin to a far lesser extent.

Then, detailed case study comparisons of trios—a Miracle Worker, Long Runner, and Average Joe—in nine different sectors revealed the causal mechanisms behind these financial results. Specifically, exceptional performance hinged on superior non-price differentiation and higher revenue, typically driven by higher prices. Nothing else seemed to systematically matter; in fact, exceptional companies seemed willing to change anything, and sometimes just about everything, about their businesses in order to sustain their differentiation and revenue leads.

Hence, the three rules:

1) Better before cheaper: Don’t compete on price, compete on value.
2) Revenue before cost: Drive profitability with higher volume and price, not lower cost.
3) There are no other rules: Do whatever you have to in order to remain aligned with the first two rules.
levers and transition to them in smart ways. As biopharma companies adapt to fundamental shifts in the industry, they will likely face a series of choices and tradeoffs such as:

- How deeply should we go into targeted therapeutics and companion diagnostics?

- Is it wise to keep our portfolio broad, or should we focus on just a few areas?

- Do we really want (or need) to play in the branded generics market?

- Should we look at bundling services around a specific therapy? What implications would this have for our portfolio, R&D, and business development?

- What commercial models make sense in light of new regulations as well as health care provider and customer expectations?

- How do we control costs and deliver higher value to our full set of stakeholders?

- How do we enter emerging markets?

Different companies may find different yet equally effective answers to these questions. The three rules provide a framework for decision making that can help biopharma companies evaluate alternatives and identify strategic decisions and tactics that can position them to outperform the competition and create sustainable long-term performance.
ONE of the biopharma industry’s most notable features is that successful companies have historically competed on the quality of the science, i.e., on a non-price dimension of value consistent with *better before cheaper*, the first of the three rules. Many major participants in biopharma have sought to win in the marketplace by delivering superior products that competed on quality attributes (safety profiles, efficacy in clinical trials, and to a lesser degree, convenience) rather than on price. Even the emergence of large generics players that compete on price has not altered this strategy at many industry leaders focused on delivering the next wave of science.

Similarly, many bio-pharma companies have pursued growth and differentiation over cost containment, a strategy consistent with *revenue before cost*, the second rule. They have done this through large-scale investments in R&D to deliver superior product performance in areas of high need. Indeed, the non-price value created by new therapies with patent protection, combined with high volumes, drove industry growth for more than 30 years. Granted, not all companies in the biopharma industry have achieved equal success—a phenomenon that is partly due to the forces of serendipity on an industry where big bets are made on R&D and where the standards for and hurdles to bringing a product to market are so high. Uncertainty plagues the R&D process, and even companies that try to adhere to the three rules find differential success driven by a combination of strategic choices and simple luck.

Historically, biopharma companies have relied on two primary levers that allowed them to create value without competing on price: new science and considerable sales and marketing investments. Especially from the 1980s through 2000, biopharma companies created novel chemical entities that solved medical needs for diseases that afflicted a broad spectrum of the population. Although R&D costs were high, patent protection and patient demand kept prices at a premium and volumes up, creating “blockbuster” drugs with billion-dollar revenues. These blockbuster drugs were supported by sales and marketing efforts along clear commercial lines. In the 1980s, a biopharma company’s buyer population was composed primarily of physicians, and the sales and marketing pitch focused on the clinical efficacy and safety of a company’s products. Biopharma companies’ channel strategy focused mainly on in-person contacts and direct-to-consumer advertising.
Although these growth levers remain predominant among biopharma firms, staying the course in today’s environment is more difficult and complex. From 2008 to 2012, over $120 billion in drug sales were lost to patent expirations (figure 2). Pipelines to replace this revenue are not nearly as promising as they once were.\(^3\) Next-generation breakthroughs for therapies affecting large populations are fewer and farther between.

Absent major scientific breakthroughs based on genetics or biotechnology, many pharmaceutical pipelines are thin on drugs with blockbuster potential. The past two decades of scientific advances in broad primary care areas such as cardiology, gastroenterology, and hematology have provided an effective set of treatments for the most prevalent conditions. Research continues in these fields, but the majority of recent new drug entities (NDEs) filed for US Food and Drug Administration (FDA) approval are for “me too” drugs or represent modifications to the existing standard of care—new dosages, new combinations, or new indications.\(^6\) If true innovation can be defined as breaking the limits of existing safety and efficacy tradeoffs to attain improved health outcomes, then it may be estimated that, between 2006 and 2011, fewer than 10 truly innovative treatments were approved by the FDA out of a total of 35 submissions (figure 3). The majority of new molecules launched between 2007 and 2011 already had established mechanisms of action.\(^7\)

Adding to the challenge of increasing revenue through renewed R&D is its declining productivity, as measured by the internal rate of return (IRR).\(^8\) The average IRR on R&D investment for the top 12 drug makers dropped from 10.5 percent in 2010 to 4.8 percent in 2013.\(^7\) The average cost of bringing a new drug to market today is approximately $1.3 billion; for big pharma firms, the cost can be as high as $11 billion.\(^10\)

Another factor making R&D still more challenging is that regulatory oversight and consumer/patient protection are evolving in response to increasing consumer expectations and awareness, changing government mandates, and industry growth. Regulators are more strictly monitoring biopharma companies’ business practices and scrutinizing innovations that could produce subsequent unintended consequences. In recent years, new regulations and policies in institutions have been put in place that impose more stringent

![Figure 2. Patent expirations by value, 2008–2012](source: DTTL Global Life Sciences and Health Care industry group analysis of Global Generic, Cygnus. Graphic: Deloitte University Press | DUPress.com)
quality measures, tighten drug approval procedures, and limit sales force access to physicians.

One of the most potentially far-reaching changes driven by the PPACA was the creation of the Patient-Centered Outcomes Research Institute (PCORI), a US-based non-governmental institute that could substantially impact R&D investment. PCORI is charged with examining the “relative health outcomes, clinical effectiveness, and appropriateness” of different medical treatments by evaluating existing studies and conducting its own. Drug makers fear uncertainty about the fate of their potential products, as real-world data is an increasingly necessary component of the evidence required to demonstrate a product’s effectiveness to payers, regulatory agencies, physicians, and patients. Although CER and the analysis of secondary data provided by real-world evidence (RWE) can validate and indicate a product’s effectiveness, non-supportive findings could mean higher R&D expenses. For example, a CER-induced 50 percent increase in average phase III clinical trial size would lead to a 15 percent increase in average drug development costs and a 2.5 percentage point decline in average industry profit margin, according to research by the National Pharmaceutical Council.

In addition, RWE is poised to have a profound impact on a company’s basis for competition. Speed to market will likely become more important than ever, because being first to market with a new therapy can mean setting the standard. Biopharma manufacturers that cannot demonstrate that their drugs are more effective and provide greater value than the current standard will probably struggle with market adoption, which will negatively impact revenue and profitability.

As the scientific opportunities to create offerings with non-price value have diminished, and the regulatory environment has tightened, commercial opportunities have also narrowed. Biopharma companies today have new stakeholders that require new and different types of commercial engagement methods “beyond the pill.” For the most part, physicians and hospitals have significantly limited their interactions with pharmaceutical sales representatives, effectively closing that channel. Legislation and policy have also
COMPARATIVE EFFECTIVENESS RESEARCH DEFINED

“Comparative effectiveness research (CER) is the conduct and synthesis of research comparing the benefits and harms of different interventions and strategies to prevent, diagnose, treat and monitor health conditions. The goal of CER is to improve health outcomes by developing and disseminating evidence-based information to patients, clinicians, and other decision makers, responding to their expressed needs, about which interventions are most effective for which patients under specific circumstances.”

—Federal Coordinating Council for Comparative Effectiveness Research (FCCER), report to the President and Congress, June 30, 2009

limited the amount and type of direct-to-consumer marketing that biopharma companies can undertake.

Given the decline of the old model and the complexity of transitioning to something new, for the first time in a long time, the industry is contemplating whether the most viable path forward is not focused on growth and differentiation, but rather rooted in superior cost positions. This is new territory for biopharma companies, and how and when to make major transformations is unclear. Many players have largely stuck with the traditional levers for creating value, supplemented with restructuring and cost reduction. Since 2000, pharmaceutical companies have cut approximately 300,000 jobs, with over 50 percent of the reduction occurring since 2009. This dramatic reduction in employees reflects companies’ decisions to cut their sales forces and R&D resources.

Generic competitors in the United States have already staked out positions based on cost. But market leaders have also been focusing heavily on cost positions to stabilize margin erosion, and many are acting in ways consistent with cost-containment strategies. For example, the wave of recent consolidation, while delivering inorganic top-line growth for each acquiring entity, consisted largely of value creation plays predicated on cost-restructuring the combined enterprise—essentially scale efficiency plays. Moreover, as major compounds come off patent, market leaders are looking at competing in the space of “branded generics,” essentially a cost/price positioning play.

With the two traditional levers losing their effectiveness, many, if not all, biopharma players may find these cost-focused strategies to be necessary for at least a transitional period. The question that companies should ask is how they can emerge from this period with new strategies that are again oriented toward non-price value and growth.
New levers for following the three rules

Although biopharma companies are still seeking non-price value positions versus their competitors, achieving that position is increasingly complex. Table 1 shows some of the avenues successful biopharma companies are taking to achieve better before cheaper and revenue before cost.

### Table 1. Strategies for following the three rules in biopharma

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Better before cheaper</th>
<th>Revenue before cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Target complex disease areas</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Develop multifaceted patient support programs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase a drug’s value by combining it with companion therapies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capture value using new commercial models, including value-based contracting with ACOs and payers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Diversify the sales toolkit</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Seek new markets for existing drugs</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Biogen’s ability to come up with market-leading drugs such as Avonex, Tysabri, and Tecfidera in the high-margin multiple sclerosis segment justifies its Miracle Worker status. The company’s ROA was driven by very high gross margins (90+ percent) and relatively low marketing expenses due to the high brand value of its products. Biogen merged with Idec in 2003 to gain expertise in the oncology segment; the merged company plugged biologics capability gaps through several bolt-on acquisitions.

Long Runner Genzyme built solid capabilities around creating products to treat rare genetic diseases that could be granted orphan status from the FDA, positioning itself as one of the largest players in this niche segment. Orphan drug development carries certain non-price value incentives, including extended patent protection, subsidized clinical trials, and an easier path to market approval. In the late 2000s, manufacturing and clinical setbacks derailed Genzyme’s sustained growth trajectory and led to its 2011 acquisition by Sanofi.¹⁵
The deal gave Sanofi a new pipeline of drugs to help offset its market share losses from drugs coming off patent.

Of course, scale has its advantages, and large biopharma companies have the ability to pursue research into discrete sets of therapeutic areas. This type of portfolio strategy has worked well for Long Runner Roche Holdings.

Roche currently has 72 new molecular entities (NMEs) in clinical development. In 2012, Roche said it had “positive results in 11 out of 14 late-stage studies”—results that more than offset the late-stage clinical failure of cardiac drug Dalcetrapib as well as the more recent failure of Aleglitazar, a potential diabetes blockbuster. Oncology remains Roche’s primary therapeutic area of focus, generating more than 60 percent of its sales. However, Roche is also developing treatments for Alzheimer’s disease, schizophrenia, and multiple sclerosis. The company’s diagnostics business includes in vitro testing for early detection, evaluation, and monitoring of diseases, with its diabetes diagnostics products a notable success.

Develop multifaceted patient support programs

Low patient adherence to a therapeutic regime is a common issue. About 50 percent of the 2 billion prescriptions filled each year are not taken correctly. Approximately one-third of patients never fill their prescriptions, and another third do not take them once filled. Biopharma companies that can develop services and support for patients may find that as adherence to treatment regimens improves, providers may choose a product with effective support programs over others—even those that might have slightly better efficacy profiles.

Creating patient adherence programs is both a better before cheaper and a revenue before cost strategy because a biopharma company with an enhanced program may be able to charge a price premium based on a product’s overall efficacy, while the product’s potential adoption by providers can bring volume.

AbbVie, for instance, developed a program called myHUMIRA to support patients who were prescribed the company’s rheumatoid
arthritis medication. The program offerings included nurse support, medication reminders, and free disposal of used Humira syringes. The program elicited an enormous response, with 266,997 inbound calls for patient assistance, 37,386 patient enrollments, and 96 percent overall program satisfaction in 2011.19

Bayer has a global multiple sclerosis portal, MS-Gateway, that offers users general disease education resources, branded product information, and an online community for discussing symptoms, treatment, nutrition, and other topics in public spaces and through private messages. Registered users can also receive a personal consultation with a neurologist. The portal, with 12,000+ members and 200,000+ posts, drove 7–9 percent of the global sales growth of Betaferon, Bayer’s multiple sclerosis drug, in 2008.20

Increase a drug’s value by combining it with companion diagnostics

Many biopharma companies make drugs that are either coming off patent or that are efficacious but nevertheless not the standard of care. The non-price value of these drugs is limited—unless their value can be increased by making a more compelling case for using them. This better before cheaper strategy can be achieved by embedding the drug more effectively in a broader care protocol or by pairing it with companion diagnostics and treatments that deliver overall superior performance.

Product development at some biopharma firms has moved beyond production of individual therapies. It is no longer about just selling the pill but about combining it with an ecosystem of attributes, and perhaps other capabilities, that will enhance the product’s efficacy. For instance, a product may not be the most efficacious, but when combined with a means of enhancing patient adherence, its outcomes could potentially be the best in the market. The value thus delivered to patients, payers, and providers could move the product toward a non-price value position.

Biogen Idec is one biopharma firm employing this strategy. Concerned by Avonex’s patent expiration in 2012, Biogen Idec invested aggressively in the late 2000s to develop extensions for the drug. The company developed an Avonex pen and a titration kit that significantly improved ease of use and tolerability, allowing patients to use an auto-injector “pen” form versus a relatively more painful pre-filled syringe. This “method of use” patent for Avonex led to long-tailed growth prospects and a patent elongation until 2026.21

Capture value using new commercial models, including value-based contracting with ACOs and payers

Health care reform and the broader transformation of the health care landscape are having a significant effect on stakeholders across the health care industry. Gone are the days of the “reach and frequency” field model for driving drug sales by contacting individual physicians. In today’s ecosystem, physician access is more limited and payer, hospital, and government influence on purchasing decisions is increasing. As a result, biopharma
companies need to not only understand which stakeholders are likely to influence future treatment decisions, but also what clinical and economic parameters these stakeholders value. Products will increasingly be assessed based on their economic impact and effectiveness relative to alternative treatments. Advances in technology and data sharing will also allow for different discussions, as stakeholders will be able to share and analyze both qualitative and quantitative data even for very rare diseases. To address these factors, biopharma manufacturers should rethink their traditional commercialization strategies and move to a new model that recognizes shifting influence patterns and uses new approaches to stakeholder engagement.

If clinical differentiation, product packaging, and extensions drive value creation in better before cheaper, the second of the three rules—revenue before cost—is more applicable when considering new commercial strategies. This rule is about capturing a product’s potential value. Economic differentiation can be achieved through innovative strategies such as value-based pricing, risk-sharing arrangements, and pharmacoeconomic (cost-effectiveness) analyses, not to mention by undertaking CER.

Figure 4 illustrates how transitioning to new commercial models requires making different choices to help respond to an evolving health care landscape and stakeholders. Companies that seize this opportunity will likely be able to build trusted relationships with stakeholders that can not only improve patient outcomes and lead to top-line growth, but also increase commercial ROI.

Some companies have already begun to experiment with modifying their commercial models. Their programs use new resources to engage in a broader dialogue regarding products and diseases. Underpinning the company’s ambition to “change diabetes,” Novo Nordisk believes that products are only part of the equation. It encourages a more holistic

### Figure 4. The evolving stakeholder landscape

<table>
<thead>
<tr>
<th>Commercial model elements</th>
<th>Focus of traditional commercial models</th>
<th>Focus of new commercial models</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUDIENCE</td>
<td>Individual stakeholders, especially health care professionals and patients</td>
<td>Broader system of care with emphasis on interconnections and networks taking place around a patient</td>
</tr>
</tbody>
</table>
| OFFERING | • Product value  
• Clinical value  
• Health economic value | Product and non-product value including:  
• Value-added tools and services that drive better medical outcomes  
• Superior customer experiences  
• New forms of partnerships |
| CHANNEL | Primarily push channels, such as sales representative detailing and direct-to-consumer advertising | Integrated mix of push and pull channels, such as social media, online support communities, gaming, public education campaigns, and alliances with advocacy groups |

Source: Jeff Wordham and Sheryl L. Jacobson, Transforming commercial models to address new health care realities, July 12, 2013, http://dupress.com/articles/transforming commercial models to address new health care realities.
perspective, reflected in the company’s intent to “become a stakeholder in the treatment process.” In the Netherlands, Novo Nordisk’s account managers have no traditional commercial objectives. The company’s Dutch affiliate has stated that it is interested in linking the compensation of its sales reps to the results of patient Glycated hemoglobin (HBA1C) tests. As explained by the Dutch affiliate’s general manager, the new incentives would be “purely based on improvements in quality of care, not on how many products [reps] sell.”

Biopharma companies that are successful in driving such changes will alter the contractual approaches they have for ACOs and payers, moving more toward value-based contracting. For example, in 2009, Merck and Cigna reached a value-based pricing agreement over the former’s blockbuster diabetes drugs Januvia and Janumet. In exchange for better placement on insurer Cigna’s formulary, Merck agreed to peg what Cigna paid for these drugs to how well patients with Type 2 diabetes were able to control blood sugar. In 2010, Cigna announced that it had seen a 5 percent improvement in blood sugar levels and up to $8,000 in savings per person when the drugs were taken correctly. Merck gave Cigna additional discounts on the drugs (versus receiving reimbursement from Cigna) for achieving improved outcomes.

Diversify the sales toolkit

While old-fashioned pharmaceutical sales calls to the doctor’s office and conferences in exotic locations are things of the past, biopharma companies still should engage directly with physicians to communicate the benefits of their products. This strategy exemplifies revenue before cost, as companies that can effectively communicate their products’ value to stakeholders in new, innovative ways can increase product adoption and economic differentiation.

For example, Merck and Pfizer are investing heavily in new technologies, such as live online e-detailing and other online events, that enable their sales forces to engage physicians in more efficient and effective ways. As another example, in 2010, AstraZeneca replaced its sales representatives for its acid reflux drug, Nexium, with a call center and a website where physicians can order samples, download patient savings cards, and find other disease resources and product information. This strategy allowed AstraZeneca to cut or redeploy 430 sales reps to other brands, thereby efficiently managing resources. With doctors greeting the move with much enthusiasm, AstraZeneca hinted at using a similar sales model with other mature brands.

Seek new markets for existing drugs

Expanding into new markets is a revenue before cost strategy, both because it almost certainly increases the volume of sales and because certain therapies may, in some markets, receive premium pricing. Biopharma companies are increasingly targeting emerging markets such as China, India, Brazil, and others to supplement sales in the United States and Europe. Emerging markets accounted for 20 percent of global pharmaceutical sales in 2011. Key drivers fueling growth in these locations are an aging population, the rise of chronic disease, and a growing middle class with disposable income. However, when determining which emerging markets to enter, companies need to consider the risks associated with intellectual property protection and shifting payment mechanisms in each country.

Miracle Worker Amgen is just one example of a company seeking to grow revenue in new markets. During its 2013 investor meeting, Amgen discussed an expansion strategy to increase the top line in high-growth non-US, non-European Union markets, including Japan and China. In May 2013, Amgen announced a joint venture with China’s Zhejiang Beta Pharma Co. and Japan’s Astellas to commercialize its cancer therapeutic franchises in these two countries.
Applying the rules to identify the right balance of cost cutting

While some biopharma companies are deploying these strategies, many have also embarked on cost-cutting initiatives. Some of these initiatives might be counterproductive to achieving sustained performance, as indiscriminate cost-cutting mandates may provide a short-term benefit at the expense of long-term competitiveness. However, other cost-reduction efforts may simply reflect necessary changes to accommodate the industry’s new realities. Decisions to reduce a bloated sales force can be a direct and necessary response to the environmental forces currently in play, for instance, but cutting R&D spend may or may not be. Applying the better before cheaper rule offers leaders a way to evaluate whether reductions might reduce essential capabilities and possibly hinder innovation.

It is true that cost-cutting may, in many cases, increase company profitability and lessen the impact of falling sales from patent expirations. However, in and of itself, cost reduction does not align with the revenue before cost rule. In fact, the Three Rules research finds that companies attracted to short-run cost-cutting tend to be unsuccessful in their pursuit of excellence. While cost-cutting initiatives can help reduce expenses, they are unlikely to improve a biopharma company’s competitive position, as multiple companies are apt to be taking similar...
actions. On the other hand, reinvesting cost savings in research to develop products that produce more value and that are not simply line extensions can align with both better before cheaper and revenue before cost.

As CER to compare products on their safety, efficacy, and cost increases in importance, drug manufacturers may also choose to reinvest cost savings in research that can demonstrate that their treatments are more effective than cheaper alternatives. Drug makers following the better before cheaper rule can use the outcome of CER to assess whether a potential drug’s health benefits are superior to those of competing drugs—which could allow the company to charge a premium price—or whether a drug has an undifferentiated outcome, which could lead to a range of decisions up to and including the decision to halt development.
The path forward

UNDERSTANDABLY, many people who grew up in the biopharma industry may find themselves a bit adrift in the new world they face. Also understandable is the impulse to go into a “holding pattern”: reducing costs to stabilize enterprise economics, engaging in transactions to create efficiencies, and incrementally experimenting with elements of new models. This, in our view, is not going to be enough. While the pressures on biopharma-ceutical companies are real, and price is an increasingly central issue, price-based competition does not have to be the basis of the industry. Given the rapidly changing demands placed on them by their customers and stakeholders, it is important for biopharma leaders to take bolder action in deploying new growth and value tools.

Consider what it would take to align your company’s strategy with the three rules. Is too much time being spent on cost reduction and not enough on creating new value? Can the company incrementally get to new models of growth without competing on price? What would it take to move to a new model based on better before cheaper, and what—if anything—is holding the company back from moving there?

Specific questions to ask include:

• How are we creating value? How will this change in the future, and are we prepared for that change?

• How are we capturing value? Do we need to consider new pricing and payment models?

• Are we competing on price or value? Does our current set of initiatives skew heavily toward efficiency and cost reduction and away from growth and differentiation?

• How are we driving profitability? Is this likely to be sustainable in the new world, and are we likely to have differential profits and returns relative to our peer set?

The research embodied in The Three Rules shows that, despite what appear to be risks in accelerating the transition to new growth and value platforms, it may be, in fact, the most secure way of delivering superior performance. While each enterprise will be different in its specific strategy and choices, this is not a time for biopharma companies to be timid in the pursuit and application of the three rules.

While each enterprise will be different in its specific strategy and choices, this is not a time for biopharma companies to be timid in the pursuit and application of the three rules.
Acknowledgements

The authors would like to offer special thanks to Mark Cotteleer, Michael Raynor, and Robert Del Vicario (Deloitte Services LLP); Ralph Marcello, Rob Jacoby, Rohin Rajan, and Sonal Shah (Deloitte Consulting LLP); Julian Remnant and Simon Hammett (Deloitte LLP); and Selvarajan Kandasamy, Aleem Khan, Abhijit Khuperkar, Maulesh Shukla, and Geetendra Wadekar (Deloitte Support Services India Pvt. Ltd.) for their contributions to this paper.
Invigorating biopharma: How the three rules can drive superior performance

Endnotes


6. Health care reform: Redefining biopharma innovation, Deloitte Consulting LLP.

7. Ibid.


13. Ibid.


17. National Council for Patient Information and Education.


23. Ibid.


26. EIU database; company annual reports and transcripts.


Contact

John Matthews
Principal, Deloitte Consulting LLP
+1 312 604 3553
johncmatthews@deloitte.com