

Reshaping the Healthcare Leadership Dynamic

The pharmaceutical industry has shown marked resourcefulness in responding to past strategic challenges. However, the issues currently facing the sector require a different set of responses and a significant shift in industry culture. Having leaders with the experience and competencies to respond to these challenges is critical to long-term success. This paper is based on a presentation given by Jacques Bouwens at the recent FT Global Pharmaceutical and Biotechnology Conference.

The pharmaceutical industry is experiencing a confluence of several critical challenges, most of which have been brewing for some time. The drying up of the product pipeline, ongoing patent expiry concerns and a deterioration of intellectual property rights have affected the core of the business. New entrants, both generic and non-generic, have heightened competition. New regulatory hurdles, which are a reaction to effective direct-to-consumer outreach, need to be navigated. Finally, a combination of lower margins and unavailable capital has imposed severe budget constraints.

Many observers have been frustrated with the slow pace of the industry's response to these challenges. One reason for this lack of urgency has been the absence of the external threat other industries have faced in the form of being a real or potential target for a private equity takeover. While private equity deals have reached a scale that should bring players within the pharmaceutical industry within reach, most private equity firms have viewed the healthcare sector, with its volatile mixture of political attention, patient activism and payor restrictions, as too risky for their portfolios.

But while private equity firms may not have provided the needed impetus for change, there is a range

of stakeholders who now are forcing a response. Shareholders and analysts are growing impatient with the industry's underperformance over most of the last decade. Healthcare continues to be a hot-button topic among the public and government officials. Patient activism has only grown in the age of the Internet. Professional procurement organisations constrain much of the industry's bottom line. And like other public companies, global pharmaceutical firms must meet higher expectations regarding governance, compliance and transparency.

Assessing the Leadership Pipeline

In such an environment, it is important for pharmaceutical companies to assess not just the product pipeline but the leadership pipeline as well to ensure that it is producing senior executives with the right competencies to meet the current challenges. And when one does closely examine the executive ranks of the top 20 global pharmaceutical companies, a number of disturbing factors become apparent.

First, the non-executive boards of those companies—that is, the executives charged with selecting and evaluating



the chief executive officer (CEO) and ensuring a well-functioning succession plan—do not have the depth of core functional industry expertise found on the boards of other sectors. Less than 10 percent of board members have the industry knowledge needed to really understand the processes at work within their organisation—particularly research and development (R&D). In contrast, the proportion of non-executive directors with relevant inside industry experience at top global technology and consumer products companies ranges from 65 percent to 90 percent.

Second, the most common career path historically to the CEO position has been sales and marketing, before taking on country or regional management roles of increasing size and importance. In fact, nine of the CEOs of the top 20 pharmaceutical firms—nearly half—have followed exactly this path.

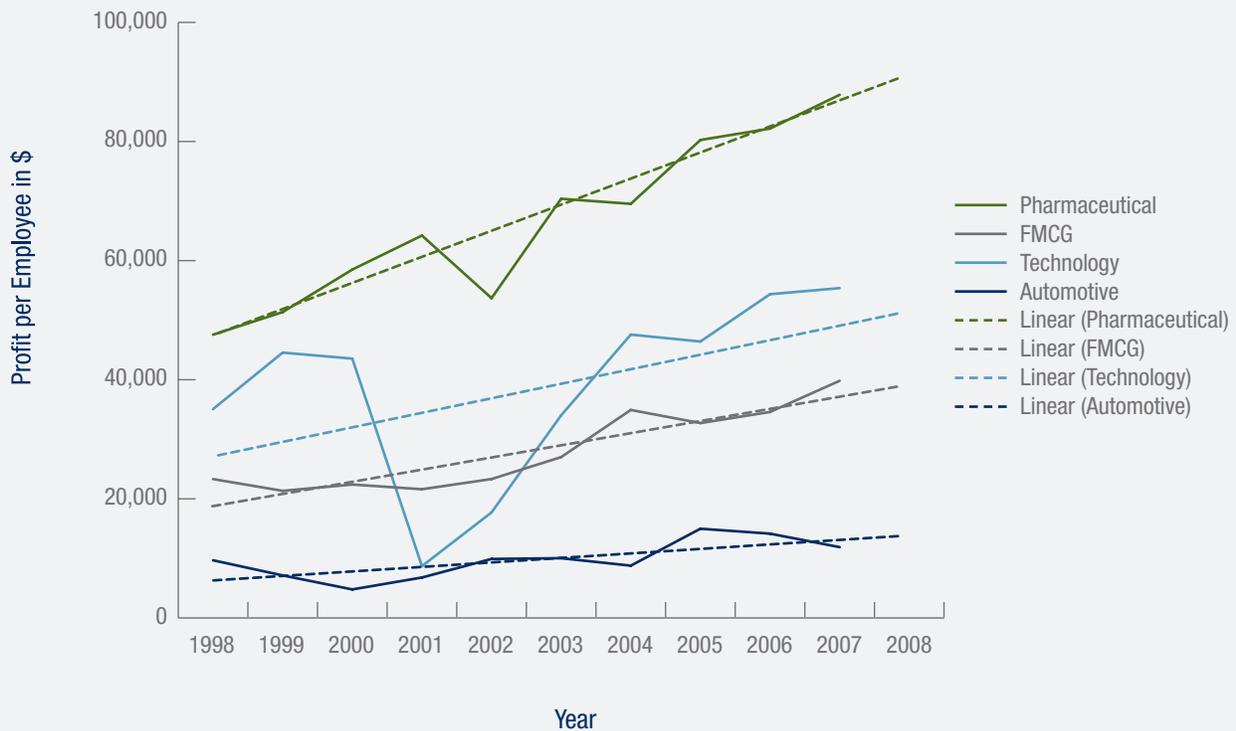
Not surprisingly, sales and marketing has been the main focus of the pharmaceutical industry’s talent

management resources. Pharmaceutical companies have developed new go-to-market strategies, invested in their sales and marketing people, and have reinforced these gains by bringing in top sales and marketing executives from the consumer goods sector.

The results of this investment have been a steady increase in profit per employee—nearly doubling over the last decade—that has outstripped other comparable industries, allowing the pharmaceutical industry to continue its profit performance despite the challenges it faces (see Diagram 1).

But the success of a strategy that emphasises sales and marketing has a cost: it has allowed other aspects of the business to avoid the ongoing scrutiny needed to achieve high performance. Many industries, for example, regularly cull the bottom 10 percent of their talent pool, but such systematic trimming is foreign to pharmaceutical culture.

Diagram 1: Profit per Employee by Sector



New Responses for a New Environment

Unfortunately, there are signs that the pharmaceutical industry is entering a transition period during which this sales-focussed strategy no longer will work. During the last decade, as product pipelines have declined in productivity, most pharmaceutical firms have responded by buying their innovation from outside—in-licensing new compounds and therapies from smaller, research-focussed firms, particularly within biotechnology. But innovation by acquisition has become less of an option, as too many acquirers chase too few targets, and capital is far less available than it once was. The shrinking margins allowed by managed care have added to the product pressure. Incremental improvement is not enough; only truly innovative therapeutic solutions can command a premium price.

Most important, the industry-wide focus on cost cutting has meant that pharmaceutical companies no longer can “throw people at the problem” by increasing sales and marketing staffs to bolster revenue. In any event, that strategy has finally reached the point of diminishing returns—a development reinforced by the fact that physicians no longer are the sole decision makers of the therapies they use.

New responses will be needed—responses that reach beyond the cost cutting, strategic acquisitions and divestitures, and intensified business development and licensing strategies we have seen in past restructurings. Instead, we can expect wholesale re-engineering of the business process and culture. The research and development function needs to be overhauled to allow the calculated risk taking necessary for innovation. That innovation needs to drive diversification into new therapeutic areas and be focussed more on developing complete solutions rather than mere products. Such a move will make the revenue stream less reimbursement dependent. There also will be a disaggregation of the value chain in which a wider range of functions is outsourced to allow companies to concentrate on their competitive strengths.

The Leadership Imperative

Implementing this re-engineering will require new types of leaders and leadership. To meet the challenges ahead, the succession planning, corporate governance and senior leadership development programs of forward-thinking pharmaceutical companies will need to change in significant ways:

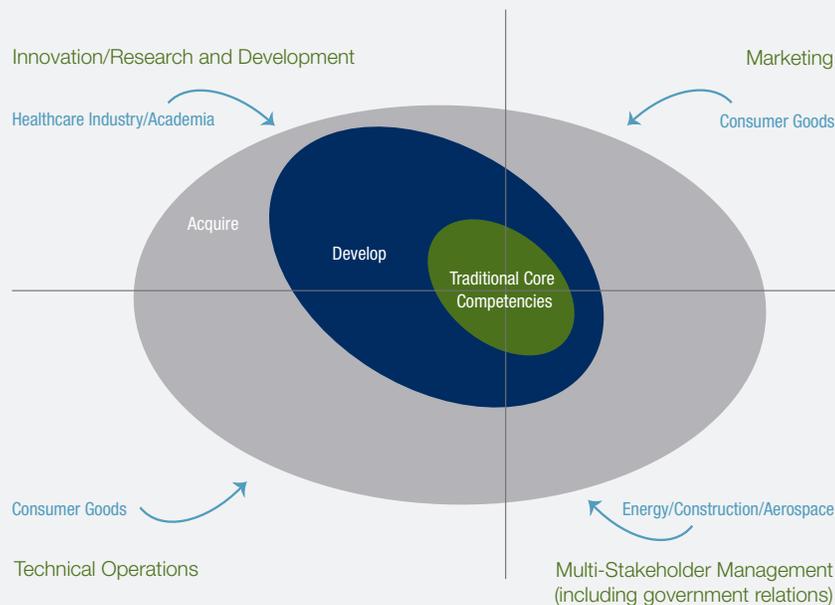
- **CEOs will need to have a broader array of cross-functional experience.** Sales and marketing no longer can be the exclusive route to the top of the organisation. The ideal pharmaceutical CEO should have significant experience in other functions, from research and development to supply chain management. There already is a move in this direction: of the 11 CEOs from top-20 pharmaceutical companies with cross-functional experience, five have been appointed during the last two years.
- **A greater emphasis must be placed on the competencies required for implementing a culture of innovation.** Historically, the pharmaceutical industry has responded to challenges through increased process management, which demands consistency, discipline and centralised control. In contrast, the new environment calls for a culture of innovation. Fostering this new culture will require a different set of competencies that must be deliberately sought in pharmaceutical leaders. The fact that some of these traits can appear contradictory—such as the ability to empower individuals while setting a strong course for the organisation—underscores the difficulty of finding such a broad range of competencies in one individual. Particularly important are the following:
 - **Learning agility:** Works easily with different constituencies and cultures, business models and technologies; absorbs new data and adjusts accordingly; maintains the humility necessary to ask the right questions.
 - **Communication:** Instills enthusiasm for and understanding of the company’s vision in an

articulate and compelling manner; is visible on the “front lines” to both communicate and listen; has a strong outward orientation.

- **Managing talent:** Sizes up and leverages the strengths and weaknesses of key players; puts high-potential people in challenging assignments and assumes the risk of doing so but is unafraid to “pull the plug” or make other tough personnel decisions when needed.
- **Developing and leveraging relationships:** Has a strong network of high-level, external relationships; builds and maintains relationships across the organisation; leverages relationships to accomplish strategic goals.
- **Driving positive change:** Builds on existing organisational strengths while setting “quantum leap” business goals to spur change where it is needed; creates a sense of urgency; draws upon best-in-class benchmarks.

• **A long-term investment in developing talent management within the company will need to be implemented.** Finding and developing leaders with this broader range of competencies will put the talent management function under scrutiny it has not had in the past. Indeed, the pharmaceutical sector traditionally has not been a talent incubator, preferring to recruit rather than develop much of its functional talent, outside of research and development, from other sectors (see Diagram 2). Going forward, however, the pharmaceutical industry will have to take a greater responsibility for identifying the competencies needed in its leadership and in cultivating those competencies through the ranks. While talent management often becomes a lower priority in a downshifting economy, the pharmaceutical industry must buck that trend, investing in top-tier talent management executives and in implementing best practices. The board should reinforce this through a quality succession plan that institutionalises a close monitoring of the company’s leadership pipeline.

Diagram 2: Pharmaceutical Talent Sourcing Strategies



- **Board nominating committees need to look more closely at the functional expertise represented by the company's directors.**

Board directors should be chosen to ensure they have the collective functional and technical expertise to be able to effectively advise the CEO on the issues facing the company and to evaluate company risk and performance in research and development, product development, global supply chain management and other complex areas. A thorough gap analysis will identify strengths and weaknesses in this area.

- **The command and control structure will need to be loosened.**

Having leaders with the right competencies will have to be matched with an organisational framework that supports a more entrepreneurial business model. More responsibility will have to be pushed further down the line into smaller business units, and a new R&D model will have to encourage and reward the right sort of strategic risk taking. Some companies already have begun taking steps in this direction.

Conclusion

The pharmaceutical industry has shown marked resourcefulness in responding to past challenges. However, the challenges it currently is facing—including reinvigorating its product development to produce innovative solutions, responding more nimbly to market opportunities and better managing a global supply chain—will require a different set of responses and changes in industry culture. Putting a robust plan in place to develop leaders with the experience and competencies needed to implement this culture change will allow the industry to build on past success while squarely embracing its new reality.

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